

# The role of natural gas in enhancing global energy security

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Ladies and gentlemen,  
Dear colleagues,

You would probably be surprised if — as a representative of the world's largest gas company — I would **not** call natural gas **the main leverage of the future energy security**. Actually, I will reiterate this dictum today at our meeting but not only because I represent precisely this industry.

Let us have a look at the state of the global energy market. The devastating tsunami in March in northeastern Japan has attracted the most attention in recent months. It was a blow not only to the Fukushima nuclear power plant. This tragedy had a **restraining influence on the development prospects of nuclear power plants around the world**, although, of course, it did not strike them out entirely.

Moreover, we are witnessing **social and political unrest in several countries of North Africa and the Middle East**, which escalated into an armed confrontation with foreign involvement, such as in Libya. I am a businessman and will not give political assessments, but rather address only the economic aspects related to the energy industry. Have these events in one of the major oil and gas regions of the world brought stability to the market? Of course, the answer is 'no.' For the time being, Libya has dropped out from the club of suppliers. Long-term instability, possible spread of political turmoil in other countries of the region, all of it poses risks to the supply of energy markets. Let me give a clear example of the consequences of protracted instability in that part of the world. According to the US Energy Information Administration, in Iraq in 2002, before the arrival and stationing of American troops which executed the change of regime, the country produced about two times more gas (mostly associated gas) than in 2009 and never in this time period the production volume came close to the pre-war figure.

What are the alternatives? Unfortunately, **renewable energy sources** that are being actively promoted by authorities in Europe as a panacea in the fight against harmful climate change **remain very expensive**. So far, these sources can produce significant volumes only being propped up by different types of subsidies, which have a distorting effect on the inter-fuel competition. Given the present financial difficulties in Europe, it is unlikely that renewable sources can be

considered, at least at this stage of their development, as a major path towards a stable and efficient energy format.

It must also be stated that **oil resources are gradually running dry**, and new oil fields are less accessible, hence, the cost of “black gold” is increasing. On top of it comes the large polluting effect of the use of petroleum and petroleum products. As for coal, it is abundant but it is fundamentally impure and in this case the ecological considerations are paramount.

It is therefore evident that of the presently available energy resources, **it is only natural gas, judging by its properties, that has the potential to increase its share in the global energy mix**. It is safe, environmentally friendly, and cheaper than oil under equal heating, gas reserves are large - including shale gas deposits that can play a balancing role in some markets. In the form of LNG, natural gas can expand the geography of deliveries, and as motor fuel can successfully compete with petroleum in the not so distant future. In short, gas has the right to be titled the fuel of the 21st century, especially in view of its environmental and economic advantages.

Take for example the environment. In terms of costs and qualities, natural gas offers the optimum solution to the EU emission reduction targets. The European Gas Advocacy Forum of which Gazprom Export is a member, commissioned a research in defense of natural gas and produced results that speak for themselves.

If you compare several scenarios on achieving the EU targets to reduce CO<sub>2</sub> emissions, the scenario based solely on renewable energy sources can help achieve 60% of the planned emission reductions by 2050 underpinned by substantial capital expenditures. While **the scenario based on the use of gas allows for the same period to achieve 80% emission reduction, and will save the EU 900 billion Euros**. With the uncertainty about the future of some of the European economies and against the burdensome budgetary restraints, 900 billion Euros is not an amount that can be neglected.

Presently, a lot is being said about renewable energy sources and with understandable enthusiasm. Of course, solar, wind, and water energy should be used. But in what proportion, at what price and for the sake of what is it advisable and reasonable to make sacrifices?

First, we should not forget that it is only in combination with gas generation capable of quickly and economically meeting peak demands, that these unpredictable sources of renewable energy can provide reliable, stable, sustainable long term and, most importantly, an economically sound solution to energy consumption problems.

Besides, although any worthy project should be supported at its start, including by government, it is important to ensure that it does not damage similar valuable undertakings. In this context, I would like to mention the current model of European energy subsidies. **Subsidization of one type of generation, priority access to network and maintenance of artificially low prices predictably undermine investment incentives in other kinds of energy generation and**

**thoroughly destabilize the whole system.** A single political decision can stop the flow of investment, but attracting investments for reconstruction of damaged reliable supply system requires a lot of effort, time and money.

