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2

Cyprus and Israel: A Precarious Energy Partnership

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RÉSUMÉ

La question de savoir si une Chypre affaiblie doit faire équipe avec une puissance régionale comme Israël pour explorer ses réserves d'énergie est à l'origine de nombreux débats parmi les Chypriotes. Mais il se pourrait qu'il ne s'agisse plus d'une question de choix pour Chypre mais de nécessité nationale et économique compte tenu de la faible position politique de ce pays. Force est de considérer que tout espoir pour la relance de l'économie semble maintenant aller de pair avec le développement futur des ressources de pétrole et de gaz naturel potentiels. Chypre doit également s'allier avec Israël pour des raisons de sécurité, parce que sans la protection du parapluie de défense de ce pays il est douteux que les entreprises d'énergie soient disposées à braver les menaces de la Turquie pour explorer ses réserves d'énergie. Sans la protection, sans les réserves d'énergie et la participation financière d'Israël, l'avenir énergétique de Chypre ne semble guère encourageant. En outre, un rapprochement inévitable entre la Turquie et Israël (recherché en urgence par les Etats-Unis) cause des craintes à Chypre, compte tenu du fait que la Turquie menace ce pays et occupe militairement 40% de son territoire depuis plus de 40 ans.

ABSTRACT

The question of whether a weak Cyprus should team up with a regional power such as Israel to explore its energy reserves is causing much debate in Cyprus. But, this might no longer be a matter of choice for Cyprus but of national and economic necessity given its weak political position and considering that all hope for reviving its economy now appears to lie with future development of its potential oil and natural gas resources. Cyprus also needs Israel for security reasons because without the protection of Israel's defense umbrella it is doubtful if any energy company would brave Turkey's threats against Cyprus to explore its energy reserves. Without Israeli protection, Israeli energy reserves and financial participation, Cyprus' energy future looks less than encouraging. Furthermore, an inevitable Turkey-Israel rapprochement (urgently sought by the US) is making Cyprus apprehensive considering that Turkey is threatening Cyprus and for more than 40 years is occupying militarily 40% of its territory.

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Introduction

The 2013 Cyprus banking-cum-sovereign debt crisis will undoubtedly stay etched in the memory of Cypriots for many years to come as this small European Union (EU) island economy continues to struggle to maintain both its financial solvency and its membership in the Euro zone. In fact this economic drama continues to unfold, with Cyprus desperately casting for a lifeline to save it from an ongoing severe economic recession.

Not only is the Cyprus financial crisis affecting Cyprus and its people, but will remain as a constant reminder of the potential threats to the Euro zone banking system and the nascent European Monetary Union. The potential lifeline for the Cyprus economy that has been widely discussed are the gas but also petroleum) deposits located within Cyprus' Exclusive Economic Zone (EEZ) and off its southern coast, in the Levantine Basin between Cyprus, Lebanon, Israel, the Gaza Strip, and Egypt. While Cyprus has negotiated and delimitated its EEZ with both Israel (2010) and Egypt (2003), as well as with Lebanon (2007) (although that treaty has yet to be ratified by the Lebanese Legislature), it is Cyprus' energy partnership with Israel that could make or break this economic lifeline for Cyprus. As will be seen, the potential energy partnership between Cyprus and Israel is both complicated and fraught with difficulties of Byzantine proportions. It is this energy partnership between two unequal partners in what is obviously a very complicated and dangerous region of the world that is the focus of this paper.

The Cyprus Problem

Cyprus has existed as a potential flashpoint of international conflict from the very beginning of its existence as an independent nation in 1960. The economic problems of this small island nation in the Eastern Mediterranean have at the same time paralleled its rollercoaster political problems. At the time of Independence in 1960, the Cypriot economy, although battered by the effect of the anti-colonial liberation struggle against British rule from 1955-1959; was in relatively good shape thanks to British outlays in Cyprus, both in terms of civilian infrastructure and military build-up, as Britain continued to withdraw from more far flung imperial outposts and to adopt a more limited global posture, including its withdrawal from Palestine, Aden, and the Suez Canal.

