

# WHEN IMPORTERS TURN TO EXPORTING OIL AND GAS — THE SHALE GAS HYPE AND CERTAIN GEOPOLITICAL CHANGES LIE AHEAD IN THE EASTERN MEDITERRANEAN

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Commemorating World War I has just started, but actually the repercussions of World War I are still going on. The territorial reshuffling of the remnants of the Ottoman Empire in 1920, notably at the San Remo conference, is a direct outcome of World War I. Gaining physical access to Middle Eastern oilfields was the West's priority, given the importance of oil for all forms of mobility and warfare. First pipelines were drawn, then borders between the new Arab nation states administered as mandates were traced. Iraq was created by the San Remo oil agreement and Iraq risks further destabilization due to oil interests.

Subsequent to the invasion of Iraq by the US and her allies in March 2003 new wars have emerged and put Iraq at the brink of collapse. The Kurdish question remains unresolved, but current developments in fighting Daech, the Islamic State in Iraq and the Levant, have triggered a new momentum for Kurdish statehood. While the Kurds were promised a state in the Treaty of Sevres 1920, the Treaty of Lausanne 1923 effectively ended those prospects. The current Kurdistan Regional Government in Northern Iraq actually behaves as if it were sovereign nation when concluding contracts with oil companies. In the absence of a Federal Oil Law and due to the ambiguous provision of the Iraqi Federal Constitution of 2005, notably article 109, many parties have dif-

ferent interpretations on the ownership of oil reserves. Many fear that Kurdish statehood in Iraq, in the midst of the increasing destabilization, would prompt irredentism across neighbouring countries. The many proxy wars in Syria and their spill over across the region contribute furthermore to the risk of state implosions unless regional powers stop their interventions and arming of militias in the region. The energy and security nexus is evident in today's context: fragile Iraq with its many untapped oilfields, and Iran returning to the global stage — bringing its natural gas on a market hyped by the “shale gas revolution” — as well as the new petroleum frontier in the Levant Basin.

Energy cooperation should be the name of the game from the Gulf to the Eastern Mediterranean. Saudi Arabia and Iran can do business in natural gas trade and refining, and in transforming their fossil fuel dominated energy mixes. The Gulf Cooperation Council (GCC) summit on 11 December 2013 welcomed the Nov 24<sup>th</sup> deal on Iran stating that it could bolster GCC cooperation with Iran<sup>1</sup>. In theory, energy could also be a catalyst for cooperation among Israel, Egypt, Lebanon, Turkey, Syria, and Cyprus, plus the Palestinian territories, with the rise of off-

<sup>1</sup> The summit communiqué also supports UAE over Iran's seizure of three isles near the Strait of Hormuz.

shore gas exploration in the Eastern Mediterranean. Energy cooperation should transcend all ideological differences. Talking to engineers is different from talking to politicians and diplomats who are often unable to discern the potential gains from energy cooperation. Big oil means big money and here power politics will always have its say. Still, the profound dilemma of the Middle East, the enormous human suffering and the risk of unlimited military showdown should push for a different logic. Countries, which used to be import-dependent, could turn into exporters, e.g. USA, Israel, Lebanon etc. Conversely, traditional exporters of fossil fuels may have to rethink their energy mix and may even have to import certain types of primary energy and expertise. A paradigm shift could trigger new dynamics. It is up to governments to act, companies have already taken their business risk and prepared changes on the ground.

### **Dominance of fossil energy and some possible trends in the unconventional sector**

The overall global energy-mix is dominated by fossil forms of energy, which accounted for 82% of energy supply in 2012 and will constitute 80% of the global total by 2035. Oil is the most traded commodity in the world, accounting for roughly 12% of overall world trade. By far the largest part of internationally traded oil originates in the Middle East; it will remain the most important factor to the pricing of crude oil. For natural gas, trading will continue to be regionalized with each of the world's three main markets — Russia, North America, the Gulf — having a different combination of market fundamentals. The separation between the oil and

gas markets, the break-up of the traditional price connection could also result in a more volatile gas market. Every exploration project is determined by costs and the market price, which will eventually be the crucial test for the current shale boom on the basis of horizontal drilling and fracking. Despite all the geopolitical unrest in resource rich regions, we witness a 25% drop of the average global oil-price. The traditional paradigm of the risk prime in the oil price seems to be outlawed by the tremendous slowdown in demand. The global economy could be in worse shape than many economists make us believe.

