Strategic Sectors | **Economy & Territory**

The Energy Geopolitics of the Eastern Mediterranean and the Cyprus Problem

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The discovery over a period of seven years, (2008-2015) of approximately 2.56 trillion cubic metres (tcm) of natural gas[1] beneath the waters of the Exclusive Economic Zones of Cyprus, Israel and Egypt, has concentrated international attention on the potential emergence of the region as an important gas producer and potential exporter. Since then, various political and economic stakeholders from the region and beyond have tried to evaluate the significance of this newfound wealth and whether it would stabilize or destabilize the eastern Mediterranean.

Some of the conventional thinking which resulted from their evaluation is that the region will have a major impact on Europe's gas diversification strategy, helping it to measurably diminish its dependence on Russia by exporting to the EU anywhere between 20-50 bcm/year,[2] while at the same time contributing to solving the Cyprus problem.[3] These perceptions over-emphasize the perceived "capability" of these discoveries to either restructure regional geopolitics or limit the EU's imports from Russia, which is and will most likely remain Europe's primary gas supplier well into the late 2020s. *The discoveries, which until the early 2020s will be mainly directed to markets inside the eastern Mediterranean, tend to reconfirm and not fundamentally alter the geopolitical status quo.*

In other words, there is no "peace pipeline" in the eastern Mediterranean that could provide an important enough driver to change the cost/benefit analysis of the parties involved in the region's entrenched conflicts, such as the Arab-Israeli dispute or for that matter the Cyprus conflict. The discovery of the Gaza Marine field in the EEZ of the future Palestinian State in 1999 did not move Israel or the Palestinians closer to peace. The discovery and monetization of Leviathan in Israel as well as the contested claims between Lebanon and Israel over an 854 km^2 portion in their respective EEZ did not seriously worsen their bilateral relationship nor did it stop Lebanon from moving forward with its own exploration round scheduled for 2017.

The proposed linkage of the Cyprus Question with the monetization of Cypriot Gas reserves boils down to the erroneous understanding that the potential revenues generated by the export of these gas reserves can *act as a "peace incentive" for Turkey and the Turkish Cypriots since* it would:

[1] 820 bcm were discovered between 2008-2012 in Israel, in Tamar (238 bcm), Leviathan (500), Dalit (21 bcm), Tanin & Karish (60 bcm). Around 100 bcm were discovered inside Cyprus' EEZ, the Aphrodite field, and 1,645 bcm in the Egyptian EEZ, 548 bcm between 2010-2014 in various fields in the offshore Nile Delta, 182 bcm in the Attol-1 field discovered by BP in North Damietta license area in March 2015 and 914 bcm in the Zhor field discovered by ENI in August 2015.

[2] For the highly optimistic 20-50 bcm/y estimate, see Seth Cropsey, *U.S. Policy and the Strategic Relationship of Greece, Cyprus and Israel,* The Hudson Institute, Washington: March 2015, p.16. Andreas Stergiou has characterized the discovery of gas in Israeli and Cyprus as a development of "supreme importance" for the EU's gas strategy, Andreas Stergiou, *Russian policy in the Eastern Mediterranean and the implications for EU external action*, EU Institute for Strategic Studies, www.iss.europa.eu/fr/publications/detail-page/article/russian-policy-in-the-eastern-mediterranean-and-the-implications-for-eu-external-action/#_ftn1 (accessed 20/05/2016).

[3] Matthew Bryza, "Eastern Mediterranean Natural Gas: Potential for historical breakthroughs among Israel, Turkey, Cyprus,", in David Koranyi & Sami Andoura (eds.), *Energy in the Eastern Mediterranean: Promise or Peril?*, Atlantic Council of the United States & Egmont Royal Institute for International Affairs, Academia Press: 2014, pp.39-46.

(a) limit Turkey's own dependence on Russian gas and further diversify EU gas imports from Moscow via Turkey, (b) give a positive incentive for Turkish-Cypriots to share the Republic of Cyprus' (RoC) prospective wealth after a solution is found and (c) provide a major means of financing the cost of re-unification thereby facilitating an overall settlement.