These expenditures were further bolstered by Britain's efforts to suppress the EOKA (National Organization of Cypriot Fighters) struggle for independence from Britain and union with Greece.[1]

The early years following Independence, saw remarkable economic progress in spite of inter-communal clashes during 1963-1964 and 1967, as the economy moved from a primarily import-substitution manufacturing strategy to a more export and service oriented strategy focusing on tourism and banking.[2] This brief post-Independence economic miracle came to an abrupt halt in July 1974 when Turkey invaded the island purportedly to restore constitutional order following the coup carried out by the military junta then ruling Greece with the collusion of Greek Cypriot collaborators on the island. The economic consequences of the Turkish invasion and subsequent occupation of approximately one third of the island were catastrophic, resulting in the displacement of one third of the population, the contraction of the economy by two thirds, and the separation of the historically intermingled Greek and Turkish Cypriot ethnic communities into two separate geographic entities.[3]

In 1983 the Turkish occupied northern area instigated an attempted secession through a declaration of unilateral independence of the "Turkish Republic of Northern Cyprus "(TRNC) which has since been recognized only by Turkey. The Greek dominated and internationally recognized "South" Republic of Cyprus has since managed to restructure its economy after the loss of the most productive and resource-rich northern areas after investing heavily in tourism, banking, shipping, and financial services. The per capita GDP of the Republic of Cyprus had reached $23,735 in 2004 when it became a full member of the EU; while the 'North' lagged behind, internationally isolated and subsidized heavily by Turkey, managing at best a per capita GDP one third that of the more dynamic and prosperous 'South.'[4] The 2004 Treaty of Accession to the EU encompasses the Republic of Cyprus with the provision for the suspension of the application of the acquis in the northern Turkish-occupied part of the island, to be lifted when the island is reunited.[5]

In 2008, Cyprus became the 14th member state of the EU to join the Euro zone, adopting the Euro currency and abandoning the Cypriot Pound. It appeared at the time, that the economic success story of the Republic of Cyprus, together with its accession to the European Union, was a palatable alternative, if not full compensation, for the political and social cost of the 'Cyprus Problem' that had plagued Cyprus since its creation in 1960. By 2008 the per capita GDP had risen to $29,400, while in the Turkish occupied "North", the figure continued to remain at approximately one third that of the South.[6] Unfortunately, the jubilation of the Greek dominated Republic of Cyprus resulting from its accession to the EU and the adoption of the Euro currency would be short-lived as the Cypriot economy subsequently imploded as a result of the fallout of the Greek debt crisis. Cypriot banks had invested heavily in Greek government bonds which were subject to a 70% write-down "haircut" as part of the Euro zone's bailout of the Greek economy. This virtually wiped out the equity of Cyprus' two largest banks (Bank of Cyprus and Cyprus Popular Bank "Laiki") that were the backbone of the Cyprus economy.

Enter Israel

Israel for the most part has treated Cyprus, its much smaller and only non-Muslim neighbor, with indifference and on occasion distain over the past 50 years. One could argue that this originated with newly-Independent Cyprus' association with and founding membership of the Non-Aligned Movement (NAM), made up of nations of the world that sought to stay out of the Cold War confrontation that was at its most intense at the time of Cyprus Independence in 1960.[7] Under the leadership of its first President, Archbishop Makarios, Cyprus developed close ideological ties with the likes of Egypt, under Gamal Abdel Nasser; with India, under Jawaharlal Nehru; and with Yugoslavia, under Josip Broz Tito. It is therefore not surprising that Cyprus has traditionally been a firm supporter of Palestinian rights for self-determination and statehood; and thus eyed with suspicion by Israel.

In the 1980s and increasingly in the 1990s when Israel-Turkey relations grew ever closer, militarily, politically, and economically; it is not surprising that Israel-Cyprus relations were at best 'proper' if not 'frosty' as on the occasion when two alleged Israeli spies were expelled from Cyprus in 1998,[8] or in 2002 when Antroulla Vasiliou, the wife of former Cypriot President, George Vasiliou, was declared a persona non grata in Israel when a parliamentary delegation she was leading, tried to meet with Palestinian leader Yasser Arafat, who was then under house arrest.[9]

