

Energy International Risk Assessment

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CONTENTS

I

CRISIS IN IRAQ

I) SECTARIAN FIGHTING PUTS ENERGY SECURITY AT RISK 2-4

II) SADDAM HUSSEIN STRIKES BACK FROM THE GRAVE 4-6

III) KURDS GET PRETEXT FOR FURTHER DISTANCING FROM BAGHDAD 6-7

II

THE BLESSING AND SCOURGE OF OIL PRICE VOLATILITY 8-9

III

THE LOGIC AND REPERCUSSIONS OF 'REGIME CHANGE STRATEGY' 9-11

IV

PRODUCTION COSTS SQUEEZE NEW GAS PROJECTS 11-12

OPEN FORUM

I

ENERGY DEPENDENCE? LET'S GET THE FACTS AND FIGURES RIGHT 12-13

Letter From The Editor

The dramatic developments in Iraq take the forefront in this month's EIRA issue. While western oil companies seem to be content with the situation in oil-rich Kurdistan, it is the hydrocarbon deposits in the southern part of the country which are still at stake.

The second part of our analyses deals with the aftermath of the wave of regime changes, or the threat of change, all over the Eastern Mediterranean, the Middle East and further north, up until Ukraine.

To complete the picture, in the third part of the issue we analyse the prevalence of economics over politics in decision-making in the world of energy. Our analyses predict serious problems in the Southern European Energy Corridor and obstacles facing East Mediterranean energy prospects.

We welcome your comments and contributions. With our next issue due in September, we wish our contributors and readers a happy summer.

Yours Sincerely,

George Hatzioannou
Editor

Crisis In Iraq

Sectarian Fighting Puts Energy Security At Risk

The worryingly successful attack by Islamists in Iraq against governmental armed forces and local administrations in several crucial areas is a timely reminder that the post-Saddam country remains a rather unstable hydrocarbon provider for the global market for already more than 10 years marked by the US invasion and occupation. On 10 June, the Islamists took control of the second largest city, Mosul, and later launched an impressive military offensive.

The recent developments have their roots in deep religious antagonism between the Sunnis and the Shiites, in the enmity between Arab and non-Arab segments of society, which provoked social unrest exacerbated by foreign interventions and outside pressure. The first tragic occurrence was the American-led war against Saddam Hussein's regime. The toppling of the undeniably repressive regime ruptured the well-oiled (with petrodollars as the main lubrication) and relatively effective mechanism of governance which, far from being perfect, has evolved through centuries with the Sunni minority enjoying supreme authority on these patched lands.

The second tragic event was the civil war in Syria where the situation was just the opposite: the Sunnis had the numbers on their side but lacked access to power. The actors outside the country, the Gulf monarchies and Western powers, used their proxy warriors to start a war against Bashar Assad's regime which sought allies in Tehran, Baghdad, as well as in Moscow and Beijing. The Sunni guerilla warfare in Syria enhanced the fragility of the internal political balance in Lebanon. If taken against the background of troubling consequences of the Arab Spring initiated in 2011, the overall MENA panorama is covered with thick gun smoke.

The protagonist of the latest developments in Iraq is the Sunni extremist formation known as ISIS (Islamic State of Iraq and Syria or Islamic State of Iraq and the Levant). Arabs are calling it

Da'ish (Dawla islamiyya fi Iraq wa Shaam). In the region, Isis is considered to be the most violent and fundamentalist movement within the jihadist conglomerate.

Its genesis is linked to the arrival in Iraq of a Jordanian, Abu Musab al-Zarqawi, the one who founded the Al-Qaeda in 2004 in Mesopotamia. Fighters from Saudi Arabia, Yemen, Libya, Egypt and other Arab countries enthusiastically rushed to Iraq. Al-Zarqawi's formidable idea was to create chaos in the country. He succeeded but his anti-Shiite violent acts generated growing antagonism among the Muslims. Al-Zarqawi was killed in the US Air Force bomber's raid in 2006.

The new warlord to head the local Al-Qaeda was Emir Abu Omar al-Baghdadi. One year later the organization assumed the name of Islamic State of Iraq. In the years 2008-2009, this formation was steadily in the limelight. Only more advanced American tactics combining air strikes with ground operations by Sunni anti-jihadists, *sahwas*, represented by local tribes' fighters, squeezed al-Baghdadi's militia out of the core territory, the desert part of the Sunni provinces Anbar and Nineveh. The emir was killed in 2010 in the course of an American bombardment. The weakened group was left with its current warlord, Abu Bakr al-Baghdadi, also known as Abu Dua.

The start of internal conflict in Syria gave a new chance to the organization, renamed Isis to link Syria to Iraq. Money, armaments, Islamist fighters flocking to Iraq from dozens of countries, all created a constellation of new militias with their own chiefs, sponsors, and goals. Al-Baghdadi used the momentum and started a full fledge operation in Syria. His trained fanatics were truly efficient. However, a year ago dispute with the other most robust Islamist organization, Jabhat al-Nusra, turned into an open confrontation. Isis wanted to go further in its 'divine mission' and recreate the Caliphate under Sharia rule, while al-Nusra, formed by former Syrian prisoners freed by the regime at the beginning of the confrontation, preferred to limit its ambitions to the national agenda. It was finally blessed as the Syrian branch of Al-Qaeda

by its parent organization, which is masterly hiding somewhere in Pakistan.

