



## Which Market Is Iranian Gas Heading To?

Pakistan and India are bargaining with Iran over gas pricing. These two countries are said to have offered half the price that Iran has asked for its gas during negotiations with Tehran. It would be suitable to compare those countries' gas market especially from an economic point of view with other potential buyers of Iranian gas. It is, however, obvious that political considerations will also be taken into account in the final decision making. This article is concerned mainly with economic considerations.

The first potential buyer of Iranian gas that immediately crosses the mind as replacement of India and Pakistan is the European Union. It is imperative to consider this Union's natural gas demand as well as economic advantages of European market to that of India and Pakistan for our country. In addition, Iranian gas has a number of advantages for Europe that should be considered. The knowledge about these mutual advantages can be used as an effective card on the bargaining table with India and Pakistan.

The following factors will be considered in this article:

- Comparison of the two alternatives' energy strategies;
- Rate of risk for either of two markets;
- Investment capability of each alternative in the development of Iran's gas reserves;
- The volume of Iran's commercial relations with either of them as well as the necessity of establishing Iran's commercial relations with them;
- Considerations for national interest and the impact of gas exchange on international relations;
- Finally, Europe's level of interest and demand for Iranian gas, which could be employed in the process of bargaining and imposing Iran's suitable conditions on the other party.

About 17 percent of the world total energy is consumed by the European Union and the share of natural gas in Europe's energy consumption basket has reached to about 24 percent.

This rate of increase has mainly been due to

the high oil prices, regulations for conservation of the environment, and the development of gas-fired power plants in the European Union.

In view of this increase in demand, Europe's level of natural gas output has almost remained constant since 1987.

In 2003, Europe's natural gas import was 204.7 billion cubic meters, being 41.4 percent of its total gas requirements. Russia, Algeria and Nigeria have respectively provided 130.6, 30.8 and 8.4 billion cubic meters of Europe's gas requirements. If Turkey is also considered a part of Europe, it can be said that Iran with gas export of 3.5 billion cubic meters has occupied the fourth place. The other Middle East countries have provided a total of 5.5 billion cubic meters.

Europe's interest in diversification of a part of its gas supply has been strengthened due to disruptions occurred last winter as a result of differences between Russia and Ukraine causing a lot of inconveniences for Europeans in that season. Europe imports about 68 percent of its gas requirements only from Russia and it is, therefore, highly dependent on Russia for security of its gas supply. It is therefore logical that Europeans decide to reduce such level of dependency.

On the other hand, it seems that the Middle East has priority over Africa for Europe. First, it is unlikely that there would be more gas in Africa for supply to Europe. Second, construction and maintenance of offshore pipelines for gas transfer is very hard task and costly. However, Middle East gas will provide a third route to Europe which will pass through Turkey, in addition to Mediterranean and East European routes. Predicting this issue in time, Turkey has had several routes under study and negotiation for connection to Europe's gas network. One of such routes called "Nabaco". It has lately been supported and welcomed by the European Union. On the other hand, Turkey is preparing infrastructures for negotiation with gas owners in the Middle East and Caspian Sea region.

Iran has more than 17 percent of world gas reserves. It is considered one of the best potential sources for diversification of European Union's gas supply. It seems that, for the following reasons, European market is more suitable for Iran compared to markets in India and Pakistan.

1. Both India and Pakistan lack clear strategies and long-term planning in their energy sector and, as

a result, their energy market is in no way guaranteed. In addition, although the energy and gas market of these two countries are not under exclusive control of government, the private energy sectors in India and Pakistan are not fully developed to be able to control and improve the market. Therefore, the gas market in these two countries is considerably high risk. If a gas export contract with those two countries is concluded, the possibility that they would not keep their commitments for receiving enough gas will be very high; consequently the return of investment of the project would be faced with difficulty. Of course, in gas contracts, necessary mechanisms are generally included in order to prevent such a loss. However, experience shows that especially when the party to a contract is a government which does not observe its commitments, such mechanisms can not be very effective.