Israel- Cyprus relations thawed almost overnight in the aftermath of the 2010 Gaza flotilla raid by Israeli commandos that led to the death of 9 Turkish nationals. The Gaza flotilla raid was a military operation by Israel against six ships of the "Gaza Freedom Flotilla" on May 31, 2010, in international waters. The flotilla, organized by the Free Gaza Movement and the Turkish Foundation for Human Rights and Freedoms and Humanitarian Relief (IHH), was carrying humanitarian aid and construction materials, with the intention of breaking the Israeli-Egyptian blockade of the Gaza Strip.[10] Turkey's then Prime Minister and now President Recep Tayyip Erdogan has since adopted a decidedly anti-Israeli position in Turkey's policy towards Israel. This has earned Erdogan admiration across the Muslim world but it has left the Israel-Turkey relationship in shambles, much to the dismay of the US, a key ally of both Israel and Turkey, who sees both countries playing key but different roles in its strategic policy for the region as a whole.

While 2010 marked a low point in Israel-Turkey relations it also marked a high point for Israeli energy independence when Israel discovered the Leviathan natural gas field, the world's biggest offshore gas find of 2010, estimated at 17-18 trillion cubic feet, in the Levantine Basin between Cyprus, Lebanon, Israel, the Gaza Strip and Egypt.[11] This came on the heels of another discovery, the Tamar field in 2009, with estimated natural gas reserves of 8-9 trillion cubic feet.[12]

When Cyprus also discovered natural gas in 2011, in an adjoining area to Israel's Leviathan find, known as the Aphrodite field, since estimated at 3-6 trillion cubic feet, the prospect of a joint exploration of oil and gas in the Levantine Basin, now totaling an estimated 30-35 trillion cubic feet, brought the two countries closer together.[13] The United States Geological Survey has estimated the natural gas reserves of the whole Levantine Basin at 122 trillion cubic feet, enough to supply the world at the present rate of consumption for one year.[14] The recent rapprochement of Cyprus and Israel now includes very close collaboration on military, cultural, and political matters. Given the inherent dangers of alliances of smaller and weaker nations with more powerful nations that inevitably have broader national interests, one wonders if it is prudent for Cyprus to enter such a relationship with no holds barred. However, given the recent and ongoing financial and debt problems facing Cyprus, as well as the deepening economic recession accompanied by historically high levels of unemployment, not to mention the increasing pressure on the Republic of Cyprus to reach an overall settlement of the broader Cyprus Problem; it might no longer be a matter of choice for Cyprus but of national and economic necessity.

The Cyprus Banking-cum-Debt Crisis

Just as 'The Cyprus Problem' had begun to take on a perennial nature, to the point of been abandoned by the international community as one of those intractable conflicts that had no plausible resolution, the picture began to change quickly, taking many astute international observers by surprise. The surprise did not come from the political arena, namely, a possible breakthrough in the interminable inter-communal discussions that have been held on and off for decades, but from the economic arena.

The economy of Cyprus can generally be characterized as small, open and dynamic, with services constituting its 'engine of growth.' For the most part, the Cyprus economy since its Independence in 1960 is what would be considered in the economic literature a success story. For a number of years, Cyprus had been experiencing rising living standards, as shown by the high level of real convergence with the EU, with the per capita GDP standing at around 92% of the average for the EU27 in 2011.[15]

The services sector of the economy was the fastest growing sector and accounted for about 80.5% of GDP in 2011. This reflects the gradual restructuring of the Cyprus economy from an exporter of minerals and agricultural products in the period 1960-1974, to an exporter of light manufactured goods through the early part of the 1980s, and to an international tourist, banking, shipping and financial services centre since then. The manufacturing sector accounted for about 17.1% of GDP in 2011, while the primary sector (agriculture and fishing) continues to shrink, reaching only 2.4% of GDP in 2011. The economy of Cyprus is open, with a share of total imports and exports to GDP of over 90%.[16]

Serious problems surfaced in the Cypriot banking and financial sector in early 2011 as the Greek fiscal crisis and euro zone debt crisis deepened. Cyprus' borrowing costs had risen steadily because of its exposure to Greek debt. Two of Cyprus's biggest banks (Bank of Cyprus and Cyprus Popular Bank 'Laiki') were among the largest holders of Greek bonds in Europe and had a substantial presence in Greece through bank branches and subsidiaries. In July 2012, Cyprus became the fifth euro zone government to request an economic bailout program from the Eurogroup (European Commission, the European Central Bank (ECB), and the International Monetary Fund (IMF); collectively also known as the "Troika").[17]

