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PolicyWatch 2770

The Quiet Advance of Eastern Mediterranean Gas

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Mar 8, 2017
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Brief Analysis

News that Israel has begun exporting gas to Jordan indicates that commercial logic can prevail despite adverse political rhetoric.

In January, without fanfare, natural gas from Israel's offshore Tamar field began flowing across the border near the southern end of the Dead Sea, where it will provide power for a bromine plant and potash factory in Jordan. Although the quantities of gas involved are relatively small, the development was significant because it came at a time when King Abdullah was profoundly concerned that the new Trump administration intended to move the U.S. embassy in Israel from Tel Aviv to Jerusalem. The palace had ample reason to play down Jordan's ties with its western neighbor, but carrying out the gas deal was apparently deemed more important. And while the king's sensitivity probably explains why Amman has not publicly agreed to buy gas from Israel's much larger Leviathan field, the same under-the-table approach to hydrocarbon development seems to be playing out in that case as well.

MORE DEALS AFOOT?

The prospect of a major deal with Jordan's main electricity generator, the National Electric Power Company (NEPCO), is considered a key element in Leviathan's viability, and observers had expected the go-ahead for that project to be announced at the end of 2016. As the new year came and went, the absence of news seemed to augur badly for the deal, as did Jordan's tense domestic opposition to buying Israeli gas (though such sentiment should be tempered by the population's dependence on Israeli drinking water).

On February 23, however, Houston-based Noble Energy -- which leads the consortia for Tamar and Leviathan -- suddenly announced that it would move forward with developing the latter. The company made no direct reference to Jordanian involvement, instead obliquely mentioning that the project would provide "affordable energy resources to Israeli citizens and neighboring countries," and that the gas would reach "regional markets via onshore export pipelines." Yet the company's clear insinuation is that King Abdullah has privately agreed to buy Leviathan gas. In Noble's view, even an unannounced Jordanian commitment is apparently bankable, enabling it to secure financing for the project.

COMPLEX REGIONAL CONTEXT

Supplying Israeli gas to Jordan's Dead Sea factories also confronts a wider Middle Eastern taboo. While Amman and Egypt have peace treaties with Israel allowing for commercial trade, most other Arab countries have continued their perpetual boycott. Indeed, a Saudi bank divested from one of the factories -- the Arab Potash Company -- at the first sign that Israeli gas would be flowing there. Yet **according to APC's website (http://www.arabpotash.com/Pages/viewpage.aspx?pageID=20)**, the company's board of directors still appears to include representatives from its Emirati, Iraqi, Libyan, and Kuwaiti quasi-governmental shareholders. APC is also a partial owner of the other factory receiving Tamar gas, the Jordan Bromine Company.

Putting Israel's gas progress with Jordan in a broader commercial and regulatory context is instructive as well. Last month, apparently disappointed by the lack of interest from foreign companies, Energy Minister Yuval Steinitz announced a new timeframe for bids to explore in Israel's exclusive economic zone (EEZ). Bid submission will now start at the end of May and end on July 10, and financial guarantees must be valid until March 2018. This suggests that licenses may not actually be awarded until next year.

One factor in this decision was no doubt the continuing reluctance of international oil and gas companies to risk their commercial interests and future prospects with Arab countries and Iran by doing business with Israel. For instance, despite concerns about Tehran's troublemaking role in the region, the Islamic Republic is a particularly attractive prospect for energy companies because it has the largest proven gas reserves in the world, some 180 times the size of Israel's.

Moreover, Israel arguably shot itself in the foot by changing its taxation framework for gas production. Whatever the domestic rationale behind that move, such changes can have consequences when exploration companies are deciding whether to risk their own capital in a search for hydrocarbon reserves that lie far below the seabed, in challenging waters more than a mile deep.

THE NILE AND LEVANT BASINS

The quantities of hydrocarbons in the region known geologically as the Nile and Levant Basins represent but a fraction of those found in the Persian Gulf countries. Even so, the current and future prospects in the Eastern Mediterranean (mainly gas but also some oil) could substantially improve the economies of Egypt, Cyprus, and Lebanon along with Israel and Jordan. Recent developments in the area support such optimism.

First, Egypt is moving rapidly to bring its Zohr offshore gas field online. Cairo claims that the field is larger than Leviathan, though it suffers from high levels of hydrogen sulfide that needs to be removed at an onshore facility currently under construction. Britain's BP and Russia's Rosneft have bought into the field, and Italy's Eni will develop it. Yet while Egypt hopes to regain its status as a gas exporter, high domestic demand could make this an elusive dream. Currently, all domestic production is directed toward generating electricity, and extra liquefied natural gas must be shipped in weekly from Qatar for this purpose. Egypt's industrial plants are still suffering shortages, however, and its two LNG export terminals on the Nile Delta are almost idle. Against this backdrop, imports of Israeli gas would seem to be commercially attractive, at least in the interim.

