

QATAR'S NATURAL GAS: THE FOREIGN-POLICY DRIVER

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Qatar finds itself in a very peculiar position, nestled sometimes uncomfortably between oil powerhouse Saudi Arabia to the south and a bellicose Iran and chaotic Iraq across the Persian/Arabian Gulf.¹ For most of its existence as an independent nation, Qatar has striven to carve out an independent foreign policy. In order to understand Qatar's overall gas policy, it is important to view it through the prism of the country's ambitious foreign policy initiatives.

Qatar's exploitation of its immense natural-gas reserves, estimated to be the third largest in the world (after Russia and Iran), at 910.5 trillion cubic feet, is key to its 1980s quest to become the "Saudi Arabia" of liquified natural gas (LNG) and natural-gas sales.² Recent natural-gas availability reports, as illustrated by Figure One, show that Qatar has compiled absolutely compelling numbers.

Most of Qatar's natural gas lies in the largest field of non-associated gas in the

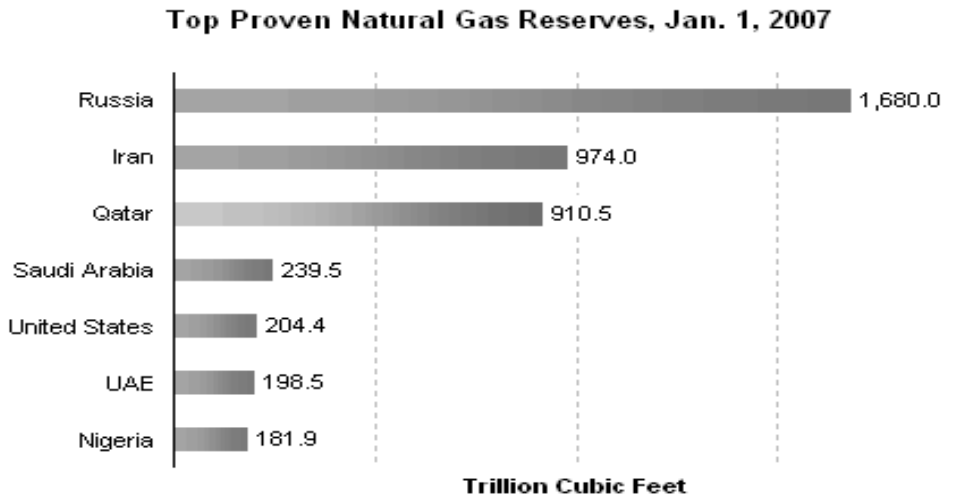
world, the immense offshore North Field.³ A multitude of domestic and foreign challenges in the early 1980s moved the emir, Khalifa bin Hamad al-Thani, to rearrange Qatar's oil-production priorities in favor of natural gas, which had been treated as a nuisance. It is now the cornerstone of Qatar's ambitious foreign-policy initiative.

A VOLTE-FACE

Qatar hosts one of the most extensive welfare states in the Middle East: free medical care, education and low cost housing are available for its citizens. Critics argue that, however subtly, the generous social programs may represent a conscious decision to undermine internal dissent to Qatar's generally benign autocratic rule and buy out all opposition. As long as the benefits flow, the people (or those able to mobilize politically) seem satisfied with the status quo.⁴

Rising oil prices in the 1970s enabled the emir to provide a vast array of social

Figure 1



Source: Oil & Gas Journal, Jan. 1, 2007

programs. The end of the boom rudely awakened Qatar to the fact that the golden days of Qatari oil production were finite. International oil companies (IOCs) had become unhappy that contracts were less lucrative, in part because Qatar's fields were beyond their prime. The fall in oil prices in 1982 and 1983 caused the social contract to fray. After years of government budget surpluses, oil production hit a plateau that caused Qatar to incur seemingly endless deficits.