Some voices claim that this price decline might also be due to the increase in supply because of the rise in unconventional production in North America. This type of exploration is more vulnerable to a low price level than conventional, i.e. relatively easy to drill and thereby “cheap” oil and gas. The US in 2013 turned into the world's largest producer of petroleum liquids given its rising engagement in non-conventional resources<sup>2</sup>. US dependence on imported oil and other liquid fuels is projected to shrink from 60% in 2005 to about 25% by 2016. But flows from Middle Eastern oil will continue due to commitments by major export companies, like Saudi Aramco, which have significant assets in the US. The rise of US unconventional deposits, ranging from tight oil to shale oil, shale gas and CMB (coal-meth-

<sup>2</sup> A shale oil and gas field in the US discovered in autumn 2013, described as the biggest petroleum discovery in history, is larger than the Bakken and Eagle Ford shales combined, with potential for recoverable reserves put at 1000 bnbarrels The Global Prospects for Oil: The Geo-Politics for Natural Gas will be stronger. Consulted on Dec. 30th, 10:00 am. URL: <http://www.thefreelibrary.com/The+Global+Prospects+For+Oil%3B+The+Geo-Politics+For+Natural+Gas+Will...-a0353763954>

ane-bed), has already altered energy trading routes. Rapid innovation in the US drove down shale gas production costs from over 13 USD/m BTU in mid-2008 to currently around 3-4.5 USD. Yet, the US-gas market has evolved as an isolated market over the past years. The turning point will be when export bans stemming from the 1970s are lifted, otherwise the price drops, which means: “The US shale revolution carries within itself the seeds of its own destruction”<sup>3</sup>. The world average price of 100-110 USD pb for crude oil is the ideal incentive for developers of unconventional resources in the US and Canada<sup>4</sup>. The price of 90 USD pb is referred to as “a red line, all need it!” according to a Saudi Aramco official. Since drilling in the unconventional sector requires much higher costs than conventional oil and gas exploration, a drop of the average global oil price below 70 USD pb could jeopardize companies’ investments. The withdrawal of Royal Dutch Shell from all unconventional projects in Canada and the US in August 2013 illustrates this.

Subsequent to the IEA WEO (World Energy Outlook) of 2012 the bottom line in public debate was “forget about the Middle East”, since the US would turn energy-independent; an old dream and target since the oil crisis of 1973 and the creation of the IEA by US Secretary of State Henry Kissinger. However, the WEO of 2013 has revealed this assertion to be an exaggeration<sup>5</sup>. The Middle

East, the world’s only major source of low-cost oil, will remain at the core of the long-term prospects of the world oil market, notably able to meet long-term growth in Chinese and Indian consumption. Over the next 10 years, OPEC countries’ share of world oil consumption is projected to decline, but towards the mid 2010s non-OPEC production will start to decline and MENA countries will have to cover the bulk of the growth in world supply from then on. Crude oil production of 10.3 mbpd enables Saudi Arabia to earn 1 bn USD per day. This is the highest output in 32 years and Riyadh affirms it can go further as the world’s swing producer. Saudi sedimentary terrain is of exceptional quality, huge conventional oil reserves lie in just nine field groups, where recovery costs are the lowest in the world.

The IEA went too far in earlier reports referring to the “shale hydrocarbon revolution born in the USA”. For the time being, the global energy landscape has not been turned upside down. While some voices are joining the chorus lauding the shale boom and its geopolitical implications, such as disengagement from the Middle East, others are more prudent and ponder on the many questions it brings. They range from environmental dangers, rise in accidents due to “shale by rail”, and commercial costs to the geological uncertainty of rapid depletion. Royal Dutch Shell has decided to stop all its unconventional projects in the United States and Canada and considers rhetoric about the shale revolution to be “hype”<sup>6</sup>.

<sup>3</sup> Argus Dec. 20, 2013 Editorial.

<sup>4</sup> See interview with author. URL: <http://kurier.at/wirtschaft/marktplatz/energieexpertin-kneissl-die-usa-wollen-hohen-oelpreis/36.356.971>

<sup>5</sup> See also presentation by IEA chief economist Fatih Birol in Vienna, Nov. 18th, 2013: “The US will be the largest oil producer by around 2015. But this is only first chapter of the story. US shale

output will not continue to increase beyond then. It will plateau and then decline after 2020”.

