

## The Geopolitics of Oil and Gas

**Are the Arabs from outer space? Are the North Africans aliens whose goodwill we must seek in order to ensure that our supplies of oil and gas are safe? Are we Europeans seriously casting Southern Rim Mediterranean countries in the role of the devils that might one day hold us to ransom and withhold supplies of energy which are vital to our citizens and industries? Is Algeria really building a Gas OPEP with Russia? In other words do we wish to see ourselves as Fortress Europe besieged by the Barbarians? Maybe I am being facetious but as I listen to certain political leaders and media in Europe I wonder.**

"Two challenges face Europe which transcend national interests and will define not only the continent's future, but the world within which Europe exists in the 21st century: security and the reconciling of energy, climate change and economic development goals. To an increasing degree these challenges will interact, not least in Europe's policy towards the Middle East and North Africa. The wrong energy policy could create new enemies for Europe and new risks to energy supply. It could accelerate climate change and deepen poverty in Southern Rim Mediterranean countries." This quotation is taken from a letter published earlier this year in the Financial Times by the Chancellor of the University of Oxford, my former alma mater, Chris Patten and a group he chairs, the Oxford University high-Level Task Force on Energy Security, Climate Change and Development. Southern Rim Mediterranean countries, not least Algeria, have much to offer the European Union (EU) if only the latter chooses to think long term vis a vis its southern near abroad. That much is clear from debates during two successive conferences, From the Cost of No Maghreb to a North African Tiger, or-

ganised by The European Institute of the Mediterranean and The Toledo International Centre for Peace in Madrid and Barcelona in May 2006 and November 2007.

Before I proceed any further, I would like to thank The Konrad Adenauer Stiftung for inviting me to the capital of Germany. This is my first visit to Berlin since 1965 when I led a group of Sciences Politiques Grenoble university students to Eastern Europe – in those days travelling to East Berlin and Moscow was like travelling to the planet Mars, outer space indeed, whose inhabitants we viewed as Barbarians. As a French citizen whose mother is English I would like to pay my respects to the memory Konrad Adenauer, the eminent German statesman who reconciled my country with yours, indeed with all democrats in Europe after the Second World War.

The Geopolitics of oil and gas is a vast subject indeed: in this brief presentation I will focus on gas. Indeed the difference between the two fossil fuels needs to be better understood. Most comment on gas focuses on Russia whereas Algeria, which is the EU's third largest outside supplier of gas, is virtually never mentioned. Unlike Russia, it has not abused its energy muscle and behaved in a loutish fashion towards its near abroad. Russia will of course remain Europe's largest outsider provider of gas, followed by Norway for the foreseeable future. But by 2030, Algerian the volume of gas the EU imports from Algeria will be on a par with what it imports from Norway. Libya will be a larger player as will Egypt and maybe Qatar. This means that four important Arab countries will play a key role in supplying a form of energy the EU finds ever more attractive. Will the EU and Southern Rim Mediterranean countries be able to build a

relationship based on trust and mutual benefit where gas is concerned?

The growing importance of these four countries must be set in a context in which Europe is, according to the CEO of the Italian energy giant ENI to be "sleepwalking into a staggering dependence on imported gas". Gas prices lag those of oil, to which they are indexed, by six months, which means that some hefty bills are going to be landing on customer's doorsteps next spring and summer. Europe bemoans its growing dependence on gas from beyond its borders but what it fails to appreciate is that the European Commission's pursuit of market liberalisation, including the unbundling of the ownership of gas and electricity transmission from the supply business is an irrelevance. There are some very good reasons for this: gas security from the customer's point of view has three key aspects: gas availability, adequacy of the gas network and system integrity. But security is also a concern for gas exporters.

Until the 1990s, downstream market security for producers was ensured within long term contracts which shared risks between the stakeholders on a fair basis: price risks were carried by exporters and volume risks by importers. The EU has asked for the removal of long term contracts with take or pay clauses to facilitate the entrance of new suppliers and, hence, develop supply diversification. However stable outlets remain necessary for gas development projects which require large infrastructures and involve important economic risks. Securing the market is for the aforementioned exporting Arab countries not only necessary for investment but also for the stability of export revenues. They claim that security of the outlets must be understood as a legitimate counterpart to security of supply. In Europe, priority was at first given to competition development in a context of abundant and cheap energy, the focus only switching to security of supply as energy prices started to rise. Uncertainty today concerns both production and demand.

