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Natural Gas in the Eastern Mediterranean: Will Economic Wisdom Prevail?

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Among the countries of the Eastern Mediterranean – a region with a long history of rivalries and disputes – there is a growing understanding that the window of opportunity to use natural gas to improve their economic situation significantly may close due to strong competition from other regions that are more stable politically and have larger quantities of natural gas. The growing economic wisdom in the eastern Mediterranean basin will not solve the various disputes between the countries of the region, but it may reduce the chances of those conflicts erupting.

A number of seemingly unconnected developments over the past year have created the possibility of a new dynamic concerning the economic potential in natural gas resources in the Eastern Mediterranean basin. Accelerated activity in the matter may also contribute to a positive change in the geopolitical situation in the region.

The first such development concerns regional economic cooperation**,** which is also important politically. In January 2019, the energy ministers of Egypt, Greece, Cyprus, Italy, Israel, Jordan, and the Palestinian Authority met in Cairo and established the Eastern Mediterranean Natural Gas Forum. The Forum is intended to help its members benefit from their natural resources and infrastructure. Emphasized among the declared aims was the inherent benefit to members from the use of existing infrastructure to transport natural gas, and from the development of alternative infrastructures in response to future discoveries of natural gas.

The Forum has great political and economic importance. The international community's attempts to establish a framework for Mediterranean economic cooperation, such as the economic working group established at the Madrid Conference in late 1991, or the Barcelona process that began in 1995 with the aim of creating a political-economic framework for the European Union and Mediterranean countries, ended in failure. This failure was partly due to conditioning regional cooperation on progress in the political process between Israel and the Palestinians and the negative ramifications of the Arab Spring on the ability to embark on regional cooperation. Natural gas discoveries in the Eastern Mediterranean clearly emphasized the economic damage from the lack of a framework for coordinating positions vis-à-vis consumers from outside the region, and the inability to exploit joint transportation infrastructure efficiently.

The participation of three European Union members in the regional gas forum is essentially a continuation of the dialogue that Israel began with Greece and Cyprus. This dialogue rests on two components. The first is the idea of a pipeline to transport the gas from the Eastern Mediterranean to Europe. The second is the creation of a framework for communication and coordination vis-à-vis the aggressive regional policy of Turkey. For more than a decade since the natural gas reserves were discovered, the European Union has avoided direct involvement – political or financial – in the issue of regional energy cooperation. However, under pressure from Greece, Cyprus, and Italy, the EU agreed to participate in financing a feasibility study for a maritime gas pipeline. The pipeline, which in the first stage will be able to transport 10 billion cubic meters per year, and with a construction cost estimated at $6 billion, was defined as a "joint interest project" by the EU.

Just recently, the US began exhibiting overt interest in the development of natural gas resources and related activity in the Eastern Mediterranean, attested to by visits to the region by US Secretary of Energy Rick Perry and Assistant Secretary of State for Energy Resources Francis Fannon. Both were present at the second meeting of the Natural Gas Forum on July 24, 2019 in Cairo. The American interest in the region is not due to economic reasons. Contrary to large European companies such as Total of France or Italy's ENI, which are active in Egypt and Lebanon, the large American energy companies are thus far not involved in the Eastern Mediterranean. Noble Energy, which is active in Israel and Cyprus, is not considered an energy giant. The US maintains its presence in the Mediterranean mainly for global considerations of blocking Russian penetration into the region.

European and American involvement in regional natural gas activity is considered economically and politically important, since it provides international sponsorship and makes it easier for the region's governments striving for regional cooperation to advance the development of resources. However, it also makes it more difficult to withstand domestic political actors that are opposed to cooperation with Israel or with the US and Europe.

The second development concerns efforts to solve the dispute between Lebanon and Israel regarding borders, particularly the maritime boundary. Struggles between opposing forces, guided by ethnic and religious interests, are delaying Lebanese development of the natural gas in its maritime Exclusive Economic Zone (EEZ). Beyond their effect on the general functioning of the Lebanese government, the divisiveness has led to delays of several years in the advancement of legislative and regulatory measures regarding natural gas – tenders and taxation – that are required in order to begin exploration. Moreover, in 2010 a maritime border dispute broke out between Israel and Lebanon regarding an area of 850 sq km. Israel agreed in 2012 to a compromise proposed by American mediator Fred Hoff, while the Lebanese government has still not responded to the proposal. Israel, which was already in the midst of natural gas production from maritime fields far from the area under dispute, has not suffered any damage as a result, while the dispute only increased the wariness of foreign companies regarding activity in Lebanon. Even though companies such as Total competed and won concessions from the Lebanese government for explorations in Block 9, which includes part of the area under dispute, the company announced that it would not operate there. Moreover, if a compromise acceptable to both the Lebanese and Israeli governments is reached, and gas is found in the zone close to the area under dispute, the production of that gas could encounter difficulties if there is no binding agreement on sharing the gas that straddles the agreed dividing line.