<sup>6</sup> Interview with CEO Peter Voser in the Financial Times, Oct. 5, 2013.

The abundance of relatively easy to drill conventional oil and gas, notably in Africa and the Middle East, can still dampen prospects.

In Middle Eastern circles it is strongly debated whether the US shale revolution and its possible market impact is a threat or an opportunity. Promising geological surveys are being conducted in the region. Besides Algeria and Jordan, Saudi Arabia will be the third shale gas producer in the MENA from late 2019 or early 2020, when Saudi Aramco mobilises 40 rigs for shale gas production. Wasteful burning of crude oil for power generation motivates Riyadh, but the depth of reservoirs and very low permeability will make hydraulic fracturing very difficult<sup>7</sup>. Riyadh is ready to speed up its approach to this particular area of the energy business and involve US companies.

The OPEC WOO (World Oil Outlook) 2013 sees tight oil as a short- to medium- term phenomenon on account of the “inherent constraints and challenges” associated with geological facts. Saudi oil minister Ali Al-Naimi confirmed at the OPEC ministerial conference on Dec-4<sup>th</sup>, 2013 in Vienna, that “any addition to supply in this big market is very welcome”. But inside OPEC and beyond experts believe that those extra barrels are not here to stay. It is a matter of investment and declining rates which are at 30–40% per year, requiring continuous investments. These will always depend on the price. And the price in the long run is always a matter of supply and demand. Therefore the question remains:

### **What lies ahead for the global economy?**

Energy is the driver of the global economy. Uncertainty of a genuine recovery prevails, for the major problem remains the debt situation, which requires fiscal constraint and policies supporting growth. Two models seem to shape prospects. One is quantitative easing (QE) as practiced by the US Federal Reserve Bank, the Bank of England, and many more. The other is financial repression led by China and other BRICS. The Fed’s QE boils down to printing more dollars and letting their real purchasing power outside the US drop by alarming rates. This is of particular concern for commodity producers, which actually import inflation. OPEC remembers the meltdown of the 1970s, so the best place to protect your oil against inflation is to keep it under the surface, as an old saying goes. Given the enormous rise in production costs also in the conventional sector, other political needs in many producing states — e.g. build up against political protests by raising living standards — and uncertainty curb the appetite for long-term and cost-intensive investment in new explorations.

Geopolitics affect the Middle East more than ever before; according to the UN’s World Economic Situation and Prospects 2014 (WESP) political tensions will worsen. Of particular concern is the mounting tension between Iran’s Shiite government and the Wahabi-ruled Saudi Arabia, with the latter leading the Sunni front in a Muslim world of over 1.5 bn people. These tensions are evident in a number of proxy conflicts, particularly the war in Syria. The emergence of Daech, the Islamic Caliphate, which stretches from Northern Syria into Iraq, in June 2014

<sup>7</sup> Saudi Aramco’s General Supervisor for Gas Reservoir Management, Adnan Kanaan, in APS Review Vol. 81 No. 26; 23/31 Dec. 2013.

is a harsh reminder of a potential threat of implosion. Daech finances itself, inter alia, thanks to oil smuggling. This revenue has mounted for many criminal gangs since the early 1990s when a sort of vacuum arose in Northern Iraq due to the No-Fly-Zone by the US, the UK and France. Over the past years, no-go-areas out of any central control have increased in space and number. This lamentable fact has contributed to the rise of Daech, founded in 2004 by the Jordanian Musab Az-Zarkawi, thereby dissenting from Al-Qaida. Interestingly, the capture of Mosul and the seizure of control of certain oil terminals and refineries was a turning point for Daech in summer 2014. It was the Mosul-Haifa Pipeline which served as a territorial reference for the reshaping of the Middle Eastern map after World War 1. The Iraq war of 2003 backfires in 2014 and affects the world far beyond the region.

These and other risks, occurring unexpectedly, could derail the world economy far beyond the UN report's projections<sup>8</sup>. King Abdullah of Saudi-Arabia is upset with US weakness, he sees Obama as a "passenger" watching Putin taking the front-seat<sup>9</sup>. Russia has proved to be a more predictable ally than the US, which furthermore seems to be losing interest in the region after military adventures and a foreign-policy *volte face* subsequent to the Arab spring.