Currently, the available information shows that India is facing difficulty with full absorption of LNG import volumes according to contracts it has concluded. On the contrary, the European energy market is well established and based on clear strategies, and it is thus very unlikely that the European Union disregards its commitments.

2. The investment problem is the principal factor in development of Iran's vast underground gas reserves. Meeting its domestic gas requirements, striking balance between domestic supply and demand, and creating suitable conditions for gas export are all affected by this main problem. Iran's presence in markets such as India and Pakistan does not create significant incentives for international oil companies to have cooperation for development of the country's gas reserves. This is due to the issues mentioned earlier. However, entering into European market will definitely ease and expedite such a process.

3. Commercial relations between Iran and Europe are much wider, and perhaps not at all comparable with those of India and Pakistan. Iran has significant imports from the European Union which is not proportionate to its export to this Union. Iran's gas export to the European Union can improve the trade balance between Iran and the EU.

4. Turkey is on the threshold of joining the European Union and does not have any critical and serious problem with the Union. The requirement for gas could also expedite Turkey's joining to the European Union. Under such a condition, Iranian

gas will be directly connected to the European Union without any additional risk. On the other hand, the risk pertaining to historical relations between India and Pakistan would naturally raise the investment cost of gas export to these countries.

5. From a national security point of view, perhaps European Union has much more power than Pakistan and India to influence international relations, especially on key issues pertaining to Iran's relations with international community. Dependence of European Union on Iranian gas can improve mutual relations, thus, reducing US ability to unite European Union with itself against Iran. Iranian gas export to the European Union can be within a framework of wider energy cooperation, by further covering Iran's nuclear issues and helping its resolution.

The Russian government and "Gazprom", its largest state oil and gas company, have recently expressed willingness to cooperate and participate in the construction of gas export pipeline from Iran to India. For a country such as Iran, possessing 17 percent of world gas reserves, any cooperation with important companies on gas marketing is desirable and considered as a long-term investment. However, such cooperation should be considered cautiously.

As mentioned earlier, due to last winter's Russian gas disruptions to Europe as a result of historical differences between Russia and Ukraine as well as some alarming remarks by the Russian authorities regarding future gas supply to Europe, the European Union has decided to further diversify its gas supplies. It seems that the Russians have been somewhat concerned about Europe's resolve on supply diversification. Therefore, there is every possibility that the Russian rival, i.e. Gazprom, be interested to prevent entry of its new rival into the European market and diverting it to the Eastern market. Even if Iran wanted to enter into Western market, it could not do so independently and need to do it only through Gazprom. Such a situation would maintain continuous control by Gazprom over its rival and its desired market. Thus, any dealings with Russian Gazprom would require high vigilance and clear strategy to serve both parties interests. In addition, the past records of Gazprom should also be taken into consideration. At some stages, Gazprom expressed willingness for the development of different phases of South Pars Gas Field. But, in practice, it did not have a serious attitude. This

attitude led to the suspicions that it was perhaps pursuing a policy in order to sabotage development of its rival gas reserves. With respect to Russian behavior, there is also a more important analysis and possibility which can be mooted as follows:

Relative increase in the world dependence on natural gas has impacted the oil market. Today both oil and gas have undergone changes in their roles, gradually transforming energy geo-politics. Under new conditions, gas is assuming a more important role in energy market and Russia enjoys a better position in the gas geo-politics as compared to oil geo-politics. This is due to the following factors:

Firstly - Russian gas reserves are much larger than its oil reserves and

Secondly - pipelines are still more popular for transferring gas. Due to its large land area and geography connecting east and west parts of the world, Russians can have a determining role in Europe, India and China, having demands for gas. Therefore, they wish to maintain their advantageous position in the gas market. If the above analysis is correct, coordination and unity between Iran and Russia, possessing a total of more than half of the world's gas reserves, could be vital and strategic and its importance and value should be taken into consideration in any international developments. If there is available gas in Iran for export (there are serious doubts in this respect which are out of the scope of the present article), the European gas market is definitely preferable for Iran compared to Indian and Pakistani markets. Unless, these two countries pay attractive prices for gas and provide suitable facilities to overshadow the above mentioned risks and differences.

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