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Israel’s Energy Sector Between Peace and Plague

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A number of global and regional events in the past year directly affected Israel’s energy sector, both strengthening its energy supply security while weakening its export potential. On the one hand, COVID-19 has caused a global slump in energy prices and investment, further distancing Israel’s hopes of exporting gas to Europe via pipeline. On the other hand, recent normalization agreements between Israel and its regional neighbors have opened new trade routes for oil and made Israel a more attractive destination for international energy companies, albeit with some new environmental risks included. Finally, the entrance of Chevron into Israel's energy sector will bring with it economic opportunities, but also legal challenges.

The impact of COVID-19 on energy production and export in the East Mediterranean

Even before the COVID-19 pandemic first emerged in early 2020, Israel had a very challenging task of finding foreign markets for its gas. While both Jordan and Egypt signed long-term supply deals with Israel’s Tamar and Leviathan fields, this only accounts for 30% of the gas that Israel has earmarked for exports. Without additional markets, Israel will struggle to attract new companies to explore for gas without a clear buyer on the horizon.

The COVID-19 epidemic made the prospects of the East-Med Pipeline even more dubious, as energy demand in Europe declined and led to gas prices going to an all-time low of under $2 per BTU. The economic slowdown also led to an unprecedented slump in global energy investments across the board – from fossil fuels to renewables and new electricity grid developments. The hardest hit sector is the oil and gas upstream (exploration and production of new fields) which declined by 35%, from $483b in 2019 to an estimated $313b in 2020.[1] Even before the COVID-19 pandemic, European gas prices have been steadily falling due to increased competition brought on by a flood of new liquified natural gas (LNG) suppliers, mainly from the USA, Australia and Russia. From $6 per BTU on the European spot-market in 2018, they went down to $4 in 2019.[2] European gas prices are expected to remain low until the middle of the decade even when COVID-19 subsides.

1 Investment estimates for 2020 continue to point to a record slump in spending (23 October 2020), IEA. https://bit.ly/3mVzzuh

2 Mike Fulwood and Jack Sharples, "$2 Gas in Europe: Down, Down, Deeper and Down". Oxford Institute for Energy Studies. https://www.oxfordenergy.org/publications/2-gas-in-europe-part-iii-down-down-deeper-and-down

Under these conditions, the prospect of new pipelines and new production projects in the East Mediterranean by private energy companies seems much less likely in the upcoming years. While tensions over gas finds and maritime borders between Turkey and Greece escalate, the economic sense in producing these fields diminishes since any gas exported from the region to Europe can't compete with current prices. Although it is tempting to view deep-sea energy discoveries as the main reason for these recent clashes between Turkey and its neighbors, this conclusion seems to be less convincing given the current state of the global oil and gas markets. As the economic viability of deep-sea gas production in the East Mediterranean Sea is steadily decreasing, maritime clashes between Turkey and Greece have only intensified. This indicates that while energy may have motivated Turkey's initial expansion into the sea, it is now being used mainly as an excuse to pursue much broader geopolitical goals.

Both Turkey and Greece/Cyprus are aware that any new gas discoveries will likely stay in the ground for the time being, but both sides are using these fields to strengthen alliances in the region. For Turkey, the desire to strengthen ties with Libya's Government of National Accord (GNA) is masked by its actions to block the East-Med gas pipeline by expanding its EEZ to Libya's maritime border. For Greece, Cyprus and Israel, it is an opportunity to strengthen security and strategic ties over the construction of a pipeline that is economically unviable. For both sides there's an interest to continue the rhetoric over the East-Med Pipeline, even if it never materializes.

Chevron Buys Noble

The global slump in oil prices did bring with it an unexpected development for Israel. On July 2020 one of the biggest U.S. oil companies in the world – Chevron – announced that it intends to take over Noble Energy, which operates the Tamar and Leviathan gas fields in Israel. The deal, which is estimated at about five billion dollars, was made possible by the COVID-19-induced crash in oil prices which severely damaged Noble Energy's investments in the US oil shale industry and forced it to sell its assets at relatively low prices.

Chevron's entry as a partner in the gas fields in Israel entails many economic and political opportunities. It is one of the largest and most stable private energy companies in the world and is very active in the USA, Australia, Nigeria, Angola and Kazakhstan. Its entry into the Israeli energy sector could send an encouraging message to other companies that have so far feared investing in Israel due to political reasons. Chevron's presence in the eastern Mediterranean can also help promote regional cooperation between Israel and its neighbors, which are necessary for the export of Israeli gas to Europe. Together with the Tamar and Leviathan fields, Chevron will also gain control of the Aphrodite field, which is currently shared jointly by Cyprus and Israel, in addition to the search concessions it recently acquired from Egypt in the Red Sea.