### **Changing of the guard in the Middle East?**

Whether or not the shale boom will be a lasting one, various indications confirm that the US wishes to disengage from

the region, which binds most of its time and diplomacy, but amounts to a negligible share of its trade. It is China's soaring energy consumption rather than the US' rising production that will fundamentally shift the world energy order. Some analysts claim that the Sino-Russian relationship will truly shift global energy boundaries. Pipelines are turning east, a fact the West still has to take note of.

In January 2012, then Chinese Prime Minister Wen Jiabo made his first trips to Saudi Arabia and the Gulf, two decades after the People's Republic and Saudi Arabia established ties. Ever since, the trade volume overtook that of the US and Saudi Arabia, excluding arms trade<sup>10</sup>. Saudi Arabia is the largest crude oil exporter to China, which became the world's number one importer in October 2013. Qatar became the largest LNG exporter to China in 2011. Geopolitics of Abu Dhabi upstream concessions shows that the bidding process gave priority to Asian firms. Asians are involved in UAE's military security and their own energy security. Bilateral energy cooperation with China increases with the construction of a Strait of Hormuz bypass crude pipeline. Korean firms are leading Abu Dhabi's USD multi-billion nuclear power programme to build four nuclear reactors to ease the country's gas shortage; this trend holds true for Japan to develop CCS (Carbon Capture Storage) technology.

If any US disengagement materializes, the question is who will move in; re-

<sup>8</sup> APS Review Vol. 81 No. 26; 23/31 Dec. 2013.

<sup>9</sup> APS Review Vol. 81 No. 17 21/23 Oct. 2013 Gas Market Trends.

<sup>10</sup> US-GCC Defence Ties: Pentagon on Oct. 17 said was to sell Washington's GCC allies Saudi Arabia and the UAE 10.8 bn USD worth of the most advance American missiles and munitions, including "bunker-buster" bombs. The move followed a series of US weapons deals in recent years which had bolstered the air power and missile arsenals of GCC states.

spectively, is there a need to move in? Will regional powers share their spheres of influence in a more balanced way? While China and India are already present in the region and Russia regains prestige as a reliable ally, sought after now also by Egypt, the chessboard of the region is reshuffled. The map of the outcome of World War I is under scrutiny and anxiety grows that some states might collapse, others emerge. Lebanization and balkanization are two interchangeable terms, which have been joined by Iraqization, Somalization etc. It always breaks down to fragmentation of a state and the decline of its monopoly of force. Meanwhile, one of the oldest nation-states, Iran, is preparing its comeback to the international scene and energy markets.

### **The return of Iran on the global stage**

The US and Iran have conducted unofficial contacts on their bilateral rapprochement for the past years, discussing topics of common interests stretching from Afghanistan to Syria. Very precise talks started in March 2013 in Oman, months before the Iranian presidential elections. On Nov. 24<sup>th</sup>, 2013 Iran and the P5+1 (the five permanent members of the UN Security Council — China, France, Russia, the UK, and the US — plus Germany) signed a six-month interim nuclear deal in Geneva that sets the stage for the conclusion of a more detailed agreement to regulate Iran's nuclear program — in exchange for the gradual relaxation of international economic sanctions<sup>11</sup>. The agreement promises to open a new chap-

ter in relations between the US and Iran and to have a significant impact on the international oil industry when Iranian oil exports will be back on the international market.

The return of international oil companies (IOCs) will take some time: BP, ConocoPhillips, Eni, ExxonMobil, Total, Royal Dutch Shell, and Statoil have all been invited by the Iranian oil minister Namdar Zanganeh; talks have been held but the IOCs wish to wait until June 2014, to watch the outcome of the interim deal. Meanwhile Tehran is busy with preparing for the moment once business starts. Actually Iranian consulting companies have received requests for market studies by US companies since 2012. New contracts are under preparation, offering “far better Exploration & Production contracts” than the usual buy-back deals which are no longer popular among major companies, according to Iranian officials: “The Iranian ones should be even better than the 20-year technical support agreements, which Baghdad has awarded for the development of Iraq's main oil and gas fields.” Zanganeh announced Iran's crude oil exports will exceed 2.7 mbpd shortly after all the UNSC and OECD/G20 sanctions against Tehran will have been lifted and then exceed 4 mbpd<sup>12</sup>. Iran's production of crude oil fell from 6mbpd in the 1970s to less than 3.3 mbpd in 1997. IOCs withdrew from Iran with the implementation of UNSC sanctions in the past six years.