Second, Cyprus -- whose own EEZ is tantalizingly close to the Zohr field -- is hoping for new discoveries by international companies previously disappointed by local prospects. Its only discovered field, Aphrodite, is yet to be exploited. Given the island's small population, most if not all of its eventual gas production would be for export, but this would only be achievable through cooperation with Israel and/or Egypt. Turkey's acquiescence may be required as well.

Third, after years of delay, Lebanon ratified decrees in January that divided its offshore EEZ into ten exploration blocs and established a commercial process for awarding licenses. Yet three of these blocs are located along Lebanon's self-declared southern maritime border, beyond which lie Israeli waters. Beirut still does not officially recognize Israel, and the Lebanese tender document did not incorporate any of the U.S.-brokered proposals for dividing the contentious maritime zone, so the licensing process could run into problems. According to industry experts, one of the three blocs in question is the most likely to contain gas in commercial quantities, but it is difficult to imagine any international exploration company wanting a license in an area that could be legally and even militarily contested. Other potential obstacles include deciding which areas of Lebanon would initially benefit from any new gas flows, and how any eventual export revenues would be divided between the country's various armed factions.

Fourth, the Hamas-controlled Gaza Strip has an unexploited offshore field known as Gaza Marine, which could be used to generate electricity both there and in the West Bank. Technically, however, the field is owned by the Ramallah-based Palestinian Authority, which is reluctant to invest in a project that could economically and politically bolster its Hamas rivals.

OTHER EXPORT OPTIONS

The Eastern Mediterranean's most tantalizing gas export option is a proposed undersea pipeline from Israel's Leviathan field to Turkey, either across Cyprus or skirting the island to the east. The former route could be problematic given the lack of a peace settlement in the divided country, where Turkish troops have occupied the north since a crisis with Greece in 1974. Israel's relations with Turkey have improved recently, but perhaps not enough to sign a twenty-year gas supply deal with associated heavy investment in an expensive pipeline.

A further possibility (though one that strains credulity) is an undersea pipeline that stretches from Aphrodite and/or Leviathan to Cyprus, the Greek island of Crete, and the Greek mainland. A variation of this would be installing an undersea cable known as a "connector" to link the Israeli, Cypriot, and Greek electric grids.

ECONOMIC VS. POLITICAL REALITIES

To be sure, all of these low-key advances are overshadowed somewhat by the region's latest troubles. Jordan is burdened by Syrian refugees, and Lebanon's future shape is probably linked to the incumbency of President Bashar al-Assad in Damascus. Meanwhile, Iran is affecting the Eastern Mediterranean situation from afar by supplying hostile actors with cruise missiles capable of hitting offshore drilling rigs and production platforms, among other destabilizing actions.

Yet the February go-ahead on Leviathan means that Israel can now bring gas ashore in the center of the country rather than at Ashkelon, where facilities are within rocket range of Gaza. Similarly, a steady supply of Israeli gas would reduce Jordan's near-total reliance on supplies arriving by sea at Aqaba, and perhaps end its schemes to import Iraqi gas overland or build Russian nuclear reactors.

Energy security is as much about having alternatives as it is about any notion of energy independence. U.S. diplomacy has played a low-key and not always effective role in encouraging the commercial exploitation of Eastern

Mediterranean natural gas. But it is a necessary role that needs to be continued, even if commercial interests remain the main driver of multilateral dealmaking.

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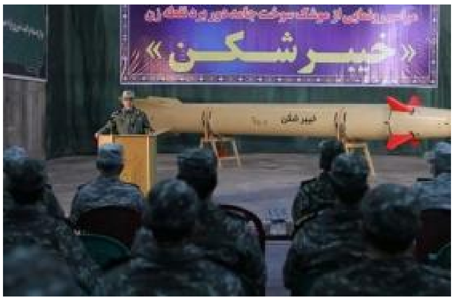

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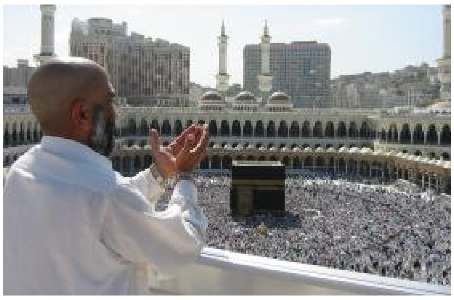

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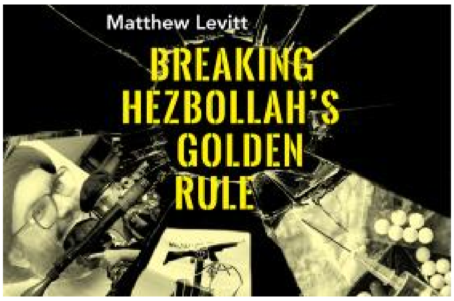

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