Politics trump economics in the complex game of Eastern Mediterranean hydrocarbons

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A 2010 publication of the U.S. Geological Survey caused major excitement in Cyprus, an island that at the time was suffering from the economic collapse of its neighbor and major trading partner, Greece. According to the publication, the seabed of the Eastern Mediterranean could contain up to 120 trillion cubic feet (tcf) of natural gas.[3] Three years later, the Cypriot administration has high hopes that natural gas exports may get Cyprus—the third smallest European Union member state—back on its feet, after its own financial collapse in 2012. Unfortunately for the Cypriots, the reality on the ground is sobering, and it is currently unclear whether Cyprus will become a producer, or an exporter, of natural gas. Around Cyprus, other countries hope to benefit from the energy potential as well, including Israel, Lebanon and the Palestinian Authority. In the Israeli Exclusive Economic Zone (EEZ), in particular, substantial reserves of natural gas have been found, though the verdict is out whether these will in fact all be produced.

Exploration of Cyprus's offshore concessions is at an early stage. Energy majors such as ENI and Total are among the first to explore possible gas (and oil) reserves and they expect results not before 2015. To date, only two test wells have been drilled by Houston-based Noble Energy. Proven reserves have been downgraded since and are currently estimated to be between 3 and 5 tcf. At this level of reserves, investing in a natural gas liquefaction terminal, which the Cypriot administration has supported, is not economically viable. A better alternative would be to construct a pipeline to Turkey, which has a large and rapidly growing market for natural gas.

Unfortunately, Cyprus's offshore exploration is not just determined by economics and energy reserves. Since the Greek coup d'état and the subsequent Turkish military intervention in 1974, the Cypriot island has been split in two, with the north declaring itself the Turkish Republic of Northern Cyprus (TRNC) in 1983, a move that only Turkey recognizes. There have been a multitude of attempts to reunite the island and restore relations between the Greek and Turkish Cypriot communities, including the U.N. Annan Plan in2004, but all have failed. Driving through Cyprus's capital city Nicosia, one cannot help lament the fact that the European Union failed to forge reconciliation as part of the build-up for Cyprus's accession to the Union in 2004. The result is the presence of a U.N. buffer zone within E.U. borders.

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[2] In November 2013, the Peace Research Institute Oslo (PRIO) Cyprus Center partnered with the Friedrich Ebert Stiftung and the Foreign Policy Program at Brookings, in hosting a multilateral conference on Eastern Mediterranean energy resources in the U.N. buffer zone in Nicosia, Cyprus. About 150 people attended the event, including participants from both parts of Cyprus, Israel, Lebanon and Turkey, and the ambassadors of the United States, Norway, Germany and the Netherlands, as well as the Special Envoy for Energy from Israel. On the same trip, the authors also met with the Cypriot Minister for Energy, Commerce, Industry and Tourism.

[3] In comparison, BP estimates suggest that by late 2012 global proven reserves of natural gas were roughly 6,600 tcf. Nevertheless, findings in the Eastern Mediterranean could be regionally significant.

The *de facto* split of the island has substantial and potentially far-reaching effects on Cyprus's hydrocarbon ambitions. According to the the Cypriot Minister for Energy, the question of Cypriot reconciliation remains the government's top priority, with monetization of energy reserves a distant second. The Cypriot government strongly objects to any scenario in which Cypriot natural resources would be sold to Turkey, even indirectly, without solving the Cyprus issue first. The Cypriot government agrees in principle to sharing the potential natural gas revenue with all Cypriots, excluding "separatist groups without legal standing", meaning of course TRNC as an entity.

For its part, Turkish policy makers have so far been rather indifferent to Cyprus's natural gas potential, perhaps due to the limited amount of proven reserves. Still, Ankara has made clear that it expects potential natural gas revenues to be shared with all Cypriots. The Turkish government has also indicated that it will not tolerate exploration for hydrocarbons in what it considers to be TRNC's EEZ, and has sent gunboats to underline that it means business. This stance was bolstered by Turkish Prime Minister Erdoğan's November 2013 declaration that "there is no country named Cyprus." With the upcoming series of elections and domestic political fervor running high, Turkey's stance is unlikely to change any time soon.