Isis has gained a lot of ground in Eastern and Northern Syria and, importantly, established command over the border with Turkey, which is vital to hydrocarbon logistics. Al-Baghdadi also placed under control some oil production facilities which provides him with additional room for maneuver and lessens dependence on foreign financial sponsors. Isis has started to distribute food to locals building up its positive image, established connections with some tribes in the Syrian East, in particular in the Raqqa region.

At the same time, executions of governmental soldiers and rebels from other Islamist groups, Christians, prisoners, as well as looting, enforcement of tough Sharia rules etc. alienate the population. Other anti-regime militias started coordinated actions against Isis, particularly in the zone of Idlib, Hama and Raqqa cities and scored some success. This internal conflict flared up at the beginning of 2014, with the Salafist brigades from the Islamic Front as the main striking force against Isis. As a result, the Sunni jihadists found themselves killing each other, exterminating comrades-in-ideology. This confrontation was of great help to the Syrian regime but Isis has lost the indisputable leading position among the opposition.

Simultaneously, in Iraq the Sunni minority was more and more frustrated being sidelined by the Shiite Government unable to establish a genuine internal dialogue. The Sunnis seemed to have plotted a Sunni comeback to power for some time. Peaceful protests at the end of 2012 did not bear fruit. Isis rallied support from some of the tribes and in January 2014 launched its first attack targeting their former strongholds in Anbar province, Fallujah and Ramadi, and launching a bombing campaign in Baghdad. Since then the military activity spread geographically, attacking not only targets in the Sunni regions but also in the Shiite and even Kurdish zones, focusing on oil producing facilities.

The June offensive and military gains do not seem to be the culmination but simply a new phase of hostilities. Now Isis controls large parts of the territory in both Syria and Iraq; basically, the border between the two countries has disappeared, setting the stage for a sort of a proto-Caliphate. Isis is in possession of considerable military and financial resources, including large quantities of American made armaments and ammunition abandoned by Iraqi soldiers who fled from Mosul and elsewhere, as well as money they got plundering banks and 'taxing' local businesses.

The Government in Baghdad finds itself in a delicate situation, to put it mildly. The Prime Minister, Nuri al-Maliki, is a Shiite who recently won the elections and is trying to forge a new working coalition. Not everyone, particularly the United States, was happy with his win because of al-Maliki's good connections with Shiite Iran. One of al-Maliki's promises was to control Islamists and guarantee security to citizens. But the effective offensive of Isis disclosed the weakness of the US-trained Iraqi army and police, and the limited potential of the Government in terms of providing security in critical situations. The Iraqi military are not very motivated and desertions are a massive phenomenon. The \$14 billion spent by the US in training and arming the Iraqi security forces did not result in turning them into a reliable safeguard against threat to internal peace and stability.

In broader terms, the current development is characterized by the following essential elements:

1. Isis turned to be a major armed player in the key regions spanning across large parts of the Sunni-populated Mesopotamia and Syria, which proved to be able to operate in wider geographical zones threatening oil production in Mosul, Kirkuk, etc.
2. The Iraqi Government is not capable of fighting Isis all alone; it needs support from the US and/or Iran. It also sets the scene for a US-Iranian dialogue in a new dimension.
3. Despite some losses in Syria, Isis is still one of the most efficient forces on the ground in the region.

4. The US is reluctant to deliver modern weapons to the Iraqi Government not having much confidence in its ability to use them correctly and preventing Islamists from getting a hold of it.
5. The armed conflict in Syria spilled out and now engulfs part of Iraq with a risk of spreading even further. At that stage, fighting in Iraq could be stopped only by combined efforts of all involved countries. However, there is no sign of willingness on outside players to get fully involved. There is a likelihood of enhanced Iran-Iraq cooperation and exacerbation of the Iran-Sunni oil monarchies confrontation which might drag the US into the conflict.
6. With fighting gearing up, oil and gas deliveries to the global market from the region have been placed in the red zone of risks.

Saddam Hussein Strikes Back From The Grave

The impressive resurgence of the extremist wing of the Sunni insurgents in Iraq, namely the Islamic State of Iraq and the Levant (ISIS), is a phenomenon in its own right. It is a worthy topic for thorough academic scrutiny. In particular, the claims that high-ranking officers who used to serve under the Bull of Baghdad, that is Saddam Hussein for those who might have chosen to forget, are planning, mapping and coordinating Isis military operations, unsurprisingly effective.

If true, Isis could be equalled to a vehicle of revenge of the Sunni dictator who “strikes back” from either hell or heaven (depending on who you are).

Still, even more relevant in the search for clues of how it happened, meaning what made Isis so victorious, would be the analysis, first, of direct and indirect involvement of extra-regional actors in the miraculous comeback of this Al-Qaeda under a different name, and second, analysis of the no-less unexpected joint counter offensive of what appears to be a Shiites’ united front. What could be the yet unexposed motives of all powerful players who use proxy armies or invest their own armed forces into the civil war in Iraq?