The Lebanese foot-dragging, regarding the exploitation of natural gas, is a luxury that is increasingly difficult for Lebanon to afford. An International Monetary Fund report from early July 2019 indicates serious economic problems, chiefly a national debt that is 150 percent of GDP, likely to increase to 180 percent by 2023. Various ratings companies, which have already lowered Lebanon's rating to the low rating of B-, may lower it to CCC. Two mentioned Lebanon on August 23, 2019: Standard and Poor’s left the Lebanese rating at B-, while Fitch lowered their rating to CCC. These steps spell difficulty in selling government bonds and raising funds abroad.

These figures require the Lebanese government to take immediate fiscal and monetary steps, and consider ways to spur economic growth, which in the past five years, has averaged just 1 percent. The acceleration of activity regarding natural gas could be a main tool for changing the economic situation. Perhaps it is in this context that contacts between the US and Lebanon have resumed regarding the delineation of the maritime border, and the issue was raised in discussions between Lebanese Prime Minister Sa'ad Hariri and US Secretary of State Mike Pompeo on August 15 in Washington. In his remarks on the maritime border, Hariri said that serious discussions on the matter are underway, and that it is important to enter negotiations to reach a solution, since the issue is essential for Lebanon. (Hariri mentioned the UN, which will provide the auspices for the negotiations with Israel. This is also a source of contention between Israel and Lebanon, although it can be easily bridged.)

The third development has to do with the issue of transporting the gas to the European market. When Lebanon reaches the commercial production stage, the question of transportation of quantities of natural gas produced in the Eastern Mediterranean to the most significant nearby customer – Europe – will come into sharper focus. The alternative of laying a pipeline toward Cyprus and from there to Greece may prove to be difficult to implement for political reasons (Turkish opposition), technical reasons (difficulties in laying the pipeline on a problematic seabed), and thus also for financial reasons (costs higher than the current estimate of $6 billion). The less expensive alternative of laying a pipeline to Turkey and connecting it to the existing transportation systems to Europe is more problematic politically, not only from Israel's standpoint. It requires passage through Lebanese and Syrian EEZs, and reliance on the current regime in Turkey that in recent years has been wont to make strategic reversals and certainly does not encourage long term investment that requires trust between potential investors.

Against this background, other alternatives emerge. One is transporting the gas from the Israeli fields to facilities on the northern Egyptian coast. These facilities liquefy the gas and load it into tankers, carrying the gas to ports where the reverse process is performed — offloading, gasifying, and pumping the gas into a pipeline. The companies that operate the Leviathan field are supposed to begin transporting gas to Egypt toward late 2019, while Egypt may be both a consumer of Israeli gas and a transit point for liquefied natural gas. This alternative is very important, both because it is the only one that provides an immediate gas export response that ensures the ability of producing companies to continue developing the other fields where they have concessions, and because it enables the state to increase its tax and royalty revenue from the sale of the gas. Beyond the economic aspect, cooperation between Israel and Egypt is a strategic asset for both countries. Despite the advantages, however, this alternative is not without technical and political problems. The technical problem is the limited capacity of both the pipeline to Egypt and the Egyptian liquefaction facilities. The Israeli-American consortium will have to compete with the natural gas produced in Egypt, some of which is intended for export. From a political standpoint as well, economic dependence on a single transport mechanism may under various circumstances prove to be problematic.

For that reason, the willingness of the consortium (and in effect that of the Israeli government as well) to examine the alternative of liquefying the natural gas and shipping it to Europe from floating installations – Floating LNG – that will be positioned in Israel's EEZ is understandable. In July 2019, the Israeli-American consortium signed agreements with two companies that deal with the establishment of such floating installations. One is GOLAR, which is registered in the US, and the second is EXMAR of Belgium. The cost of an installation depends on its distance from the coast, the quantity to be liquefied, and the ability to store the liquefied gas until it is loaded onto tankers. In all cases, the cost of the floating LNG installation exceeds $1 billion. A combination of land-based installations in Egypt and a floating installation in Israel's economic waters will provide flexibility in transport and early and more rapid exploitation of quantities of natural gas, which the companies are permitted to export according to the framework adopted by the Israeli government, and which may increase if new reserves are discovered.

Settling the issue of the land and maritime boundary between Israel and Lebanon and an agreement for the joint exploitation of cross-border gas fields may enable the future utilization of a floating LNG facility by producing companies in Lebanon and Cyprus, thereby saving them huge investments in separate infrastructure. This will also increase the interest of the involved countries in maintaining regional stability.