The combination of interests between Israel, Cyprus, Greece and Egypt for joint export has existed for many years, but under the leadership of a major international oil company in the form of Chevron, there is now more chance of finding funding for ambitious production and export projects. Israel’s maritime border negotiations with Lebanon can also move forward with some pressure from Chevron, if it indeed chooses to place its weight on the issue.

At the same time, it is still too early to assume that the Chevron-Noble deal will improve Israel’s economic and energy prospects. Unlike Noble Energy, the fact that Chevron is a huge company with large currency reserves and many global projects also allows it to delay the development of its oil and gas fields and wait until global prices recover. This is inconsistent with Israel's ambitions to explore for more oil and gas fields and expedite the development of Phase II of Leviathan.

In addition, Chevron may turn out to be a tougher partner than Noble Energy when it comes to negotiating gas prices for the domestic Israeli market, especially during the expected negotiations with the Israeli Electricity Company (IEC) after its contract with the Tamar field ends in 2021. While the Israeli government struggled to withstand the various political pressures exerted by Noble Energy when signing the original contract with the IEC in 2012 and approving the much-contested "gas framework" in 2016, it will find it even more difficult to do so in the face of one of the largest and most powerful companies in the world. This might also prove a bigger challenge for the various environmental groups that protested offshore and onshore gas infrastructure in Israel while they were still under the management of Noble Energy. Like many other major oil companies in its caliber, Chevron has a reputation for litigating against environmental NGOs and even individual activists that disrupt its activities.

Another possible scenario that Israel should prepare for is that Chevron may in one point in the future, prefer to sell its share of the gas fields in Israel and altogether remove itself for Israel’s energy sector. Politically, Chevron's involvement in Israel may block it from operating in other countries, although today this barrier is not as strong as it used to be, following the thawing of relations between Israel and the Arab Gulf states ("Abraham Accord" 2020). Another reason for leaving may be

Israel's notoriously unstable and politicized regulatory system, which was exposed at its peak during the public debates over the gas framework. Chevron may not be interested in inheriting the negative image left behind by Noble Energy among large sections of the public, and may prefer to bring in another entity that will buy its assets in Israel.

Any future move to leave Israel is expected to delay the exploration and development efforts of additional fields or the ability to sign new export deals, and might create concern among Israeli decision-makers who are now looking towards Israel's newly-created "sovereign wealth fund" (which absorbs gas revenue to prevent the "Dutch Disease") as a solution to recover Israel's economy in the post-COVID-19 world. Israel must now monitor Chevron's moves after completing control of Noble Energy's assets and ensure that existing plans to develop gas fields in Israeli waters are not harmed as a result of the takeover process. If Chevron chooses to sell its stake in the Israeli reserves, Israel must ensure that the new investor is in line with Israel's national interests and its relations with the United States, especially in a scenario where the buyer is a Russian or Chinese company.

Regional peace deals and Israel's Energy Sector

The second half of 2020 also brought with it a series of historic normalization agreements between Israel and its regional neighbors – the UAE, Bahrain and Sudan – with additional countries in the Gulf rumored to sign similar agreements soon. While these agreements are not expected to drastically alter Israel's energy sector or relieve its various export constraints, they will open up an important maritime route for Israel's oil imports during emergencies, encourage regional cooperation and make it easier for international energy companies to operate in Israel's waters.

In the upcoming years Israel might begin to receive some oil from the UAE, both in the form of direct imports and by serving as a transit state for Emirati oil travelling between the Red Sea and the Mediterranean Sea through the Eilat Ashkelon Pipeline (EAPC).[3] In October 2020 a memorandum of understanding (MOU) was reportedly signed between EAPC and a consortium of UAE and Israeli semi-private holding companies (MRLB, Lubber Line Capital, and AF Entrepreneurship) to provide oil from the UAE through Israel.[4] While this deal won't lower fuel prices for consumers in

3 Israel has already been receiving oil from South Sudan (through Sudan) since at least 2013, but the recent agreement may increase these volumes as well.