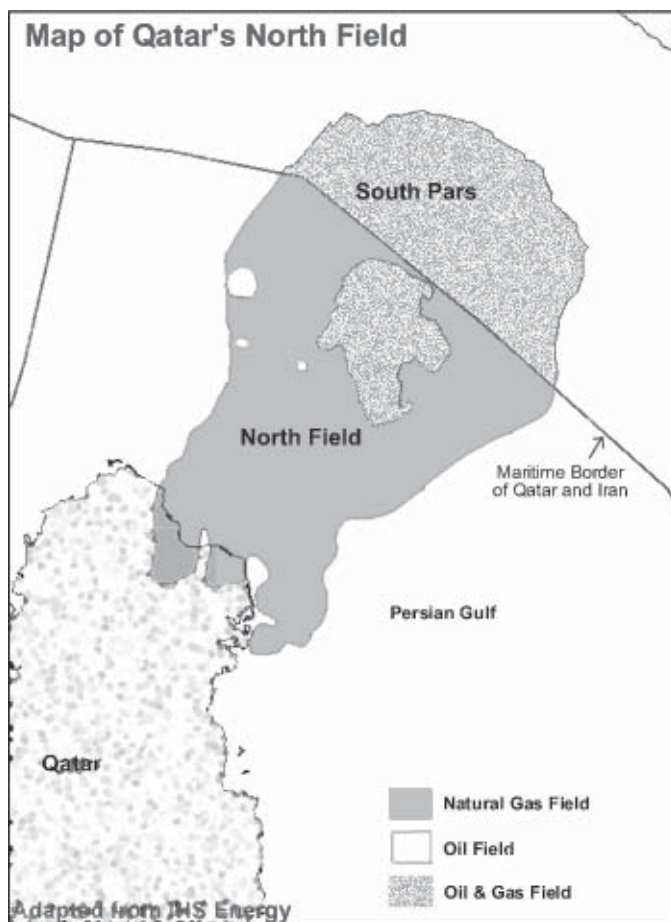
The emir introduced first-time austerity measures, departmental cuts that reduced employment by the government — Qatar's largest employer — and reforms that imposed fees for health care, water and electricity. The blowback from these unprecedented measures and the emboldened political opposition caused the emir to see the precariousness of his position.

NOT SO QUIET ON THE EASTERN FRONT

During the budget crisis of this period, the Iran-Iraq conflict degenerated into a war of attrition in which each nation deliberately targeted oil tankers in the Gulf. The so-called "tanker war" prompted Qatar to realize that it could no longer operate under the shadow of Saudi Arabia's leadership. This moved Qatar to construct a more independent foreign policy, particularly in regard to the United States and Europe.⁵

When the United States invoked Operation Earnest Will to protect Gulf oil tankers from Iranian and Iraqi attack, Qatar realized that Saudi Arabia could no longer serve as its protector. At that point, Qatar astutely decided to become a veritable Saudi Arabia of natural-gas production and thereby indispensable to the

Figure 2



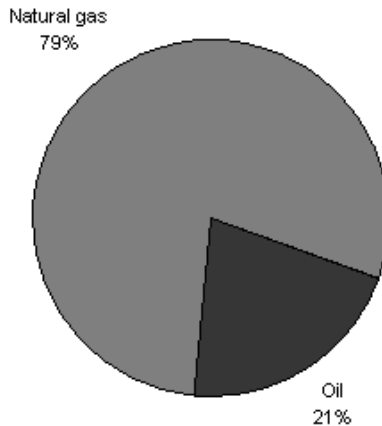
West, which had the ability to defend the country against the capriciousness of either of its warring neighbors.

PRODUCTION IN THE NORTH FIELD

Qatar required foreign expertise to develop the North Field and initiate LNG production. Even though Qatar had expropriated the North Field in the late 1970s, pundits viewed it as “expropriation-lite,” since Royal Dutch Shell continued to act as adviser and expert consultant. The emirate

was actually anxious to grant equity stakes to international oil companies in any venture because Qatar General Petroleum Company (QGPC, now QP) lacked the financial and technical expertise to efficiently develop the fields.