To reactivate the petroleum industry is above all an internal power game. It is to be expected that Iran's oil production will

<sup>11</sup> To show Western powers he is a serious partner, Rohani has combined the Atomic Energy Organization with the Ministry of Electric Power. The first, and toughest, test is whether or not the Islamic Revolutionary Guard Corps (IRGC) will

cede its control over Iran's nuclear development programme.

<sup>12</sup> Minister Zanganeh in Vienna on Dec. 4th 2013 at the OPEC Ministerial Conference.

remain with the current 2.7 mbpd level. Global oil prices may fall if and when significant volumes of additional Iranian oil return to the market: how much will depend on global demand, the political stability of a number of OPEC countries, and how large producers react to it.

A certain risk might still flow from decision making inside the US. Diplomacy is not based on trust, but “on what we can verify”, Obama stated at the Saban Forum in Washington on December 7, in response to criticism for the US opening up to Iran. The convergence of interests between the US and Iran, as it existed in a profoundly different form until the revolution of 1979, could contribute to interesting geopolitical shifts in the region. The nervous reactions by American allies like Saudi Arabia and Israel illustrate the potential upcoming changes. In parallel, new developments in the Eastern Mediterranean push for further changes, both in terms of energy and security.

**A new petroleum frontier  
in the Eastern Mediterranean complicates  
the manifold conflicts, but opens up new  
chances for cooperation**

The new petroleum frontier involves countries poor in energy-resources situated in the rich hydrocarbon region, notably Turkey, Cyprus, Israel, and Lebanon. Turkey is in between oil-rich Middle East and energy-hungry EU, involving itself as a partner for transit in various pipeline projects. But the new race offshore carries new risks, in addition to the many dimensions of the Middle East problem. In 2010, the US Geological Survey estimated 1.7 bn barrels in undiscovered oil and 122 tn cubic feet of natural gas in the so-called Levant Basin. Some call the de-

posits the “second North Sea”, but complex geopolitics in the Eastern Mediterranean could spoil this opportunity<sup>13</sup>. Indeed, many fear that the race for exploration could constitute a new *casus belli*. The size of these figures came as a surprise, despite general knowledge about offshore deposits in the Eastern Mediterranean since the 1970s, and even earlier. Because of the water depths only giant discoveries are likely to be of commercial interest; this holds particularly true for gas.

So far, Israel has managed to develop large fields, raise the capital and above all engage a company. In late 2010, many experts were sceptical that any IOC would venture into such a project thereby putting at risk other engagements in the MENA. Very few believed a medium sized company could do it, but Noble Energy of Houston is developing the Leviathan and Tamar fields off Israel, which hold 30 TCF of gas. Noble is also behind the 5-8 TCF Aphrodite field off the Greek part of Cyprus. Israel and Cyprus have signed a joint cooperation contract for LNG export projects. Cyprus is a sort of terminal for all exploration in the contested triangle between Turkey, Israel, and Cyprus. Lebanon and Turkey have stepped up work on Exploration & Production (E&P) offerings. Israel competes for a Floating LNG (FLNG) vessel: the South Korean shipbuilders Samsung, Hyundai, and Daewoo are talking with Noble Energy. FLNG is just one option that Noble considers commercialising Leviathan resources, other would be onshore LNG plants in Israel or Cyprus, as well as pipeline exports to Turkey and Jordan. Talking to Israeli officials and,

<sup>13</sup> APS Review 17, 23/30 April 2012 Gas Market Trends. Vol. 78.

above all, to engineers one has the impression that the will to use this commercial endeavour for multilateral cooperation exists. Actually, technicians involved in various training programmes in Lebanon also opt for more regional cooperation than their politicians.