Let's Talk Turkey: Facts vs Perceptions

Unfortunately, all these perceptions are flawed if one considers that:

(I) The volume of potential gas exports Turkey could realistically import, not only from Cyprus, but from Cyprus and Israel as a whole, are too limited to generate a major shift in Turkey's policy of continued military occupation and colonization. If Cyprus were to sign a standard 15-year contract in order to sell 7.5 bcm/y this would amount to around 11% of Turkish demand, expected, according to the projection of the Turkish Energy Ministry, to reach around 65 bcm/y by 2023. It would also represent 100% of Cypriot exports tied to one market, exported via one route and linked to one price.

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Even if Turkish-Israeli relations returned to a level of mutual trust similar to before the Marmara incident of 2010, Israel cannot logically commit more than 50% of its entire export capacity estimated at 18-20 bcm/y over a 20-year period to only one market, linked to one price and transported via only one pipeline, such as the 600 km Leviathan-Ceyhan project. Given the technical characteristics of such a long and deep pipeline project, a minimum of 10 bcm/y have to be committed for this pipeline to make economic sense and become "bankable." These 10 bcm/y, however, represent 50% of the entire net export volume of the Israeli State, leaving it with only two additional market options, Jordan and one of the three LNG trains currently sitting idle in Egypt. At the same time, Turkey has long-standing strategic gas partnerships with five alternative suppliers (Russia, Iran, Azerbaijan, Algeria and Nigeria) and the international spot LNG-market, through which it can cope with any major disruption in supply. *If Israel loses or is cut off from the Turkish market how easily can it find alternative buyers?*

Even in cases when the bargaining power relationship is reversed, as is partly the case between Russia and Turkey, Ankara is highly unlikely to make key foreign policy concessions in order to get cheaper and/or more diversified gas imports. *If Turkey, which is dependent on Russia for almost 60% of its gas demand, would shoot down Russian military jets for allegedly violating its airspace for 17 seconds in December 2015; what kind of concessions could the Israelis and Greek Cypriots, for whom the situation would be even more precarious, expect to get before selling Ankara, respectively, 50% and 100% of their net export capacity?*

There are those who claim that Israeli/Cypriot gas would merely transit to Europe via Turkey, but Ankara is unable to play the role of a transit state for East Med gas to Europe, especially in ways that are inimical to Russian interests after the Russian-Turkish agreement in October 2016 for the construction of the Turkish Stream pipeline system. The proponents of Turkey as a transit state for Israeli gas fail to note that there is no free capacity in the existing Turkish Natural Gas System to transport the gas from the Ceyhan region to the Turkish-EU border, with the exception of 5 bcm/y in the Trans Anatolian Pipeline (TANAP).

More importantly, they also disregard the fact that there is no pipeline connection between Ceyhan and TANAP and that, since the Trans Adriatic Pipeline will be used to serve the current (10 bcm/y) and future (+10 bcm/y) export needs of Azeri producers, such as SOCAR and BP, there is no pipeline system available to carry the gas from Eastern Thrace to its Central European destination.

No Easy Wealth: Can Cypriot Gas Exports Pay for the Costs of Reunification?

(II) The policies of Mr. Akinci, the leader of the Turkish-Cypriot community, and those of his predecessors are identical to those of Turkey when it comes to the critical issues of who should control the licensing process for the issuing of exploration/exploitation permits, and what the optimal export option is. The Turkish Cypriots are more focused on securing equal rights with the RoC in granting the licenses to the International Oil Companies (IOC) and in sharing the gas profits – *even in the absence of a solution* – than constructively engaging the Greek Cypriots in issues of critical importance to Nicosia and Athens, such as Turkey's rights of military intervention and the presence of Turkish troops in Cyprus *even after a settlement* is reached. Turkish Cypriots would essentially prefer for Nicosia to stop all hydrocarbon-related activities, which they deem as illegal and unilateral, although such claims are not recognized by any other state in the world save, of course, Turkey.

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(III) The potential net profits generated by Aphrodite's monetization will be – although significant – too limited to allow the RoC to self-finance the majority of its reunification costs that could reach anywhere between €20-25 billion. The current basic scenario Cyprus is working on is based on a price of $6.5/MMbtu (million British thermal units) for gas sold to Egypt's idle LNG terminals that would create a gross revenue stream of $23-25 billion for all Block 12 partners (BG/Shell, Noble, Avner, Delek Drilling, CHC), of which $10 billion would need to be returned to the IOCs for expenses already incurred.