Without an international bailout there is no doubt that the Cypriot banking sector would have collapsed, and with Cyprus bank balance sheet assets approximately 7-8 times the size of the economy, Cyprus itself would inevitably have defaulted. The apparent lack of urgency on the part of the Troika leading up to the March 16, 2013 initial bailout agreement was more political than economic with most of the hesitancy coming from national governments such as Germany, France, Austria, Netherlands and Finland. German officials in particular had questioned the necessity of bailing out a small island economy that represents no more than 0.2% of Euro zone output, arguing that such a 'small-scale' sovereign default would not present a systemic risk to the Euro zone. According to this argument Cyprus was not eligible for aid unless it threatened contagion and hence the stability of the entire euro region.

In stark contrast, the ECB's position was that the approximately 10 billion Euro cost of a Cyprus bailout was a small amount to pay for the peace of mind it would bring to a Euro zone still recovering from the much larger bailouts of Ireland, Portugal, Spain, and especially Greece.[18] After all, it is the fact that Cypriot banks were out of proportion to the Cyprus economy, that Cypriot banks were overloaded with Greek debt and that the Greek debt suffered a 70% haircut that ultimately led to the Cyprus banking crisis. Unlike Greece that experienced a true sovereign debt crisis, the Cyprus crisis is primarily a banking problem. However, since the Cyprus banking sector is such a large multiple of the nation's GDP, any bailout of the state would be a bailout of the private banking sector and vice versa.

Thus, the main reason for the reluctance of German and other north-European governments to be more forthcoming with aid for a fellow Euro zone member, as had been the case with Greece, was not to be seen as using German taxpayers money to aid private banks that had grown too big for their own good and whose main depositors are foreign, non-EU nationals, and primarily Russian to boot. The fact that the German media was full of allegations that many of these Russian bank deposits are the product of money laundering, or of tax avoidance, if not outright tax evasion, did not help matters either.

Consequently, it had been made clear to Cyprus that the memorandum for assistance for Cyprus would include a section on money laundering which would set out measures that Cyprus must examine on the issue and that this would be monitored.

On the other hand, it is also known that these primarily northern Euro zone nations want taxes in all member nations of the EU to be brought into line upwards so that those tax rates are closer to their own levels. They are afraid that lower taxes in places such as Cyprus, Luxembourg, and Ireland attract foreign capital flows and act as a source of tax evasion. Consequently, they are seeking closer EU co-operation on tax evasion and they saw an opportunity to squeeze countries such as Cyprus to reduce legal loop holes for tax evasion and to force them to raise their tax rates. Unfortunately, no clear distinction is made between tax avoidance and tax evasion and by extension money laundering allegations.[19]

Lastly, it was just not acceptable to the well-balanced and diversified economies of the North that the financial or banking sector of a member nation of the EU could possibly be 7-8 times the size of its economy. Such an overweight sector must be cut down to size, namely, to the weighted size of the EU average which is at most 3 times the size of the national economy.

Although, all this was common knowledge, leading up to the decision of March 16, 2013, the actual terms were a shock not only to Cyprus but also to the financial markets and many international observers. Cyprus had officially requested 17 billion Euros in June 2012 but the Euro-zone finance ministers reached a deal to provide only 10 billion Euros in bailout funds with an additional 5.8 billion Euros to be generated by a bank deposit tax or a 'haircut' in current jargon.

What was most striking and a first in modern banking times is that according to the terms of the bailout agreement all bank deposits would bear the brunt of the haircut, given that Cypriot banks had relatively few bondholders. The Cyprus banks at the time held close to 70 billion Euros in deposits, and almost half of the deposits were believed to be from non-resident Russian citizens, with Russian banks having $12 billion and Russian corporations about $19 billion at the end of 2012, according to Moody's, the rating agency.[20] According to the agreement Cyprus also agreed to raise the country's nominal corporate tax rate, the lowest in Europe, from 10% to 12.5%. Unlike other Euro bailouts, Cyprus would not be given a 'debt haircut' but a 'deposit haircut' instead.[21]