But territorial disputes will have to be settled first and arbitration on maritime borders is sought after. Turkey contests a Cypriot-Israeli accord on their respective economic exclusive zones signed in 2010. In spring 2012, Turkish TPAQ started drilling on and offshore in the Turkish Republic of Northern Cyprus. Lebanon has thus far not moved in, but focuses on institutional and educational preparation for the day tenders will have started. Approximately 42 companies, among them various big IOCs, were invited in 2010 to participate in a tender. An auction of exploration blocks to drillers has already been delayed and will probably be postponed again. Former Lebanese Energy Minister, Gebran Bassil, is frank in his criticism of inaction by the Parliament; he warns that nobody will wait for Lebanon, given other opportunities in Eastern Africa and elsewhere<sup>14</sup>. In accordance with the Petroleum Authority, a nucleus of governance was established; some say a slow pace in operation at the start will help mitigate the oil curse and enforce good governance. Energy could one day be a lucrative business in Lebanon and each faction wants a piece of it. The Petroleum Authority, which was constituted in a long process assuring fair representation of ethnic and minority groups on the board, commissioned the mapping of the seabed and

completed the interpretation of the seismic work. This gives the government an insight on resource assessment that allows it to delineate the license areas and thus capitalize on more favourable terms with contractors<sup>15</sup>. Given the many territorial disputes, a clear delimitation of Lebanon's Exclusive Economic Zone is indispensable. Lebanon is a treaty state to the UN Convention of the Law of the Sea and should use this legal instrument. Israel has not ratified the convention and handles the entire topic in a bilateral way, as in the case with Cyprus.

The first customer to sign up to buy gas from Israel's Leviathan field is the Palestinian Power Generation Company. The three Israeli partners in Leviathan — Avner, Delek Drilling, and Ration — agreed in late 2013 to buy 1.2 bn USD worth of gas over a 20-year period once the fields go online. Under the gas-export policy established by the Israeli government, gas sold to the Palestinian Authority and to Jordan will be considered par to Leviathan's export quota; 40% of all Israeli production can be exported. Many decision-makers both in Lebanon and Israel are also aware of the risk to not repeat mistakes committed in similar bonanzas, namely to destroy the rest of the economy because of a commodity boom. Such economic mistakes were also made by mature economies like the Netherlands during the North Sea boom, better known as the "Dutch Disease".

Despite the war in Syria, an energy deal was struck between Moscow and Damascus on December 23, 2013. The state controlled Russian group Soyuzneftegaz

<sup>14</sup> Debate with the National Petroleum Authority and the Minister at the Université St. Joseph in Beirut on November 28th, 2013.

<sup>15</sup> Lebanon's Gas: On the Way in MEES, Energy & Geopolitical Risk, Vol. 3. No. 8. August / September 2012. By SamerKhalaf.



and the Syrian government signed a contract for the exploration and drilling, development and production of oil and gas in 2.190 sq km area off Syria's coast, roughly speaking the coastal area between Baniyas and Tartous. Though it might take years to implement it due to the on-going war in Syria — the concession spans for 25 years — it further solidifies the ties between the two countries in the energy area. This contract gives Russia a stake in the competition for those energy reserves. Soyuzneftegas, controlled by Russia's central bank and run by former energy minister Yuri Shafranik, will shoulder part of the drilling costs for the survey which amount to 75 mio., according to a report published by the official Syrian Arab News Agency. Soyuzneftegas has been active in Syria since 2004 when it received exploration licences for two development blocks, but has so far not discovered proven reserves of hydrocarbons<sup>16</sup>.

In principle, Egypt could play an important role in the exploration projects since it possesses offshore experience, having been a successful natural gas producer and exporter for some years. It would make sense to use the existing terminals in Damietta for the LNG projects Noble envisages for the Israeli production. But given the suspension of all natural gas exports in April 2012 via the Arab gas pipeline to Israel, which provided a third of the country's needs, such a move is not yet on the agenda. These new gas findings and the impressive technical accomplishments by the companies involved, in particular Noble which assumed the many challenges against all odds, could create a new dynamic for the entire region. In var-

ious talks the author held for the purpose of this study it became evident that a legal and technical framework for common natural gas-explorations could serve the needs of the countries. But resentments and fears seem to overshadow these fresh hopes. Egypt is a particular case at stake, for it could be part of the paradigm shift in the Levantine Basin, thanks to its experience, market, and role as regional power. But the country, the army, the various power-brokers in the literal meaning of the term, and its entire bureaucracy seem lost in transition.

In short, there are huge opportunities created by the discovery of gas in the Eastern Mediterranean — not least for countries that are short of both money and energy. Developing these opportunities will require cooperation, and could be both a lucrative and politically rewarding confidence-building measure. Conversely, long-standing squabbles, for example between Cyprus and Turkey and Egypt and Israel, could scupper energy cooperation. Indeed, competition over energy resources could even increase tensions.