Shell, previously one of Qatar’s major partners, abandoned all ongoing discussions, ostensibly lured by the promise of more profitable gas ventures in Australia.⁶ The emirate, however, forged ahead with its plans through collaboration with QGPC, BP and CFP and formed Qatar Liquefied

Figure 3**Total Energy Consumption in Qatar, by Type (2004)**

Source: EIA International Energy Annual 2004

Natural Gas Company Ltd (Qatargas). Moved in part by intense Japanese interest in LNG imports, the emirate tasked Qatargas with North Field development. Yet intermittent foreign and domestic issues impeded this project for another decade.

IRANIAN WOES

As seen in Figure Two, Qatar's North Field abuts the maritime border with Iran, the site of one large geological gas deposit.

Since the discovery of the North Field, relations between Iran and Qatar have become more contentious.⁷ The long-running Iran-Iraq War had made energy-dependent Japan extremely nervous about increasing its LNG dependence on a region that was, effectively, a war zone. The development of the North Field for LNG and pipeline export, therefore, hobbled along during the 1980s. Yet, Qatar became interested in the potential of the North Field as a source for the increasing domestic

demand for energy, Natural Gas, as Figure Three reflects, began its dominant role in Qatar's domestic energy mix.

Because foreign partners were reluctant to help finance the LNG project, QGPC raised capital for the North Field through loans it had linked (with great optimism) to future petroleum sales.

In the 1990s, with foreign financing back on line, Qatar established a target date of 1996 to export North Field gas through a regional pipeline to several neighboring states that belong to the Gulf Cooperation Council (GCC), specifically, Saudi Arabia, Kuwait, Bahrain and the UAE. Even though Qatar would ultimately experience reversals, it initially thought the GCC pipeline to be a more pragmatic financial venture than the construction of a capital-intensive LNG facility.

In spite of the initial enthusiasm at the GCC summit meeting of 1989, when Qatar introduced the GCC pipeline, the project stalled due to political wrangling. Saudi

Arabia, which had started its own gas initiative, withdrew its preliminary grant of transit rights, fearful that Qatar's pipeline would adversely affect Saudi interests. Bahrain withdrew because of lower-than-forecasted gas demand and its border dispute with Qatar over the Hawar Islands. Kuwait could not go forward logistically, because Saudi objections to Qatar's transit rights effectively eliminated transport ability. The instability wrought by the Iraqi invasion and Gulf War added the coup de grace.

Even then, Qatar's failed vision had some positive results. The emirate recognized that the widespread equivocation among its neighbors constituted a wake-up call to maximize its role in LNG production and develop niche areas where it could emerge from Saudi Arabia's shadow. The prospects for LNG were the impetus that moved Qatar to economic and security partnerships outside the Saudi oil orbit.

ENTER DOLPHIN

Even though the vision of a GCC-encompassing pipeline was scuttled, fragments were reformulated as the basis of the ambitious Dolphin Project. Essentially a scaled-back version of the original plan, Dolphin envisioned that Qatari LNG would be piped to the UAE and Oman. Unlike most other transnational projects, Dolphin's primary purpose was not commercial.

Qatar saw Dolphin as a mechanism to strengthen political links with the UAE and Oman. If Dolphin delivered as expected, the economic links would strengthen regional political ties, and the resultant pipeline trade would enhance Qatar's regional status. Because Saudi Arabia was not in the picture, the remaining states formed a triumvirate, vesting themselves with the independence to develop regional

and international relations without traditional Saudi Arabian input.

More than anything else, Dolphin reflects the priorities and visions of Qatar's leadership. Initially, the involved national oil companies (NOCs) wrangled over the price that Dolphin Energy (the group set up by UAE Offsets) should pay for North Field gas. Because Qatari officials were initially unhappy with the "low" purchase price offered, QP and Dolphin Energy could not establish a mutually agreeable sale price. In view of the prospects for further delays, Qatar's emir and Abu Dhabi's leadership agreed that commercial considerations would not forestall a project of such political importance.