Recent developments reveal a new dimension of the all-out war between the Sunnis and the Shiites which was originally fought on the battleground in Syria and now is spreading over to Iraq. The turning point, if not the game-changer, could be the report in late June that warplanes sent by Bashar Assad bombed the area controlled by Isis near the border crossing in the Iraqi town of Qaim.

It came to pass also that the Shiite Iraqi militiamen who volunteered to fight the Sunni guerrillas in Syria were returning back home. They would inevitably become another key element, maybe unruly, in the anti-Sunni alliance.

The most significant factor has been the unconfirmed, yet most convincing revelation by a responsible Iraqi intelligence top executive that Iran was secretly channelling a variety of weapons to Iraqi security forces (i.e. heavy machine guns and multiple rocket launchers). The likelihood of the supply of Iranian armaments can be supported by the fact that Qassem Soleimani, commander of the Revolutionary Guard’s Quds Force, visited Baghdad in June, reportedly discussing further cooperation (provision of arms and training) with the army and militias which had already enjoyed this kind of Iranian patronage.

No matter which of the two main sponsors of the Sunni paramilitary formations is behind Isis, either Saudi Arabia or Qatar, the more intriguing substance is the diplomatic maneuvers of Western powers. The current strategy towards Iraq of the United States and the United Kingdom, which used to be intimately involved in the overthrow of Saddam Hussein, the Shiite-basher, and administered the ensued occupation of Iraq providing most of manpower on the ground, is still unclear.

British Foreign Secretary William Hague was visiting Baghdad on the day three helicopters loaded with the Iraqi government commandos landed in Tikrit stadium to oust the Sunni insurgents who controlled the city for quite a while. His talks with top officials were marked by Hague’s somewhat vague and controversial

message: the solution to the hostilities was the formation of ‘a government of national reconciliation’, whatever it means in a country split along sectarian lines more than ever in its history.

It seems that London echoes Washington, with Mr. Hague basically repeating the call by US Secretary of State John Kerry who first vowed “intense and sustained support” for Iraq and then warned that “it is essential that Iraq's leaders form a genuinely inclusive government as rapidly as possible.” The term ‘inclusive’ implies, at least at face value, the call for incorporating the Sunni and Kurdish politicians and executives into the central authorities in Baghdad.

However, the current Iraqi Prime Minister Nouri al-Maliki must have suspected a hidden agenda, given the thickening rumours that for a long time the US was unhappy with his close connections with Iran. They were even casual reports, treading the logic of conspiracy theory, that the US, frustrated by al-Maliki winning the recent elections (the bloc he leads ensured the largest share of parliamentary seats), would put pressure on him to step down.

The assumption of being victimized was probably in the back of the mind of the Iraqi Prime Minister when he vehemently rejected calls for an interim “national salvation government” and furthermore stated that it would represent “a coup against the constitution and the political process.” Naturally, the Shiite-dominated political class which was largely formed after the collapse of Hussein’s Sunni-ruled Iraq would not easily give away the gains.

Noteworthy, the ‘ugly truth’ about the attempts to oust Nouri al-Maliki did not come out into the open. Only in neighbouring Iran the Supreme Leader Ayatollah Ali Khamenei spelled out an outright accusation of the US of “seeking an Iraq under its hegemony and ruled by its stooges.”

This is a remarkable testimony of al-Maliki’s support coming from Tehran given the previous controversial relationship and especially the internal split within the Shia community inside

Iraq. At least one segment, the loyal followers of Moqtada al-Sadr's have a distrust in al-Maliki's government and his policies.

What's no less significant is the strong alienation of the Sunni community feeling threatened on a daily basis by rough raids of the Shia-dominated security forces. The promises of a steady and fair reconstruction of the national economy and social services were never met by the government despite the spike in oil revenues (from around \$50 billion in 2010 to more than \$100 billion in 2013). Where did the money go? Transparency International has the answer having ranked al-Maliki's government as the seventh most corrupt.

Without any shade of a doubt the Isis military success, in particular in the cities of Mosul and Tikrit, was largely due to popular support. Most of the Sunni tribes are rallying behind Isis. Intelligence reports claim that the jihadist element within Isis is not dominant and cannot become tail wagging. Consequently, Isis can count on a wider support of the Sunni population in the northern regions.

All these competitive advantages of Isis compared to other unpalatable extremists pose an even greater and imminent danger for al-Maliki's government.

The forecast for the coming months could be based on the projection of the two current trends and one assumption:

- First, the emerging triangular alignment of the Shiite regional forces, falling short of creating an axis of three nations, Iran-Iraq-Syria, could be instrumental in keeping al-Maliki's clan in power;
- Second, the sponsors of the Sunni paramilitary extremists might shift the accent of their strategy from Syria to Iraq and place their bets on disposing not of Bashar Assad but of Nouri al-Maliki's who appears to become the “weak link” and an easier target;
- Third, al-Maliki could attempt, or at least pretend to put together a wider coalition offering more say to the Sunnis and the Kurds.

In any case, in the context of the Isis advancement what looked as a bleak possibility of a Shia alliance between Iran-Iraq-Syria, at the early stage of the civil war which later engulfed the latter, has emerged as almost a *fait accompli*.