EU imports of gas increased by 90% between 1995 and 2005 with Norway tripling

its supplies, Algeria doubling its exports to Europe and Russia increasing its own by 27%. All three ensured stable supplies throughout the 1990s when gas prices were very low and Algeria in particular was confronted with a difficult internal crisis. Only where Liquefied Natural Gas (LNG) is concerned have there been unexpected shortages due to cost inflation caused by escalating raw materials prices and the scarcity of companies capable of building liquefaction plants. Some experts suggest that investment costs have jumped fivefold to reach \$1000 per ton of export capacity over recent years. In such a context it is easy to see why the Observatoire Méditerranéen de l'Energie has argued that "considering the rigidity of the gas chain, ensuring long term security of supply requires correctly anticipating future needs. This is particularly necessary for securing big investments in production and transportation. Such anticipation was much easier under non competitive market conditions in the past. Nowadays, even though current trends clearly emphasize that Europe will need additional imports, the amounts of these requirements should be clarified so as to correctly estimate the need for investments. For that purpose, it would be very useful to better share market information between all the market players."

Competition was supposed to bring more economic efficiency and transparency but the UK example demonstrates that successful liberalisation processes "require excess capacities in infrastructures and supply. Such a situation has never existed in continental Europe where, almost all countries import most of the gas they consume from only a few suppliers. Competition has reduced the quality of management in the supply chain as more physical flexibility is required and regulations to balance diverse interests become more complex. In long term take or pay contracts which sought to establish an economic balance between contractors were easier. Today new entrants in the market are often small companies operating as retailers and traders whose risk mitigation capacities are limited in a market dominated by giants." The result is that business developers are asking for higher

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rates of return and more flexibility in project development. These factors make the life of gas exporters such as Algeria, which has scrupulously honoured its export contracts since it began trading gas in 1964, both more complex and more expensive

The growing gas inter-dependence between producing and consuming countries spontaneously raises geopolitical issues because the future gas security of Europe largely depends on investments in external countries, producing or transit ones. The economic and political stakes associated with natural gas exacerbate the potential misunderstandings between policy makers.

In this context, securing energy supplies requires developing mutual understanding of all the stake holders. In particular, if producers should care about consumers security of supply – meaning reliable and available energy at affordable prices – consumers must show concern about producers access to markets in consuming countries to justify and protect their investments – in other words these investments must be able to add value to their overall development.

I will now turn the key role energy could play in building cooperation and trust among Mediterranean countries. Here I will use figures compiled by the Observatoire Méditerranéen de l'Energie who's Director General, Mustafa Faïd, is a former vice president of the Algerian state energy company Sonatrach. In a broad economic sense, northern and southern rim Mediterranean countries are diverging: in 2006, the medium Gross Domestic Product per inhabitant in the south was \$2,900 versus \$22,000 in the north. In the south the population has been growing at a rate above 2% per annum over the past thirty years, in the north at a rate of 0.4%. Southern Rim exports to Northern Rim countries, excluding hydrocarbons, have declined in value and foreign direct investment flows to the south remain weak even if one notes a recent improvement in Egypt and Morocco. Cooperation has often taken the shape of assistance and Southern Rim countries are ever more dependant commercially and technically speaking on their European neighbours. By what

means might we transform the nature of these relations and turn them into a more balanced partnership? Could the energy component of economic activity not act as a catalyst and offer the necessary leverage to foster broader cooperation, even integration, between the economies on both shores?

Energy resources are distributed in very unequal fashion between the two shores of the *mare nostrum* but this apparent paradox very might well offer the means of building links of mutual benefit, an interdependence which would be sought and accepted by both sides. Partnership here would offer many benefits: it could boost growth rates in the south and thus ensure greater political and economic stability.

