THE CO-CHAIRS' CONCLUSIONS

by Mehmet Öğütçü and Harry Tzimitras[1]

HOW TO OVERCOME THE IMPASSE IN THE EASTERN MEDITERRANEAN ENERGY LANDSCAPE

London, 23 January 2020

The London Energy Club

OVERVIEW

This summary of the discussions and recommendations has been issued under the Co-Chairs' responsibility in order to generate **further momentum** for positive and inclusive actions among the Eastern Mediterranean countries.

The Eastern Mediterranean is not a global game-changer in its own right. This new natural gas province should be seen in the broader context of **global gas dynamics** and the supply–demand outlook of the EU and Asia, which seem to be the largest potential markets.

Geopolitical disputes, particularly around the Exclusive Economic Zones (EEZs) and proposed pipelines, pitting Turkey against the other littoral states of Egypt, Greece, Israel and Cyprus, constitute only one of the **hurdles** confronting the development of energy riches in the region.

Commercial realities, geological difficulties, technical challenges and regulatory barriers, as well as gas-to-gas competition make life difficult for investors, developers, shippers, traders and diplomats.

The prospect of energy development serving as an **instrument of peace and prosperity** appears to be a distant one given the unresolved Cyprus problem, sharp positions on the disputed EEZs, Turkey's assertions and the existence of too many players on the crowded geopolitical and commercial chessboard.

We are grateful to Alastair Watson, Zafer Ates, John Roberts, and Charles Ellinas for their valuable inputs into this summary. Mehmet Öğütçü and Harry Tzimitras

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Yet, it is important to maintain a positive attitude and to develop **constructive, co-operative messages** for all sides to provide them with an incentive to engage in dialogue and partnership. This is easier said than done.

However, discreet and neutral platforms like the **London Energy Club** could well serve this purpose as a form of **Track-II** energy, investment and political diplomacy.

At the end of the deliberations among diplomats, energy group executives, bankers, and think-tank representatives, there was a **convergence of opinion** to continue this dialogue in partnership with PRIO and other relevant and interested organisations.

HIGHLIGHTS FROM THE DISCUSSIONS

1 Eastern Mediterranean gas resources should be neither overestimated nor underestimated. So far, about **4000 bcm of gas** has been discovered in the region. This corresponds to 2% of the world's proven gas reserves. Overall, with new exploration results, there may be double this amount — though this would still be a relatively small one.

2 Because the Eastern Mediterranean gas reserves lie at 3 km depth, the cost of extracting the gas will be high, at $3–4/MMBtu; and then there is the additional cost of de-sulphuring, transporting and marketing. Furthermore, the **proposed Eastern Mediterranean pipeline** designed to connect the producing fields to Italy via Greece will likely add another $4–4.5/MMBtu.

3 So, expect a price of about $7.5 to $8/BTU at a time when the market prices is $4–5. Russian can sell at $4 and still make profit. The European Union natural gas import price in January 2020 was **just $3.63/MMBtu**, not least because of a glut in global LNG supplies.

4 Europe is well supplied and new demand for gas is not so high, despite the declining production in the Netherlands and North Sea. Additionally, Russian gas is expected to flow without much problem in the decades to come thanks to **Nordstream 1 & 2 and TurkStream 1 & 2**, as well as the new 5-year Ukrainian transit arrangement, with flexible contracts and pricing.

5 The IEA's projections for **European gas demand** are as follows:

Stated Policies Scenario (bcm)			Sustainable Development Scenario (bcm)		
2018	2030	2040	2018	2030	2040
617	**593**	**537**	**617**	**519**	**380**

Therefore, demand is expected to fall steadily over the next 20 years.

6 Egypt will focus on the twin goals of supplying its own domestic market and selling LNG to high value markets via Idku and Damietta. While it may well seek to import gas from other Eastern Mediterranean producers to attain these goals, the **dominance of Egypt's own production** and reserves means that it will be a buyers' market for the foreseeable future, offering limited returns for non-Egyptian producers and accompanied by considerable risk regarding the durability of contracts.

7 At first sight, Turkey seems a **poor option** since gas consumption is currently falling and there are expectations that the next few years will see little more than a stabilisation of demand at around 48-50 bcm/y.

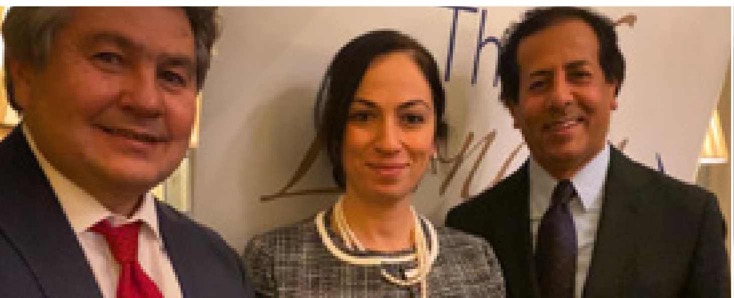
8 However, there is a real **'window of opportunity' with Turkey**, not withstanding both demand issues and the political troubles that stir tension in the region. A number of gas contracts are due for renewal in the period 2021 to 2027, and 65% of gas imports to Turkey will be up for renewal.