Dolphin has amazed analysts by its movement from an embryonic "pipe dream" to a genuine first step towards transnational GCC integration. This success is highlighted by the fact that Dolphin has even made its first deliveries to Oman. Dolphin's reach may logically be extended, as a 2001 arbitration ruling in the International Court of Justice peacefully resolved a simmering border dispute between Bahrain and Qatar.⁸

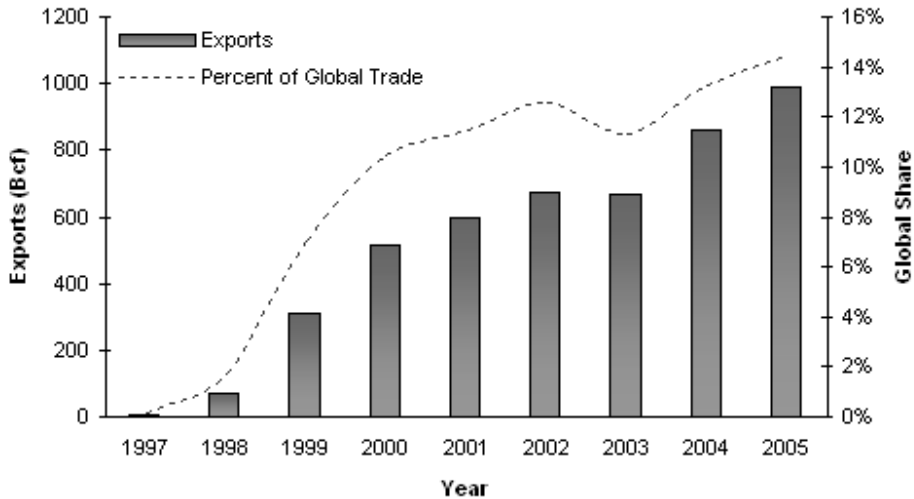
ENERGY CITY (SPOT MARKET)

Qatar envisions a niche in the international energy chain through an "Energy City," a hydrocarbon business center that will function as the brain of the Middle East energy sector.⁹ Positioned to be the first integrated energy hub of its kind in the Middle East, Energy City wants to attract revenue from the extremely lucrative streams directly and indirectly connected with the Middle Eastern energy market.

Optimally, Energy City will contain the world's first-ever dedicated energy-trading platform, known as the International

Figure 4

Qatar's LNG Exports, 1997-2005



Source: EIA Natural Gas Monthly (Aug. 2006); IEA Natural Gas Information 2006

Mercantile Exchange (IMEX), and will come under the governance of the Qatar Financial Centre Regulatory Authority. With even more profound implications, IMEX will establish a spot market for LNG sales.

No one knows to what extent the spot market will affect an industry traditionally characterized by long-term supply contracts and destination clauses that prohibit secondary trading. It may safely be said that the effect will be significant, since it will add liquidity and openness to a characteristically opaque trading sector.

GLOBAL LNG MARKET

Qatar will doubtless storm the gates of the global LNG market, as shown by the fact that it became the leader of the global LNG trade in 2006, when it overtook Indonesia.¹⁰

As seen in Figure Four, Qatar's LNG exports have steadily increased over a seven-year period. In light of this success,

the emir, Sheikh Hamad, believes that Qatar will be well positioned to increase its share in the principal markets of anticipated increase: Europe, Asia and the United States. Qatar's momentum will likely be spurred by the advances in LNG technology that have reduced the cost of "chilling" LNG to the point of liquefaction, and by the availability of larger classes of containment ships. The International Energy Agency makes the bold prediction that the global LNG market will account for approximately 50 percent of all trade by 2030.¹¹

A GAS-EXPORTING CARTEL

Some, however, watch Qatar's rise with trepidation because of the frequently discussed, and recently formed, Gas Exporter's Group, better known as the "Gas OPEC." Built on the largely toothless Gas Exporting Countries Forum founded in 2001, the Gas OPEC comprises Russia, Iran, Qatar,¹² Venezuela and Algeria. Their April 9, 2007,

meeting in Doha resulted in a formal declaration of the formation of a reinvigorated group that, in the aggregate, will control 73 percent of the world's gas reserves and 42 percent of its production.¹³ The Doha announcement has likely sent shivers down the spines of consumers in the industrialized world.