**Egypt loses its status  
as reliable producer,  
and internal energy crisis deepens**

The energy base of Egypt has almost quadrupled in size since the early 1980s. Energy and water, of which Egypt is acutely short, are two of the worst issues. It should not be excluded that the “counter-revolution/coup with popular support” of July 3, 2013 was also prompted by acute electricity crises with major black-outs on a daily basis<sup>17</sup>.

<sup>16</sup> Financial Times Dec. 26th, 2013: Russia tightens links to Bashar al-Assad with Syria energy deal.

<sup>17</sup> MEES. Vol. 3. No. 9 October 2012: Egyptian Revolution hits Energy Sector by James Cockayne. P. 14.

It proves very difficult for Egypt to sustain its position as an energy exporter; companies that planned to continue investing in the country despite all turbulences are leaving. Arrears in payments, absence of decision-making powers in the country's institutions, and a tremendous rise in violence and crime prompt investors to leave. Faced with a growing gas crunch and a stagnating economy, the provisional government is desperate to attract foreign investment into the energy sector and the country at large, but Egypt will not see an upturn in energy investments until it starts paying them promptly. Former Petroleum Minister Sharif Ismail was eager to show that his government can tackle the energy dilemma. Egypt admits to the realities of its gas crunch by indicating that it will pay higher prices to IOCs active in the country and cut the subsidies. Efforts to curtail power demand are critical. Demand management and reducing power subsidies is key to cutting wasteful consumption. Because Egypt missed out on that, it turned from an LNG exporter to an importer. The retail price of natural gas in Egypt is one of the lowest in the world. It was conceived to distribute hydrocarbon rents, protect low-income customers, enhance industrialization, but provoked other results: inefficient allocation of government resources, benefits to the wealthy, over-consumption, and environmental damage. President al-Sisi ventured into capping energy subsidies in a courageous manner shortly after taking office this spring. The measure met expected opposition, but it seems manageable. It seems like a start to tackle energy waste and the pressure on the budget.

Any subsidy reforms is a tight-rope walk between entrenched interests and weak governments, it has to address legitimate concerns over inflation and political stability and making sure that social unrest will not put everything at risk. Speaking to officials in the energy ministries from Tehran to Cairo, one is confronted with the profound dilemma: how to phase out of those generous social transfers and still enable people to have access to energy. The importance of private transport, the role of every household diesel generator stepping in, when public supply closes reveals the delicate topic of cutting subsidies. It is easier said than done. Interestingly enough, the IMF WEO 2012 spoke of "bad subsidies" in the fossil sector and the "good incentives" when it comes to renewables. In the end, market forces should be reconciled with sensible governance in all fields.

The country with its population of 90 million with growing domestic gas consumption is in dire need of a restructured energy-mix, new grids, and a viable incentive structure for IOCs to invest in increasingly expensive offshore projects. Given the enormous money transfers by Gulf states to the new transition government after the events of July 3<sup>rd</sup> 2013, Cairo could boost its empty foreign reserves by up to 18 bn USD. That enabled the government to secure paying arrears of 6 bn to the IOCs.

But is this sustainable? The subsidies bill hit USD 12.3 bn for 2009-10 financial years, up from USD 6.9 bn for 2005-06, yet only 20% of petroleum subsidies go to the people in the bottom 80% of incomes. The Oil Ministry is responsible for funding the subsidy bill, in return it withholds payments to the country's foreign opera-

tors. Big operators like BP, Shell, and Eni can cope, but not the smaller ones<sup>18</sup>. Furthermore Egypt is competing with neighbouring countries. Compared to Libya and Algeria, Egyptian upstream gas remains popular among smaller independent firms, but this should not be taken for granted. Outstanding receivables and a low gas price are the main obstacles preventing the expansion of gas production. Since July 2013 a series of production sharing contracts was struck with Shell, Apache etc and the state firm Egyptian General Petroleum Corporation. Sinopec paid 3 q billion USD for one third of Apache's operations in August 2013. Most of the oil producing ventures are in the Gulf of Suez, followed by Western Nile Delta, Sinai and Eastern province. However, the worsening security situation on the Sinai could put into jeopardy numerous projects.