Let us first consider energy use. The south uses barely 1 ton of oil equivalent per inhabitant per year, the north 3.2, in other words three times as much. Fossil fuels account for 75% of demand in the north, 95% in the south, a difference which results from the much greater share of electricity produced from nuclear source in southern Europe. Gas meets a growing share of market requirements in energy needs all round the Mediterranean. Demand for gas in Mediterranean countries has doubled between 1995 and 2005 from 139bn to 267bn cubic metres. Gas accounts for half of electricity generation in the south but only 20% in the north. Gas penetration varies: it accounts for 60% of all energy needs in Algeria 5% in Morocco. North Africa, Egypt included, boasts 5% of known world gas reserves but Algeria and Libya hold between them 87% of all resources. Electricity generation capacity amounts to 323 million kilowatts for a population of 209 million people in the EU versus 104 million kilowatts for a population of 264 million in the south.

Two pipelines carry Algerian gas to Europe, via Tunisia and Morocco while Libya and Italy have been linked by a pipeline since 2004. A fourth will soon link Algeria directly with Spain and a fifth, linking Algeria to Italy via Sardinia and Corsica is on the cards. This flow of gas, LNG or piped, has never been interrupted for either commercial, po-

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political or security reasons since it started in 1964. Egypt meanwhile is reinforcing its LNG export facilities as are Libya and particularly Algeria where LNG was invented between 1961 and 1963. These facilities help to ensure that the supply to Europe is flexible and reliable. There is also talk of a gas pipeline which will bring North African gas to Jordan and Syria and link up with Turkey, a country which is building up its role as gas hub between central Asia and Europe

Electrical interconnections are developed but not as advanced as gas ones: between North African countries they already exist and a number are planned between North African countries, Italy and Spain. What is called in French the Boucle Méditerranéenne will soon be completed. Furthermore, as electricity generation is increasingly privatised, opportunities to generate more electricity will increase. Energy flows will however be dominated by south-north flows as Europe absorbs 70% and 90% respectively of the region's oil and gas exports. European importers on the other hand only import 15% of their energy needs from the Mediterranean basin. If one adds that Algeria imports two thirds or more of its capital and consumer goods from the EU, dependency is not necessarily where many in Europe would make us believe.

The ever rising costs of exploration, production and transport due to the shortage of skilled labour and engineers bring us to the question of renewable energy. The nuclear option may have to be reconsidered at one point or another in Mediterranean countries but this will have to be done in the framework of carefully worked out agreements between countries on both shores. Europe should offer such an opportunity to southern rim countries and not simply to forestall temptations they might have to develop nuclear power for non civilian purposes.

Solar energy now figures on the agenda: the Sahara offers ample opportunity but any EU policy must rest on the offer of a balanced industrial and economic partnership with the strong backing of European capital and know how. Solar energy might offer the

EU some leverage in encouraging Southern Rim countries that do not work well together today opportunities to draw closer in the future. Morocco only uses the small amount of gas it is paid as a transit fee on the Pedro Duran Farell Gas pipeline which links Algeria with the Iberian Peninsula to power a power station near Tangiers. Gas only accounts for 5% of its energy needs which is, in strictly economic terms absurd.

One area of cooperation which was agreed at the meeting between Romano Prodi and Nicolas Sarkozy last Friday in Nice relates to the production of diesel. Europe already depends on Russia for part of the diesel it uses, a dependence which will grow as Europe increasingly switches to diesel: the two leaders agreed to a proposal that France, Italy and Spain should, jointly with Sonatrach build a Mediterranean refinery to boost the production of a form of energy which Northern Rim countries will increasingly require in years to come – thereby lessening the EU's dependence of Russia. At the same time Europe exports a lot of petrol to the US but what happens if the latter opts increasingly for bio fuels: the EU could be left with a lot of surplus petrol on its hands which it cannot dispose of. This is but one example of possible forms of cooperation between north and south.

This brings us full circle – back to the challenges facing Europe which I mentioned in my introduction and which links energy, climate and security. It is up to the EU to decide whether it wants to be a fortress and consider its neighbours as Barbarians or whether, by way of enriching the Barcelona Process, it offers a bold and forward looking partnership to its southern near abroad in the field of energy.