Traditional obstacles to this Gas OPEC, such as long-term contracts and reliance on a pipeline network, are currently being resolved by evolutionary, but sometimes swift, changes in the technical and financial lifelines of the gas market. While it may be too soon to call LNG a global, tradable, fungible commodity, the commercial constraints upon the viability of such a group are in slow but sure dissolution.

The highly respected industry-research group Wood Mackenzie recognized that, because gas is such a functional fuel substi-

tute, the real impact of Gas OPEC perhaps lies in a different quarter, principally in reduced investment opportunities for IOCs. This prediction gains plausibility when one considers that NOCs are generally inclined to share technology with other NOCs, and that gas-producing nations may be on a path to restrict access to both reserves and capital. Although gas is sometimes called the last frontier for IOCs, recent developments hint at closure. Ultimately, through Gas OPEC, gas-producing nations may tend to share skill sets among themselves and thus break free from the technology dominance of the IOCs.¹⁴

In the meantime, Qatar's vision to be a key player in gas development seems on track. Many would argue that the tiny emirate has effectively positioned itself to become the Saudi Arabia of LNG.

¹ The name for this body of water has been disputed since the 1960s between the Arab countries and Iran. In this article the more traditional designation will be used.

² Oil and Gas Journal Estimates, January 1, 2007.

³ This is the geological extension of Iran's South Pars field, which holds an estimated 280 tcf of recoverable natural-gas reserves. See Energy Information Administration: Country Brief Qatar <http://www.eia.doe.gov/emeu/cabs/Qatar/NaturalGas.html>.

⁴ The group in the Gulf countries that traditionally had significant political power vis-à-vis the emir was the merchant class, roughly comparable to the bourgeoisie in pre-revolutionary France.

⁵ As American troops have been under pressure to move out of Saudi Arabia, Qatar has welcomed them and serves as a permanent U.S. base. This gesture has been conducted against the wishes of many in the region, but it further illustrates the lengths to which Qatar will go to exercise its independence. See "Global Security: Al Udeid Air Base, Qatar" <http://www.globalsecurity.org/military/facility/udeid.htm>.

⁶ See "Shell Website: Shell in Australia" http://www.shell.com/home/content2/au-en/about_shell/2006/how_we_work/upstream_working.html.

⁷ Disputes have taken the form of the "correct" naming of the Persian Gulf, alleged overproduction of the North Field/South Pars gas structure, as well as suspicions about attempted assassinations and the political agitation of Qatar's Shia population.

⁸ See International Court of Justice <http://www.icj-cij.org/homepage/index.php?p1=0>.

⁹ See Energy City <http://www.energycity.com/>.

¹⁰ Energy Information Agency: Country Brief Qatar Natural Gas. <http://www.eia.org>.

¹¹ The International Energy Agency www.iea.org.

¹² Given Qatar's enormous projected LNG production, its role in the group could theoretically mimic Saudi Arabia's role of "swing producer."

¹³ See Lee Hudson Teslik, "A Cartel by Any Other Name," Council on Foreign Relations http://www.cfr.org/publication/13023/cartel_by_any_other_name.html?breadcrumb=%2Fregion%2F412%2Fqatar.

¹⁴ See "A Gas OPEC: The Route to Global Gas Market Power," April 10, 2007, Wood Mackenzie Press Release <http://www.woodmacresearch.com/cgi-bin/corp/portal/corp/corpPressDetail.jsp?oid=828403>.