Not far from the Cypriot findings, Israel has found substantial proven reserves. The discovered Leviathan and Tamar fields hold sufficient natural gas reserves, respectively 18 tcf and 10 tcf to date, to fuel the country for many decades.[4] Following a heated political debate, the Israeli government decided to allow up to 40% of the extracted energy resources to be exported, a move upheld by the Israeli High Court of Justice last summer. The big question now is whether this can incentivize market players to develop the newly found riches, and where this natural gas will be sold.

The 2010 *Mavi Marmara* incident has drastically deteriorated relations between Israel and Turkey. So far, the apology issued by Israel earlier in the year did not significantly improve relations, which as a result remain strained, reducing the likelihood of energy cooperation between the countries in the near future. Nonetheless, it is worth noting that private sector actors on both sides have been putting pressure on their governments to further explore the possibilities of natural gas exports from Israel. A pipeline through Lebanon and Syria is currently impossible due to the state of war between Israel and its northern neighbors—as well as the Syrian civil war; a pipeline through the Cypriot EEZ in the Mediterranean is a more viable option, though more expensive.

Egypt, another nearby potential market, has frosty relations with Israel, especially in public, despite the formal peace between the countries. Moreover, Egypt is undergoing prolonged domestic turmoil and has struggled for several years to secure the Sinai Peninsula that borders Israel. An existing pipeline through the Sinai, originally delivering Egyptian gas to Israel and Jordan, was sabotaged repeatedly, making the possibility of reversing the flow in the existing pipeline unattractive.

Jordan, Israel's neighbor to the east, with whom it has peaceful relations since 1994, may provide a market for some of the Israeli gas. A deal may face public opposition, but is more likely than one with Egypt at the moment. Jordan's market, however, is small, and it is unclear whether Jordanians would like

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[4] The Tamar field started producing in March 2013, whereas Noble Energy is currently exploring options to tap into Leviathan.

to increase their dependence on Israeli energy imports instead of developing their nuclear power capacity, or importing Iraqi natural gas.

In parallel, both the Lebanese and the Palestinians would like to start their own offshore explorations but high security, institutional, legal and infrastructural uncertainties are expected to delay their efforts. The Lebanese government disputes Israel's claimed EEZ, and the United States has attempted to resolve the dispute diplomatically. No exploration in the Lebanese EEZ has begun to date. Still, the Lebanese have expressed concerns that Israel may explore for natural gas outside its exclusive economic zone, in the Lebanese understanding, and public suspicion of Israel tapping into Lebanese wealth has been growing.

The potential for Palestinian energy exploration off the Gaza shore is complicated not only by the Israeli blockade of the Hamas-controlled Gaza Strip, but also by the intra-Palestinian division between the internationally recognized Palestinian Authority in Ramallah, led by Mahmoud Abbas, and the Hamas authorities on the ground in Gaza. Furthermore, any uptick in violence between the Gaza Strip and Israel—the latest round was in November 2012—would put investment at great risk.

As politics hamper the best economic options to sell hydrocarbons in the region, some alternative ideas have been proposed, though to date none have received strong private sector support. The Cypriot government is discussing the construction of a pipeline to Crete and then on to Greece. This would be one of the longest pipelines ever constructed, and, more importantly, an extremely costly option that would involve building in waters that are up to two kilometers deep. Another idea that has been discussed is constructing a floating Liquefied Natural Gas (LNG) terminal, although this is a new and costly technology. A LNG terminal would also bring additional security challenges for Israel, as would pipelines to and from Israel. Finally, the insecurity of the Sinai Desert has prompted some to suggest the construction of a subsea pipeline from Leviathan to the existing LNG terminals in Egypt, one of which is currently idle due to flattening production and increased domestic consumption.

For most countries in the Eastern Mediterranean it is too early to celebrate. U.S. Geological Surveys are not the same as proven natural gas reserve figures. With the exception of Israel, all states involved require additional hydrocarbon finds before commercialization and particularly lucrative exports can take place, if at all. These findings may well take place in the coming years, but until then national governments are better off managing public expectations, instead of inflating them. Even when additional energy resources are found, it remains to be seen whether there is a place for them in international markets, given the comparatively high costs due to technological challenges and high political risk; other natural gas coming on stream around the world; and possible changes in consumption patterns, and energy and carbon policies. The case of Israel suggests that even bringing substantial proven reserves to the market in this part of the world is challenging, and will require creative diplomacy by the regional actors and by the United States.

For now, the division of Nicosia, one of the European Union's capital cities, remains. After decades of diplomatic efforts and missed opportunities, it seems that natural gas will not join what men have divided.