4 Amiram Barkat. "Agreement signed to operate Israel pipeline for UAE oil", *Globes* (October 20, 2020). https://en.globes.co.il/en/article-agreement-signed-to-operate-israel-uae-oil-pipeline-1001346340

Israel’s domestic market (which are mostly determined by taxes, VAT and marketing fees, not by the actual cost of oil), it can increase transit revenues for the Israeli government (reportedly, up to $700m every year) and will help strengthen the diplomatic ties between Israel and these countries. This does, however, come with a potential environmental cost in the shape of markedly increased tanker volume in the gulf of Eilat (Aqaba), substantially increasing the possibility of an oil spill that will cause damage to marine life and to the beaches in Eilat.

In addition to environmental risks, there may be indirect political implications for Israel if the new oil transit deal with the UAE comes at the expense of the routes offered by Egypt. Currently, Emirati oil seeking the shortest route to the Mediterranean Sea can go through Egypt’s Suez Canal or the Suez-Mediterranean Pipeline (SuMed) which is partly owned by Egypt, Saudi Arabia and the UAE. If the new deal between Israel and the UAE takes away traffic from Egypt, this will result in a loss of valuable transit revenue for Egypt which may create political tensions with Israel, even if the loss is not significant.

In terms of security of supply, the agreement with the UAE and Sudan opens the possibility of importing oil from another maritime route during an emergency, and this has important security implications. Today, most of Israel's oil passes through Turkey, either through the Baku-Tbilisi-Ceyhan pipeline (BTC) that transfers oil from Azerbaijan through Georgia and into Turkey, or through oil tankers from Russia in the Black Sea that pass through the Bosporus Straits on their way to Israel. If the Turkish maritime route is interrupted for political or technical reasons, or if the BTC pipeline is sabotaged as part of the ongoing conflict between Azerbaijan and Armenia over Nagorno-Karabakh, temporary imports of oil from the UAE or Sudan via the Red Sea could prove to be critical until the disruption is resolved.

Beyond purchasing oil, Israel can benefit from exporting cleantech products and renewable energy technology to Sudan and the Arab Gulf states – diversifying away from just weapons and surveillance systems which Israel often uses as a crutch when building foreign trade relations. About 13% of the oil that the UAE produces is marketed to the local population, which enjoys subsidized electricity, fuel and water, and is thus more wasteful in how it consumes it. Israeli technologies that help streamline energy and water use, lower costs for desalinated seawater, and increase the efficiency of renewable energy, will help the UEA "release" some of its oil and gas for export, thus strengthen its economy. This goal also aligns with the targets set forth by several Arab Gulf States to diversify their economy beyond energy products, as a way to reduce their vulnerability and exposure to the volatile global oil market.

Lastly, the agreement with the UAE removes a geopolitical barrier that for decades had impeded on Israel's ability to attract major international energy companies to invest in it. Companies such as Exxon, Chevron, Total and BP have traditionally refrained from exploring Israel's land and economic waters for fear of an Arab boycott. Instead, they turned to mostly barren searches in Lebanon and Syria's waters. The Israel-UAE agreement gives companies confidence in entering the Israeli market, and this may also have a bearing on Chevron's decision whether to sell the Israeli gas reserves that came under its control after taking over Noble Energy.

Conclusions

The three major events of the past year that have affected Israel's energy sector (the slump in global energy prices, Chevron's takeover of Noble Energy, and the normalization agreements with UAE/Bahrain/Sudan), did not drastically alter Israel's energy projections and constraints, but rather accelerated ongoing trends. As such, a number of recommendations are in place:

1. As global and European energy prices continue to fall, Israel's target of exporting its gas to distant regions will be put on hold. It is becoming increasingly apparent that the gas finds will mainly remain a regional source for energy. As such, Israel should focus on utilizing gas for domestic consumption in sectors other than electricity (petrochemicals, heating, transportation) and encourage its neighbors to do the same.
2. While Chevron's entry into the Israeli market brings with it many economic opportunities, Israel should keep a close eye on Chevron's plans regarding the future development and ownership of the gas fields. In the event that Chevron wishes to delay further development of Leviathan, or prefers to sell its Israeli assets altogether, Israel must ensure that the new investors are in line with Israel's national interests and development goals.
3. Israel's deal to transit UAE oil through its pipeline holds political and economic benefits for both sides. The Israeli government must conduct a comprehensive strategic assessment before finalizing the oil transit deal with the UAE, considering both risks and opportunities. Notwithstanding, Israel should be aware of the environmental risks included in the deal. The substantial increase of tanker movement that this deal entails in the small bay of Eilat can turn even a small oil spill into a potential environmental disaster. Israel should enforce strict protocols and monitor this activity. In addition, the Israeli government should consider the potential competition it is creating for Egypt which could lead to a decline in transit revenue to its neighbor and may be a source of political tensions.