Now, the best scenario for the United States would be to follow a two-track policy: keep going with the rapprochement with the ayatollahs in Iran and ensure a smooth change of guard in Iraq with a pro-West, or at least not an overtly anti-West politician replacing Nouri al-Maliki. Unless, the break-up of Iraq is considered to be unavoidable and even welcome.

Kurds Get Pretext For Further Distancing From Baghdad

The capture of the main oil refinery at Baiji, north of Baghdad, at the end of June by the fighters of the Islamic State of Iraq and the Levant (Isis) brought the issue of hydrocarbons into the overall panorama of the war between the Sunnis and the Shiites raging in the region. From now on, the sectarian violence in Iraq has acquired additional geopolitical overtones which, incidentally, smell of oil and gas.

With the immediate ramification being the rationing of petrol (the refinery processes brings to the market one-third of all petrol in Iraq), yet another military gain of the rebels alerted the international energy majors of the risks to their business operations. It activated their contingency plans. Although most of the fields leased to foreign companies are located in the south and have not been affected so far, ExxonMobil and BP moved some of the workers away to safety while Royal Dutch Shell made preparations for a quick retreat.

On the wake of the capture of the oil refinery, Isis commanders warned of their intent to proceed with an offensive to seize Baghdad. Following it, the spokesperson for China National Offshore Oil Corporation (CNOOC) announced that in the case of the fall of the capital, all personnel would be promptly withdrawn.

In the aftermath of the departure of American troops from Iraq, China stepped in to fill in the void. Huge investments by a number of major

players ensued with the Chinese energy giant, CNCP and its subsidiary PetroChina at the forefront. In particular, PetroChina is now managing production at four fields in the south. At one point, one of its employees was taken hostage but later released.

The government in Beijing seems to be watching developments closely in the country which has been the target of its massive investment. The spokesperson for the Chinese Ministry of Foreign Affairs Ms. Hua Chunying made a statement underlining that China would not like to see the dramatic situation in Libya duplicated in Iraq. In February and March 2011, amid the full-fledged civil war accompanied by the NATO bombardment of Gaddafi's troops, Beijing had to evacuate 36 thousand Chinese workers involved in oil production, construction works -in particular- building a new railway infrastructure, and telecommunication projects.

Today, leaders in Beijing can experience a *déjà vu* syndrome. In February this year, Iraq's Minister of Foreign Affairs Hoshyar Zebari praised China for becoming the single largest investor in the oil and power generation sector of the economy.

Meanwhile, Isis control over the terrain in the so-called "Sunni triangle" spells danger for the proper functioning of the major export pipeline bringing oil to Turkey. All through the years, this strategic route was subject to some 600 attacks by the Sunni militants who were demonstrating in this brutal fashion their dissatisfaction with the unjust distribution of national oil wealth, or what al-Maliki once called Iraq's "national patrimony." Today, Isis is in a position to rupture this infrastructure which is crucial for the main source of revenues for Baghdad.

Moreover, once the rebels consolidate their hold of a wider territory they would be in possession of the Qaiyarah and Hamrah oil fields, of the two principal refineries at Baiji and Haditha, and the already mentioned "key infrastructure corridors such as the Iraq-Turkey Pipeline and al-Fatha, where a collection of pipelines and other facilities deliver oil, gas and fuel to the center and north of the country", according to analysts of the Iraq Oil Report.

If the government of Nouri al-Maliki is unable to wrestle control over the pipeline from Isis and, most importantly, fail to protect oil production sites in the southern provinces and in this way safeguard the interests of its major investors, like China, there will be another exodus similar to what happened in Libya.

However, in this worst case scenario there could be one party to surface as a clear winner. In the already complicated equation in Iraq one trend has gained prominence as a result of the Isis control over vast territories in the north of the country. This trend is represented by the time-honoured creeping evolution of Iraqi Kurdistan towards a genuine statehood and sovereignty.

Apart from meetings in Baghdad, US Secretary of State John Kerry engaged in conversation the head of Kurdistan Regional Government (KRG), President Masoud Barzani. In some way, this is a discreet sign of support for local separatists, and will raise the profile and ratings of Barzani and his followers. The Kurds took to arms and are ready to fight off Isis if their inherent, or whatever they perceive as inherent, national interests are affected.

The words of Mr. Barzani uttered during his meeting with Mr. Kerry are symbolic: “We are facing a new reality and a new Iraq.” The Kurdish leader called on Prime Minister al-Maliki to step down, adding it was “very difficult” to imagine how Iraq can “stay together” under the changed circumstances.

As a matter of fact, when the central government army abandoned Kirkuk, regarded by the Kurds as their historical capital city, the Kurdish paramilitary forces, better known as *peshmerga* swiftly moved in. Baghdad would see it as a territorial gain which the Kurds would be reluctant to cede once the hostilities expire. The additional lure is the smell of oil from the fields around Kirkuk. On top of that, the Kurds are expanding their control over some disputed lands in the Nineveh, Salahuddin and Diyala provinces from where they were “ethnically cleansed” at the times of the ruthless dictator Saddam Hussein.