The wish to diversify the electricity mix has been on the agenda since the Mubarak days, but little has been achieved. Various projects in wind and solar parks organized by Germany and Denmark were stopped, also in response to the events of July 3<sup>rd</sup>. 2013 An old project is currently back in the debate, namely a nuclear tender. The situation in Egypt demonstrates a clear link between energy and security. Lack of energy security contributed to social discontent, while political instability as a result of the uprisings has created even greater energy instability in the country. Stability and sustainable development in Egypt will be very much determined by how the government deals with its energy problems.

<sup>18</sup> Petroleum Economist. Vol. 80. No 9, Nov. 2013. P. 8–9. Cairo looks to ease IOC pain by James Gavin.

What we can observe is that traditional exporters are at the brink of turning into importers like is the case with Egypt. And countries so far dependent on imports might reshape their energy-base and become much less dependent on imports. Such a reshuffle of the map could create new tensions but also certain chances for new forms of cooperation. The new gas findings in the Levantine Basin are referred to by some as a risk for going to war, some claim that even the past Gaza operation in summer 2014 had an energy dimension, but others are eager to point out the opportunities. Levantine business is rooted in ancient customs and mentalities. Getting rich together instead of dividing the world into believers and unbelievers requires more pragmatism and less ideology.

The region is currently passing through fundamental unrest, maybe even a war of 30 years comparable to the disaster that hit Europe in 17<sup>th</sup> century. And the bloodshed has started many years ago due to various Western interventions. The ultimate outcome could be a substantial reshaping of the map, eventually even with new borders. Pro-Western emirs and colonels might be replaced by those on the payroll of the Chinese or India. Actually ancient trade routes between the Far East and the Middle East resemble those of today. While the West is gradually moving out of the region, the East is moving in.

The Sino-Russian energy cooperation could ultimately revolve certain paradigm in the international energy scene more profoundly than today's "shale revolution". We are speaking here of a different demographic frame and thereby of different volumes.

If one tries to understand or even anticipate developments in international politics it is always useful to put on a pair of glasses and call those the “oil market”, for these inner lens can contribute to understanding alliances and confrontations.

For decades the bon mot by the former Saudi oil minister Zaki Yamani “oil

alliances are stronger than Catholic marriages” thereby referring to the many ups and downs in the relations between the US and the Wahabite Kingdom of Saudi Arabia proved valid. But today’s changes will leave their imprint on pipelines, maps and who is an importer and who an exporter of energy.

## Когда импортеры переориентируются на экспорт нефти и газа — шельфовый газ и геополитические изменения в Восточном Средиземноморье

**Карин Кнейсль**

*Аннотация.* Ближний Восток, как мировой поставщик наиболее дешевой нефти, продолжит определять ситуацию на нефтяных рынках. Значение американской «сланцевой революции» для мирового рынка сильно преувеличивается. Пока о каком-либо значимом эффекте говорить не приходится. Все осталось на своих местах. Мировой энергетический баланс скорее изменится из-за растущих потребностей Китая и возврата на нефтяной рынок Ирана. Особый интерес с геополитической и экономической точек зрения представляет открытие газового месторождения в Восточном Средиземноморье.

*Ключевые слова:* энергетика, Ближний Восток, «сланцевая революция», нефтяные рынки.

## When Importers Turn to Exporting Oil and Gas — The Shale Gas Hype and Certain Geopolitical Changes Lie Ahead in the Eastern Mediterranean

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*Abstract.* The Middle East, the world’s only major source of low-cost oil, will remain at the core of the long-term prospects of the world oil market. The IEA went too far referring to the “shale hydrocarbon revolution born in the USA”. For the time being, the global energy landscape has not been turned upside down.

*It is China's soaring energy consumption rather than the US' rising production that will fundamentally shift the world energy order. Some analysts claim that the Sino-Russian relationship will truly shift global energy boundaries: pipelines are turning east. Global oil prices may fall if and when significant volumes of additional Iranian oil return to the market. A new petroleum frontier in the Eastern Mediterranean complicates the manifold conflicts, but opens up new chances for cooperation. There are huge opportunities created by the discovery of gas in the Eastern Mediterranean — not least for countries that are short of both money and energy. Developing these opportunities will require cooperation, and could be both a lucrative and politically rewarding confidence-building measure.*

**Key words:** energy, Middle East, shale oil and gas revolution, oil market.