

# Russian Oil to Transit Israel: The Trans-Israel Pipeline is Reborn

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## Brief Analysis

Later this month, an oil tanker will leave the Israeli Red Sea port of Eilat after taking on a cargo of Russian crude oil pumped through the Trans-Israel Pipeline (Tipline). The pipeline runs between Eilat and Ashkelon, located south of Tel Aviv on Israel's Mediterranean Sea coast. The tanker will then set course southward, past Saudi Arabia, en route to customers in Asia. This event, a first, has the potential to greatly impact the international oil market. Russian oil exports are unconstrained by the quotas of the Organization of the Petroleum Exporting Countries (OPEC), and a steady stream of expanded Russian shipments via the Tipline could help lower oil prices worldwide.

Built in 1968 to transport oil shipments from the Shah's Iran to Israel and Europe, the Tipline has been largely moribund since the 1979 Islamic revolution (except for occasional transshipments of Egyptian oil arranged as part of the peace treaty with Israel). The pipeline's principal commercial advantage lies in the fact that its 158-mile route spares tankers the much longer and costlier voyage around Africa. (The Suez Canal will only accommodate tankers with a comparatively small and unprofitable capacity of 160,000 tons.)

Up until a few years ago, using the Tipline to move oil in the other direction, from the Mediterranean to the Red Sea, had not even been considered. But the recovery and expansion of Russian oil exports since the collapse of the Soviet Union has left newly privatized Russian oil companies hungry for new markets beyond over-supplied Europe (Russian export levels are currently around 5 million barrels per day [bpd] and growing at a rate of 10 percent annually). The Tipline may provide a more economical means of reaching such markets.

Currently, most Russian oil is pumped to Black Sea terminals for shipment. Yet, these terminals cannot be used by the largest and most cost-effective tankers because of Turkish restrictions on the narrow Bosphorus strait. The Tipline provides a solution to this problem. Smaller tankers carrying Russian oil from Black Sea ports can off-load at Ashkelon. Once the oil is pumped to Eilat, larger tankers can then transport it to Asia, considered a growing and lucrative market. (The first markets for Russian oil transported in this manner are reportedly India and Taiwan.) Toward this end, work was completed earlier this year enabling the Tipline to reverse its originally designed flow. Given previous expansion of tank storage farms at both ends of the pipeline, the route is now capable of moving 1.2 million bpd, roughly equivalent to Iraq's current exports. (Presently, world oil consumption is approximately 78

million bpd.)

### Impact on the International Oil Market

For Israel, the direct economic benefits of the Tipline's revitalization will be comparatively small. Transit fees, which may be as little as 10 cents per barrel, will presumably be used to pay for the improvements in the pipeline. On a global scale, however, the extra oil on the market should ease upward pressures on prices. The OPEC cartel, which cut production in September 2003 because Iraqi oil returning to the market was depressing prices, has made several efforts to persuade Russia to restrain its exports. Indeed, the issue was reportedly on the agenda when Crown Prince Abdullah of Saudi Arabia visited Moscow in September -- a visit that apparently resulted in little agreement regarding oil. On November 3, Russian energy minister Igor Yusufov told OPEC that "an urgent production boost [was] needed to bring prices down." He also declared that Russia would pursue a seemingly contradictory policy of "continu[ing] to develop its hydrocarbon sector" while "respecting OPEC's market share." Evidently, President Vladimir Putin's stance is to allow revenue-hungry Russian oil companies to do what exactly what they want -- seize market share by selling more oil.

Russian oil transported through the Tipline could also put pressure on the so-called "Asian premium," the extra dollar or so per barrel that Middle Eastern exporters charge Asian customers simply because they can. Not surprisingly, this extra charge is a matter of considerable resentment in Asia and has played a part in restricting economic growth there.

### Improved Russian-Israeli Relations

The refurbished Tipline is another sign of improving relations between Israel and Russia. Traditionally, Israel's oil needs (estimated at 240,000 bpd) had been met by imports from Egypt, West Africa, Mexico, and the North Sea. In recent years, however, Israel has increased its oil imports from Russia and other parts of the former Soviet Union; reportedly, the majority of its needs are now met from these sources.

Last week, Israeli prime minister Ariel Sharon visited Moscow for talks with President Putin. It was Sharon's third trip to Moscow since becoming prime minister in 2001. During his visit, he called Putin a "true friend of Israel."

Some tensions persist in the Russian-Israeli relationship, however, particularly with regard to Moscow's stance on the "Roadmap" to Israeli-Palestinian peace and Russia's supply of nuclear technology to Iran. Another potential difficulty may emerge in the wake of Moscow's actions against powerful oil barons, some of whom Putin reportedly sees as political rivals. Soon after Mikhail Khodorkovsky, president of the giant Yukos oil company, was arrested recently on fraud charges, a close associate and Yukos shareholder was reportedly granted Israeli citizenship only a week after applying, a process that usually takes months.

### Effect on OPEC

On December 4, OPEC ministers will meet to review production volumes and prices. They will probably deem it premature to assess the consequences of the new trans-Israel route. Even if the route were used to its full potential, Russian oil transported to Eilat would only be enough to fill one Asia-bound oil tanker every two to three days. The OPEC production ceiling, reduced to 24.5 million bpd on November 1, is currently equivalent to just over 30 percent of world demand; the ceiling's disproportionately heavy influence on world prices is due to OPEC's dominance over internationally traded oil. Apparently, the prevailing view in the cartel is that the current price, although high in absolute terms, is historically and unreasonably low. According to this logic, if OPEC can retain price discipline for the next five years, there will be a pot of gold at the end of the rainbow. That is, OPEC reserves (which constitute nearly 70 percent of the world total) will eventually be needed to meet growing demand, thereby guaranteeing an even larger market share for OPEC -- and much higher prices.

The contrary logic is that current OPEC prices are high enough to make new investment in non-OPEC oil concessions commercially viable. Non-OPEC production will also increase because many consumers are worried about Islamic extremism and have decided to lessen their dependence on Persian Gulf oil. For example, Japan, which is wholly reliant on imported oil, currently obtains 85 percent of its supply from Gulf nations. Tokyo reportedly wants to reduce this proportion to 65 percent. Whether increased world production will reduce OPEC's market share -- and break the cartel -- remains to be seen. In any case, the refurbishing and reopening of the Tipline could make an important contribution.

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