It is evident that amid the thickening uncertainty of Iraq’s preservation as a unified state Mr. Barzani has boosted his credibility as a national leader for all Kurds and emerged as a power broker not only in Iraq but in a wider region too. This translates into diminished security risks for a wide array of mostly Western, Turkish and Gulf emirates’ energy companies who are prospecting, producing and transporting oil from Iraqi Kurdistan to global markets.

To prove the point by an example: the Qaiwan Group, an Iraqi Kurdish conglomerate operating the Bazian Refinery plans to up its capacity from 34,000 bpd to 84,000 bpd, by adding 50,000 bpd of distillation capacity and gasoline manufacturing facilities. Noteworthy, the FEED expansion of the refinery is performed by Technip France, and its trading hub is located in Dubai.

Meanwhile, to get a free hand, President Barzani can place the blame on the central government in Baghdad for failure to maintain stability and security in the country, falling prey to an unprecedented sectarian uprising. If Baghdad becomes bogged down in a protracted war with the Sunni insurgents, the Kurds might use it as a good pretext and an opportune moment to sail off as a separate state entity.

A Propos

In October 2013, the International Energy Agency made a forecast for the gradual surge of oil production in Iraq of up to 6 million bpd by 2020 and 8 million bpd by 2035. The overoptimistic government of al-Maliki set the goal of reaching the level of 10 million bpd by 2017. Actually, in May this year the production was stuck at 3.3 million bpd by 2020 with 2.5 earmarked for exports. Given the aggravated sectarian war and with the Kurds steadily inching their way towards full independence, these goals look like a lot of wishful thinking.

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The Blessing And Scourge Of Oil Price Volatility

Oil producers' appetite for drilling is dependent on many external circumstances, not the least of which is the balance of supply and demand. Yet, even more crucial is price benchmark and crude oil futures which do not necessarily reflect supply and demand correlation but respond to political risks, both actual and perceived.

Recently, three almost simultaneous occurrences, geopolitical and legal, shaped the short-term forecast for the oil and gas (O&G) global markets, including the energy markets of South East Europe.

First, in late June the US Commerce Department lifted a ban on American-extracted crude oil exports. The ban was sustained for four decades and was effectively undermined by the steady rise of the US to energy self-sufficiency with the advent of local shale oil and gas, which, in turn, is creating an export potential.

For those European markets affected by the uncertainties of future oil supplies from MENA countries in the grips of the renewed post-Arab Spring hostilities, namely Libya and Iraq, this news should have evoked a sigh of relief.

Surprisingly, nothing of the kind happened. The reason being that the decision of the Obama Administration actually covered the ultralight crude which could be considered as a 'refined petroleum product' since it was 'stabilized' for safe transportation and storage. However, it is not, strictly speaking, crude oil. And there were no limitations imposed on export of the American ultralight crude. No wonder, the news was classified as "neutral" by the markets.

Second, the other remarkable happening did not make waves either. The lower house of the US Congress stamped a bill which orders the US Department of Energy to reduce the timeframe for approval of LNG exports to non-free-trade agreement countries from 90 days to 30 days.

The three-fold reduction is significant by any yardstick, but once again this liberalization move

would not send shock waves through the energy markets and provoke exuberant joy on the European recipient end. The explanation is boringly routine: the re-fitting of the US regasification terminals originally built to welcome imported LNG and the construction of the liquefaction plants and terminals to export American-made LNG will not become operational until 2018.

What did have a dramatic impact on the energy markets was the newswires' alert on 22 June that the armed radicals of the Islamic State of Iraq and the Levant (ISIS) took control of yet another city on the "Sunni triangle". The news was still spreading around when Brent crude jumped to almost \$115 per barrel and West Texas Intermediate (WTI) went up to nearly \$107. The gradual advancement of the Isis paramilitary formations is watched closely and with apprehension by the international oil and gas majors which invested into main oil fields in the southern provinces and to some extent in the northern areas controlled by the Kurds.

Earlier, the Iraqi Oil Ministry announced the postponement of bidding on the Nassiriya oil field and refinery project, which had been planned for June 19. The decision was a forced one since the likelihood of the spread of hostilities to the southern oil-rich regions would cool off the enthusiasm of external investors.

It is reasonable to weigh short-term benefits against long-term misgivings. For the moment, oil producers outside the MENA segment of the notorious Arc of Instability are reaping reputation benefits and extra cash. The beneficiaries include Saudi Arabia and the Gulf states. However, the proximity of the petro monarchies to the battlefield in Syria and Iraq throws a shadow of doubt on their ability to remain immune to the fluid radicalization of the region. Consequently, foreign investors will either demand additional guarantees for their capital injection or simply postpone investment decisions until later.

In the short term, the oil producers, other than Libya and Iraq, can capitalize on surging prices but in mid and long-term they can become losers

as well. In some way, the current volatility of oil prices is both a blessing and a scourge.

The Logic And Repercussions Of ‘Regime Change Strategy’

Libya was recently plunged into the whirlwind of violent attacks, counterattacks, short-lasting shaky agreements, prompt appointments at the very top followed by swift dismissals, menacing warnings, and all that was taking place against the continuing downfall of oil and gas production.

It is worth finding some logic in the Libyan conundrum, if any. Once understood (if possible), it could give a chance for a plausible forecast: when will the country go back to the sustainable production of its key export commodity, hydrocarbons?

