

## Policy Watch: Russia-Iran gas OPEC unlikely

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Will a natural gas cartel emerge that will work to increase gas prices, as the Organization of the Petroleum Exporting Countries does for oil prices? Fears that this could happen have been fueled by Iranian Supreme Leader Ali Khamenei's recent call for Russia and Iran -- the world's two largest natural gas producers -- to establish "an organization of gas cooperation like OPEC." Russian President Vladimir Putin's Feb. 1 statement that "a gas OPEC is an interesting idea; we will think about it," has only increased these fears.

Putin's statement was particularly surprising since Russian officials have taken pains for several years to reassure the West that Moscow is not attempting to create a gas OPEC. Russian Energy Minister Viktor Khristenko sought to reverse the damage on Feb. 6 by stating, "Fantasies about cartels and gas OPECs are products of a sick imagination." Such a Soviet-style denial, however, is hardly reassuring.

Many petroleum analysts have pointed out that it would be far more difficult to operate a natural gas cartel than an oil cartel due to the inherent differences in the two products and the markets for them. Whether or not this is or remains true, the uncooperative nature of both the Russian and Iranian governments provides strong reason to doubt that they could spearhead an effective gas cartel.

To the extent that OPEC works as an effective oil cartel, it only does so because the largest producer -- Saudi Arabia -- has been willing to reduce production in order to raise prices (or keep them from falling).

In addition, Saudi Arabia has been able to enforce a degree of compliance with production quotas on other OPEC members through its demonstrated ability to ramp up its own production and lower prices in order to negate the benefits to other OPEC members -- and even non-members -- of producing more than Saudi Arabia wants them to.

Further, Saudi Arabia can do this effectively because its costs of producing oil are lower than virtually all other producers, so it can still profit from selling oil at a lower price when higher cost producers cannot.

For Russia and Iran to form an effective gas cartel, both would have to be willing to reduce production (or more accurately, reduce exports) in order to raise prices. However, Russia -- which is also a major oil producer -- has long refused to join OPEC (despite repeated Saudi invitations) precisely because it is unwilling to accept any limitations on how much oil it produces or exports.

It is highly doubtful, then, that Moscow would be willing to accept limitations on its gas production when it won't accept them on its oil production.

What Putin would undoubtedly like is for Moscow to be the leader of a gas cartel in which it can limit how much gas other countries export, but not be limited by them in how much Russia sells. But would Iran agree to this?

It might be supposed, though, that Iran's desire for Russia as an ally against America would

make Tehran more amenable to Russian calls for it to reduce gas exports. Iran's prolonged refusal, however, to accept Russia's proposed maritime division of the Caspian Sea (where there are substantial oil reserves) has demonstrated that Tehran will not yield to Moscow when its oil interests are at stake.

It is doubtful that it would prove any less stubborn regarding its gas interests -- especially since Russian production problems, as well as growing Russian domestic demand for natural gas, would make it difficult for Moscow to increase gas exports sufficiently to enforce production limits on Iran the way Saudi Arabia can do with other oil producers. (Nor does Russia enjoy a low cost of production advantage for gas like Saudi Arabia does for oil that would enable Moscow to attempt this profitably.)

But if Iran would not limit its gas production at Russia's behest, why did Ayatollah Khamenei propose that Russia and Iran institute a gas cartel? He may be hoping to affect Russian behavior regarding the Iranian nuclear issue more than the gas market.

The Iranians are past masters at offering Moscow some commercial advantage -- or even just the prospect of one -- when Tehran wants Russia's cooperation in thwarting American attempts to get the U.N. Security Council to take action against Iran.

And Moscow always leaps for the bait, just as Putin did this time, no matter how illusory it may be.

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