We believe that there is no goal, no matter how noble it looks and sounds, that justifies the demolition of the balance of interests of all the participants of the European energy market, the market, please note, that has been in existence for decades and enjoyed long-term investments. All through these years, Russia has been making a solid and weighty contribution to the maintenance of this balance. We have adopted, used and improved the Dutch-invented contractual model of trade, which allows to protect the interests of all parties - the supplier, the buyer, the transiter, the infrastructure operator, and the investor. **Oil-indexed long-term contracts that ensure the basic supply volumes from Russia, Qatar, Norway, Algeria and other exporting countries is exactly the mechanism that protects all the parties,** since the gas market is not like, for example, the fish market, where you can catch, sell and make a profit in one day and at the single price of boat renting. The gas market kick-starts with investment in exploration and production at one end of the pipeline, with investments in the pipeline along its entire length, and with investments in energy-intensive industries and the hosting infrastructure at the other end. Of course, these investments cannot be made without a clear long-term security of supply and transportation of large gas volumes. Long-term contracts provide such a guarantee.

Now, will lenders give money to gas projects that do not have linkage to oil? In recent years there have been calls to give up this mechanism. However, does the EU policy on infrastructure development not imply securing exactly such a contract system? If you reason not just like a politician, any owner and investor in future infrastructure is interested in guarantees on the use of that infrastructure for a maximum period. By calling for the development of infrastructure, the EU is thereby attracting the attention of market participants precisely to this problem for which long-term contract is the optimal solution.

Besides, under such a contract, a predictable and fair price insured against manipulation is valuable in itself, especially against the background of turbulences in recent years. Indeed, gas price in our contracts is pegged to a basket of alternative energy sources, relevant to a specific market. This allows the gas dynamics to keep the trend in other commodities, and also ensures that each specific country will not suffer the consequences of price shocks on goods and commodities that are totally unrelated to its economy.

The price of natural gas delivered under oil-indexed long-term contracts went up about 3 times within 10 years, like most other commodities, except, perhaps, gold, silver and oil, that rose 4 times. Two and a half years of abominably low spot prices in Europe have created the illusion that gas has lost its link to oil once and forever. This is not true and could not happen simply because oil-indexed contract prices serve as the benchmark for price arbitrage on the Continental market. **Moreover, spot gas trading is incapable of giving correct price signals to the market due to small volumes and low liquidity.** When you

ask producers to switch to spot pricing you are in fact selling us a “clock” that nearly always shows the wrong time. Even in North America, where, unlike Europe, there are hundreds and thousands of independent gas buyers and sellers, which is a prerequisite for a normal spot trading, the market seems distorted. U.S. prices are so low that they do not cover operating costs and, in our opinion, this situation will not last long. The situation there will return to normal and will make the U.S. market attractive again.

On other markets, it is the long-term contract system that continues to ensure energy security, as well as reliability, flexibility of supply at reasonable prices. Major partners of Gazprom Group understand this, otherwise, we would not have contracted more than \$4 trillion cubic meters of gas till the year 2035.

However, this picture is clouded by one factor. Natural gas has become hostage to geopolitics, in which there is an artificial demonization of Gazprom - the main supplier of “blue fuel.” Sometimes it seems that even if exports of bananas or cod were the largest source of budgetary revenues to Russia, it is in this area that political games would be played.

**We do not believe that there is currently an energy security problem in Europe which is the main export market of Gazprom. There are just no economic preconditions.** The transit crises in Ukraine in 2006 and 2009 were artificial and created by politicians, and, moreover, not from Russia. There are still apparent double standards. For example, the EU in negotiations with Ukraine on further expansion of cooperation asks for the release of former Prime Minister Yulia Tymoshenko as a certain precondition. However, the EU does not emphasize in an unequivocal form that it demands from Ukraine to ensure smooth and uninterrupted Russian gas transit to Europe. Therefore, from our point of view, whenever energy security comes to the forefront, we see a distorted, ideologically-laden, and politicized approach.

From a business perspective, we, however, see the problem differently: under conditions of mutual dependence of producers and consumers, it is necessary to ensure a harmonious development of the gas industry - production, transport and consumption in the same proportion, as required by financial, economic, environmental and other objective criteria. **Our strategy is a positive one, as the saying goes, we favour a *win-win* approach. The market should be allowed to solve emerging problems, and not politicians setting artificial terms and conditions for the sake of making them fit into their theoretical and unrealistic schemes.**

Today, we hear a lot about the need to face a serious challenge. How to balance two requirements: first, guarantee the security of reliable and affordable energy, and, second, move forward to low-carbon, efficient and environmentally friendly energy regime. I will reveal a small secret: we at Gazprom have the know-how; we know how to do it. Natural gas is more than just a bridge fuel. It is the best solution for energy security and low-carbon economy for decades to come.

I am sure that a positive approach will prevail. The work of the International Energy Agency, which in a recent report drew attention to the advantages of

natural gas and its enormous potential, allows me to come to exactly that optimistic conclusion.

**Thank you for your attention!**