After the revolution and the civil war which brought down dictator Muammar Gaddafi and a regime change, Libya found itself with an extremely weak government, with a spreading of arms looted from army warehouses, a surge of radical Islam of different origin and shade, and from a social perspective, sent backward in history with the resurgence of the rule of tribes, militias and a triumph of primordial instincts and interests.

Almost three years after the regime change there appeared a new leader pretending to know how to rebuild the country: it is the retired General Khalifa Haftar (see “Libya: Second Civil War Three Years After Gaddafi”, EIRA, Volume 2, Issue 6, June 2014). General Haftar launched “Operation Dignity” swearing to eradicate extremism and terrorism. He targeted Islamist strongholds in Cyrenaica, in the east of Libya, organized an incursion into Tripoli, the capital city, and he allegedly has the backing of a number of tribes (namely Al-Ubaydat, Al-Baraisa, Al-Awaqir, Al-Arif) and also of some military officers from the defunct armed forces.

General Haftar (born in 1949) is quite a controversial character. A quarter of a century ago he commanded Libyan troops sent to fight a

France-sponsored regime in Chad. In 1987 he was captured during a battle at Wadi Doum. He was repudiated by Gaddafi, and, infuriated, joined the former enemies, attacking Libyans at the southern border of the country only to be repudiated by his new ally, the President of Chad, Idriss Déby in 1990. He found himself in the Central African Republic, then in Zaire and finally was brought to the US establishing a special relationship with the Americans. He spent many years in Virginia, but was not involved in subversion against Gaddafi’s regime. Coming back to the country in 2011, Khalifa Haftar tried to find his way back to the top leadership.

His first attempt was not very successful. He tried to become commander of the armed forces of the National Transitional Council but lost the bid to General Abdul Fatah Younis. Later General Younis was killed in an assassination attempt, and Khalifa Haftar was suspected of being behind that plot. In December 2011, Younis’ father, Rami al-Ubaydi, published on YouTube a long interview explaining what was happening in the country. He mentioned Khalifa Haftar naming him as the “American guy” in Libya. Almost a year later, a US General, Carter Ham, then Commander of Africom, during a visit to Tripoli proposed organizing training classes for the new Libyan armed forces under Haftar’s command.

Irrespective of his past and present ties, Haftar now plays a different role, either sustained or not by the US and/or some ex-officers from Gaddafi’s army. The country is exhausted by chaos. Haftar attempts to install his control over Cyrenaica and then, if possible, all over Libya. He tries to position himself as Libyan ‘al-Sisi’ acting against Islamists, in particular those linked to the Muslim Brotherhood. This assumption serves as a pretext to his enemies to accuse Haftar of acting in Egyptian interests. Egypt wants to see the eradication of the Muslim Brotherhood not only within its borders but everywhere else in the region, including Cyrenaica, located nearby. The logic is simple: the cleansed Libyan province would not become a power base for Islamists, who would send money, fighters and weapons to their Egyptian associate. Egypt would also like to see a restart of

oil production and export from that part of Libya.

In a broader MENA context, the policy pursued by General Haftar suits not only the interests of the new leadership of Egypt, but also those of Saudi Arabia and its allies among the Gulf petro monarchies which are more and more focused on anti-Brotherhood campaigns. Viewed from that perspective, Khalifa Haftar's crusade could be defined as a consolidated move against the Muslim Brotherhood, the branch of radical Islam supported by Qatar. The ultimate goal could be the revision of the consequences of the Arab Spring, offset social and political catastrophe for the region and restore the crucial money-earning hydrocarbon production. But it would not be correct to qualify the geared up new battle in Libya as a confrontation pitting 'bad' Islamic radicals against 'good' laics as often presented in the media. Basically, what we see now is a bitter uncompromising conflict between Wahhabis and the Brotherhood, between different versions of radical Islam supported by different Gulf monarchies.

Qatar is not the only unhappy one with these developments. Algeria is also on alert although for other reasons. It wows for a stabilization at its borders with Libya, in Tripolitania. Algeria fears a flow of arms and Islamic fighters through its borders and new attacks as the one which took place in Amenas: the country wants to protect its own gas fields located not far from Libya. There were reports that lately up to 40.000 Algerian military personnel were deployed in zones neighboring unstable Libya. Simultaneously, Cyrenaica has witnessed the consolidation of the new Islamist militias, e.g. "Jund Allah" or the Council of the Shura of Young Muslims which is controlling the radical stronghold, Derna. Here could be the hiding place for some wanted Islamist militants such as Mokhtar Belmokhtar, from Algeria, or Abu Ayyad, from Tunisia. Libya is also becoming a target for Al-Qaeda affiliated groups and attracts Islamic fighters from Syria and from the entire MENA region.

The motivations of Qatar and Algeria in the ongoing internal conflict in Libya are as different as their political and ideological choices. Yet they find themselves on the same side of the local

barricades. It should be noted that the problem is not only linked to Libya: there is a Qatari-Saudi standoff in Syria and in the Gulf Cooperation Council.

The degree of support of that kind of politics from the US remains an unknown quantity due to complicated ramifications of the tug of war between some influent Arab countries, including the ongoing civil war in Syria. Washington seems to be overburdened by the avalanche of dramatic events in the region.