From the remaining $13-15 billion, anywhere between 40-50% will be given to the RoC, resulting in a net revenue of approximately $6.3 billion over a 15-year period equal to $420 million/year or an average of €370 million/year for the duration of the period, if the current euro-dollar exchange rate remains at a ratio of 1:1.13. These €370 million/year must be compared against a 2013 GDP of €18 billion for the RoC and will be far less in the early years of the export contract's execution, since most of the revenues will be given to the IOCs in order to recoup their investment costs. Even if the contract were signed today it would take until 2021 for the exports to start and until 2024-2025 for any serious revenue to begin flowing into Cyprus' coffers, whether reunited or not.

Turkey's attempts to stop the development of Cyprus' potential hydrocarbon wealth will only mean that the Turkish Cypriots will have nothing to gain from such a development if Ankara succeeds in its efforts to block further exploration and exploitation in the Cypriot EEZ

Aphrodite's gas sales would represent only 2% of the RoC's 2013 GDP at a time when the island's tourist industry is generating more than €2 billion, equal to 11.5% of GDP. This is hardly enough to cover a substantial cost of reunification expenses, *including compensation for refugees, which must be available during the first post-settlement years*, in order for any settlement plan to have a real chance of being accepted by the majority of Greek Cypriots in a referendum.

Turkey's attempts to stop the development of Cyprus' potential hydrocarbon wealth will only mean that the Turkish Cypriots will have nothing to gain from such a development if Ankara succeeds in its efforts to block further exploration and exploitation in the Cypriot EEZ. In April 2017, ExxonMobil, Total and ENI did not seem to be intimidated by Ankara's

reactions and threats, since they signed new exploration contracts with Nicosia granting exclusive rights over blocks 6, 8 and 10 of the Cyprus EEZ, while in July 2017 Total is expected to start drilling on Block 11 where many geologists believe the beginning of a Zhor-sized discovery may lie.

Cypriot and Israeli gas exports to or via the Egyptian LNG facilities are the *shortcut* for EU gas imports from the eastern Mediterranean and the beginning of an intra-regional pipeline network

If Turkey succeeds in bullying Cyprus into accepting a moratorium of its exploration strategy then there will also be no benefits for the EU; and these benefits are significant to EU energy security, although they do not come close to constituting a serious alternative to Russia.[4] If, by 2020-2021, Cypriot and Israeli gas is fed to Egypt's existing idle LNG facilities that are able to liquefy up to 15.86 bcm/y, then the EU will be importing East Med LNG in significant volumes for the first time since the beginning of the Arab Revolts in early 2011. For this to happen, Cyprus needs to sign a gas sales and purchasing contract in 2017. For every year the signing of such a contract is delayed there is a 4-5-year delay in its eventual execution.

Egypt's LNG facilities that were commissioned in 2005 reached their peak utilization rate in 2010 with a total liquefaction volume of 9.71 bcm. 48.6% of that LNG (4.72 bcm) was eventually consumed in the EU, primarily in Spain which at the time imported 2.62 bcm. Under such a scenario, the EU may import anywhere between 30-50% of the combined Damietta/Idku export capacity amounting to 5.23-7.93 bcm/y.

The East Med can make a contribution to the EU's energy security that is comparable to the 10 bcm/y of Azeri gas the EU expects to receive from TANAP/TAP by 2020. There is an important difference though. Aphrodite and Leviathan were discovered in 2011 and can reach Europe by 2021. Shah Deniz was discovered in 1999 and is expected to reach the EU by 2020. Cypriot and Israeli gas exports to or via the Egyptian LNG facilities are the *shortcut* for EU gas imports from the eastern Mediterranean and the beginning of an intra-regional pipeline network that will complement the structured cooperation between the region's *status quo* powers, Cyprus, Greece, Egypt and Israel. If more reserves are discovered in either Egypt or Cyprus' EEZ in the coming months and years, or if a discovery is made in the Lebanese EEZ, then both a regional LNG export terminal in Vassilikos and the East Med Gas pipeline project could easily become viable export options.

[4] To put it into perspective, according to the 2016 BP Statistical Review of World Energy, Russia exported more than 131 bcm to the EU in 2015 covering around 32% of its gas consumption. Around 70% of these exports are bound to long-term export contacts which are set to expire between 2025-2027 and cannot be unilaterally broken on the side of the importer due to the existence of "take or pay" clauses that oblige the importer to pay for up to 70-85% of the contracted gas volume regardless of whether or not this is consumed.