9 This could open the doors for East Med gas if there is a realistic, competitive gas pricing arrangement in place for Turkey better than other options Ankara has. The political impasse also has to be overcome via **creative win—win solutions**.

10 The **EU's Green Deal** anticipates that by 2050 there will be net-zero greenhouse gas emissions in the EU, with a 55% reduction planned by 2030. While coal will be the first target, with companies facing bankruptcy, gas will be the second. As part of the Green Deal, gas demand will be reduced by 20-30% until 2030; and by 75% by 2050.

11 The EU is aiming not only for a carbon neutral EU but for a carbon neutral Continent. A carbon border tax is apparently also under consideration and this would force the EU's neighbours to reduce their own carbon footprints. Gas providers will suffer, so will gas consumers such as Turkey. **Prospects for gasification** in the West Balkans may also be affected.

12 What appetite is there for large scale gas projects? Not much because the **European Investment Bank (EIB) and European Bank for Reconstruction and Development (EBRD)** have already said they will not help finance fossil fuel projects including gas. Commercial banks will likely follow suit. This is a challenge for everyone, including any output from the Eastern Mediterranean.



13 Renewables pose a **real challenge to gas**. India, for example, is moving to implement cheap renewable power on a large scale. The target is to install 450GW of renewable power by 2030; 120% of current capacity. At the same time, coal consumption is to double by 2040. Gas is planned to be only 8% of energy mix by 2040.

14 It should also be born in mind that Turkey has already developed 6 GW of solar at a very low price. Furthermore, Turkey (unlike Germany) did not go into solar early, so has no heavy initial costs. Turkey is also developing geothermal. More is following. Turkey is reckoned to have the **highest potential for wind power** in Europe after Scotland.

15 The increase in global gas demand is slowing down. So the challenge for the Eastern Mediterranean gas producers is to manage to sell the commodity to pretty much anyone at present. There is a **real risk** that it may never be sold.

16 What will happen to the surplus in case of global demand diminishing (in part as a result of the Green Initiative)? The US can provide 100 mt (which at **$7–7.5/MMBtu** delivered at present is not competitive) and Qatar 70 mt to the market. Nigeria and Mozambique will bring an additional 35mt. Qatar gas production is 40 to 50 USD cents per MMBtu. By comparison, the Eastern Mediterranean gas production costs are at $3.5–4. Evidently, the competition is very high, and Egypt is finding it difficult selling its LNG.

17 There is a strategic case to increase indigenous energy production in Asia, to reduce the importance of gas purchased from politically risky sources. There should be further diversification of resources.

18 All gas trading in Europe is by private companies, not governments. So, would governments play a greater role in determining the sourcing of gas imports? This is not likely. Note that one major government, Germany, want to continue and indeed expand gas trading with Russia, despite concerns about excessive dependence.

19 Nor is Russia likely to do anything drastic. Russia does not possess a monopoly in mainstream **European markets** and its prices are competitive.

20 With global markets being difficult, the remaining option for the Eastern Mediterranean is to sell its gas to regional markets. This is because the extraction and delivery of Eastern Mediterranean gas will be expensive and Eastern Mediterranean prices are unlikely to be competitive in a wider, global market. Eastern Mediterranean gas will find it difficult to compete in Europe, since the EU's Green Deal means that consumption of gas in Europe will fall considerably over the next 20 years. Moreover, there will be an abundance of cheap supply. But the intra-regional gas trading requires **solution of regional problems**.

21 The time has come for new, inclusive initiatives to facilitate gas development in the Eastern Mediterranean. Any effort that would be designed or intended to **exclude Turkey** would unlikely succeed fully, as Turkey has the longest coast in Eastern Mediterranean, the biggest economy and — despite current stagnation — the most attractive gas market. Turkey also has the potential to affect the region through unilateral actions. Hence, engaging Turkey through diplomacy and dialogue carries **considerable benefits** for all parties.

22 **Positive actions**, which may help to ease the impasse in the Eastern Mediterranean and to inspire new steps forward, could include the following:

- Eastern Mediterranean countries should resolve their disputes on core issues concerning **maritime jurisdiction through diplomacy, failing that, should refer them to international courts** and refrain from unnecessary or inflammatory actions before legal issues are resolved.
- Notwithstanding the important efforts of the United Nations to solve certain conflicts, like the Cyprus issue, which should be supported and facilitated wherever possible, such disputes should be set aside in order to allow **commercial realities** to take precedence between private sector players.
- Addressing, as a matter or urgency, the potential for **increased gasification** within the region and for generating added value from gas.
- Initiating a **track-II diplomacy channel**, involving key stakeholders, as there appears to be little prospect that conventional diplomatic and political engagement will resolve the various impasses in the near future.
- Making the most of the efforts and initiatives by expert neutral organisations, like the **London Energy Club** and the role they could play, however modest. There was a strong support at the end of the meeting for such continued efforts.
- There will be **further consultations** on how to move this process forward.

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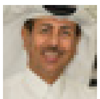
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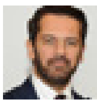
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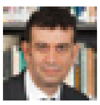
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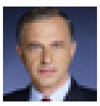
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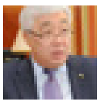
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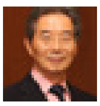
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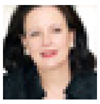
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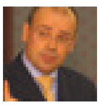
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