The devastating developments in Libya after the regime change, driven by the US and some Western European and Arab countries, is a testimony to failure of the strategists to take into consideration the local, specific peculiarities. The most surprised seem to be the American neoconservatives who are still influencing the foreign policy agenda. Regime changes aimed at replacing dictatorships and autocratic rule by democracy, in theory, should bring to the people pro-US rulers, adequate policies and above all prosperity, freedom and the rule of law. The realities on the ground happen to be very different from textbooks.

The best illustration is Libya and other countries of the MENA region where such regime changes started some years ago. It is ignorance of the Libyan hardcore realities, its historical and cultural pluralism, its tribal social structure and other archaic but deeply rooted properties which brought the country to its present decomposition, total insecurity and dramatic fall of hydrocarbon production. The rebuilding, or better, the building from scratch of the Statehood after 40 years of a personal cult and dictatorship is not going well so far. Would it be possible? If yes, on what basis?

The same mistake seems to be made in Ukraine where the regime change organizers did not take into account deep internal divisions. Half of the country welcomed the new rulers, half did not, bringing most radicals from both of them to organize armed militias. As a result of regime change a thoroughly failed state emerged in the middle of Europe (the geographic center of the Old Continent is located in Western Ukraine)

which is steadily heading into a political, economical, and social dead-end.

In Ukraine, the cycle after the regime change is at the very beginning, while in Libya it has already gone a long way. With due respect to differences between the two countries, it should be noted that the recent developments are somehow similar because of the stubborn ignorance and neglect of local specifics by regime changers.

Could Khalifa Haftar present a viable solution for Libya just like General al-Sisi seems to be an answer to Egypt's ills? We'll have to wait and see; the crisis is evolving fast enough. As for Ukraine, the solution could be the one formulated as "two F" by a sophisticated American columnist, William Pfaff: "Federalization" and "Finlandization" which could serve as a solid base for nation-building and state-building.

Anyway, the succession of events in MENA after regime changes is putting under pressure energy security for Europe. Libya is unable to produce and deliver oil and gas in due volumes. Ukraine with its outdated gas transportation system (the main route for Russian supplies to Europe and, in particular, to the Balkans) constitutes another risk factor. At the end of day, the regime change scenarios implemented in countries with unstable political regimes endanger essential hydrocarbon import flows going to South East Europe.

Production Costs Squeeze New Gas Projects

European high-profile energy majors have either retreated or announced a planned withdrawal from natural gas projects in Azerbaijan.

In June, French Total sold its 10% share in Shah-Deniz-II and South-Caucasian pipeline projects and headed for exit. The buyer was TPAO from Turkey with the deal fixed at \$1.5 billion. The Turkish share went up to 19%.

A month earlier, Norwegian Statoil sold its 10% share in the same widely publicized projects. The Norwegian heritage was partitioned between British BP and Azerbaijani SOCAR with their

shares' portfolio rising to 28.8% and 16.7% respectively. The price tag totaled \$1.45 billion.

In a similar gesture of frustration Total and German E.ON declared their intention to also leave the TAP pipeline project designed at bringing gas from Azerbaijan to Greece, Albania and Southern Italy. TAP is the extension of the pipelines from the Shah Deniz offshore fields to Turkey and then through Turkey to Greece.

These sudden moves will bring about a new configuration of shareholders spearheading the construction of the Southern Gas Corridor infrastructure. The main players and power brokers left are SOCAR and BP.

Market analysts question the root causes of what looks like a massive desertion of the Southern Corridor. One of the key reasons is linked to the Shah-Deniz-II actual reserves and more important, to the final costs of production. So far, the initial investments reached \$3 billion. The estimated production and transportation (to bring gas to the Turkish border) costs will add \$28 billion to the master bill. Another \$10 billion should be added to lay the TANAP pipeline through Turkey and another \$1.5 billion to build the TAP pipeline. All in all, supplying 16 billion cubic meters of Azeri gas along the Southern Corridor would demand investments of roughly \$40 billion. It is a bit too much for a region not noted for exuberant prosperity, solid purchasing power, and extra cash to spend.

What is even more troubling is the final price of gas to be marketed and sold. The producers, as this is a standard practice in the industry, do not disclose the price, yet, the calculations made by experts of *The Wall Street Journal* suggest Azeri gas will cost no less than \$400 per 1000 cubic meters.

The high costs are placing many new gas projects in the red zone. It is a powerful demotivator. Hopes for the East Mediterranean region to capitalize on local cheap gas were dealt a blow by the recent withdrawal of Australian Woodside Petroleum from an earlier agreement to take a stake of \$2.7 billion in Israel's Leviathan gas project. The Australian company which specializes in LNG deliveries to Asia discovered to its dismay that pursuing the project will be

counterproductive as it will not help meet its financial targets.

In fact, the Azeri and Israeli projects are modest in size, and any turbulence affecting them will not have a strong impact on global gas markets, probably sending shivers to local stakeholders.

The looming problems are far more serious in other regions with ambitions to become suppliers of huge amounts of LNG, namely Australia, East Africa and North America. The cause of what might be termed the “The new uncertainty” in the making is once again the high cost of production and the expectations of lower prices. Many LNG projects make business sense only at high prices which can be paid by selected few, e.g. Japan. If prices slide down, many new LNG projects would not be able to generate even low profit margins.

The most vulnerable appear to be the Australian companies burdened not only by expensive high-tech but pricy labor. Yet, Australia still bets on dethroning Qatar as the biggest LNG producer in the world. However, Australian LNG is viable and expedient only at current prices on the Japanese energy market which are roughly double of the average Europeans prices. Even in North America, the birthplace of the “shale boom”, LNG projects have not yet taken off the ground. In the short and mid-term it translates into a tight global LNG market.

“There is always so much talk about these big LNG projects around the world, but only a small fraction of it will get built”, said Matthias Bichsel, director of projects and technology at Royal Dutch Shell. “Costs in the oil and gas sector are still on the rise and outpacing inflation, and gas projects are extremely price-sensitive because the margins are so thin,” Mr. Bichsel emphasized in an interview with the Australian daily Sydney Morning Herald.

All in all, adventurous policies, unsustainable managerial decisions, and rising costs of production and transportation of energy resources from fields to customers seem to be wrapping themselves up into formidable challenges for the projects which are primarily aimed to guarantee energy security. The Balkan region is one which is threatened the most with additional problems surfacing linked to the

Russian South Stream gas pipeline project and ambiguity thickening around the TAP/TANAP pipeline projects. These risks are of a different nature but combined with geopolitical tensions and market turbulences they spell uncertainty for the energy security of South East Europe.

Open Forum

Energy Dependence? Let's Get The Facts And Figures Right

***By Demosthenes Floros**

Over the next few years, and thanks to the TTIP, US shale gas could turn out to be an alternative to Moscow's hydrocarbons. An option only Washington would benefit from, certainly not the Old Continent or - least of all - Rome.

The events in Ukraine represent a real geopolitical conflict, whose protagonists are the United States of America on the one hand, and the Russian Federation on the other. This fight – in which China, without exposing itself too much, is supporting Russia (in spite of China's abstention at the UN), – is taking on an increasingly global dimension. The conflict is actually taking place, both politically and militarily, in at least three different scenarios: Ukraine, Syria and Venezuela (with the issue of the Iranian nuclear weapons in the background).

From a power generation point of view, the US administration's aim is the reduction of the Russian gas supplies to Europe and their future replacement with the American *shale in the form of LNG*. First, it will take time since the US will have to put in place and manage a complicated mechanism of liquefaction facilities, LNG tankers, strict timeline of deliveries, link-up with regasification plants in Europe, etc. Moreover, issues would arise in connection with transport costs and sale prices: the Asian market is more lucrative than the European one. In addition, law restrictions prevent the US from exporting to the countries with which they did not sign a free trade agreement. Part of these problems could be solved if Washington and Brussels signed the

Transatlantic Treaty between Washington and Brussels (T-Tip).

At present, 57% of EU energy is made up of hydrocarbons: 33% of oil and 24% of natural gas. In 2013, the Russian Federation supplied Europe (included Turkey) with approximately 31% of its methane demand, equal to 161.5 billion m³ (24% of EU). According to the data provided by Gazprom Export, 53% of this amount, equalling 86.1 billion m³, passed through Ukraine's territory (in 2012, the export was 84.2 billion m³, i.e. 61% of the total). Before the construction of the North Stream, the pipeline under the Baltic, up to 80% of Moscow's gas passed through Ukraine. Conversely, Europe is still Russia's top customer – based on the data provided by sicurezzaenergetica.it – since the former absorbs 61% of the Euro-Asian giant energy exports (50% of natural gas). More precisely, Moscow earns an amount equal to 18% of its gross domestic product from energy export (368 billion dollars).

It follows that there is a relation of real interdependence between the European Union and the Russian Federation, rather than a mere subordination of the first to the second: proof of this are the investments made by German, Dutch, French and Italian multinational companies in the North Stream (maximum capacity 55 billion m³), Blue Stream (16 billion m³) and South Stream (63 billion m³) pipelines- ENI has a joint venture with Gazprom in Blue Stream and owns 20% of South Stream AG.

Replacing the Russian energy flows with the American ones would drastically reduce Moscow's currency inflow, thanks to which, over the past years, it could establish a State Fund of 530 billion dollars (60 billion dollars of which were used to contain the fall of the Stock Exchange and the capital flight caused by sanctions). This would force the Kremlin to look at Asia and strengthen its strategic relation with Beijing (in 2011, 21.7% of the world's manufacturing production was in China), though compromising an energy and manufacturing cooperation with Europe.

Italy, with its small and medium enterprises, as well as with ENI and ENEL, would be the most affected. In addition, after the strategic error of the war in Libya, which supplied us with 24% of our oil consumptions, freezing the EU-Gazprom talks around the possibility that, as happened with TAP, the South Stream pipeline will be exempted from the obligation to grant access to third parties as provided for in the Third Energy Package (in 2013, 43% of our gas consumptions was satisfied by Russians) would definitely not be of help for our country.

Are we so sure that the Ukrainian crisis is a unique opportunity for Europe to break free from Russian energy dependence?

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