Faced with an ultimatum from the ECB that emergency funding to Cypriot banks would be terminated, and a 'take it or leave it' attitude from the Eurogroup, Cyprus agreed to the terms of a 'revised' bailout in the early hours of Monday, March 25, 2013. Unlike the initial agreement, Cyprus ended up agreeing to guarantee all bank deposits less than 100,000 Euros but agreeing to 'shut-down' its second largest bank (Cyprus Popular Bank 'Laiki'), consolidate if not dismantle its largest bank (Bank of Cyprus) by ceding the operations of all its branches in Greece to Greek banks, as well as accepting a one-time levy (haircut) on bank deposits exceeding 100,000 Euros at a rate of at least 40-60% as needed. This of course would be coupled with short-term capital controls and other administrative regulations as needed.

It was clear from the March 28, 2013, bailout agreement that the Cyprus economy would contract severely. However, it was not long before another bombshell fell when the terms of the agreement were "updated" at a meeting of the 17 finance ministers of the Euro zone in Dublin on April 12, 2013, to reflect a more detailed "debt sustainability analysis" which showed that the economy was actually in worse shape than initially assumed. In order to keep its debt and deficit from spinning out of control and to meet the terms of the 10 billion Euro bailout secured just two weeks earlier, Cyprus would now need a total of 23 billion Euros of financing, of which Cyprus would have to contribute 13 billion Euros, more than twice what was originally expected. In so doing, Cyprus also agreed to sell 400 million Euros of its gold reserves, or an estimated 10 tons from its 13-ton reserve, renegotiate the terms of its 2.5 billion Euro loan with Russia, and impose further losses on Bank of Cyprus depositors and creditors. It was also suggested that holders of Cypriot government bonds could be urged to agree to a debt swap (haircut).[22] Dutch Finance Minister Jeroen Dijsselbloem and German Finance Minister Wolfgang Schauble made it crystal clear that the extent of aid from the Euro group would remain at 10 billion Euros, with 9 billion coming from the ECB and the remaining 1 billion from the IMF.[23]

No doubt the repercussions of the terms of this bailout agreement will be far reaching as this is the first time that bank depositors have been asked to shoulder any of the losses of bank failures. While Euro officials have been quick to claim that Cyprus is a unique case and that depositors' money is safe, no matter what the circumstances; it would appear to be contrary to the ECB's efforts to reassure financial markets and depositors that the European Banking System is sound and depositors have no safer place to keep their money than EU banks. Cyprus may be small in just about all respects from a global perspective but it is once again living up to its reputation as a potential flashpoint of regional if not global significance, especially as global integration makes contagion more the norm than the aberration. It remains to be seen if a Euro-wide unified banking system is feasible if it is perceived that there is a double standard as far as the integrity of bank deposits is concerned, and where a Euro in Cyprus is not the same as a Euro in Germany. This will only add to the perception of a growing North-South rift in the Euro zone.

An Energy Solution for Cyprus

Newly elected Cyprus President Nicos Anastasiades appealed to Cypriots the day after the terms of the initial bailout were made public to accept the levy on bank deposits as the "least painful solution." He went on to say that depositors would be offered bank shares covering the full amount of their losses, while those who left their savings in banks for another two years would be rewarded with bonds backed by future income from exploiting Cyprus's natural gas deposits. It was not clear at the time if these were off-the-cuff remarks of a recently elected politician or actual policy prescriptions. What is clear is that no one expected the backlash that would ensue, not only from Cypriot bank depositors but also in European financial markets and beyond. Furthermore, it was also clear that if Cypriot banks, that represent its most important sector and engine to growth in recent decades, were to be downsized and if all the restrictions and conditions imposed on Cyprus through the bailout agreement were fully implemented, it is highly unlikely that Cyprus would survive as a regional financial center. In fact the whole purpose of the exercise was to put an end to the 'Cyprus banking model' once and for all.

The fallout from the whole financial crisis in combination with the onerous terms of the bailout agreement, have resulted in a predicted recession, deeper than anything Cyprus has experienced since the Turkish invasion and occupation of 1974. Thus, all hope for the Cyprus economy now appears to lie with future development of its oil and natural gas resources; a scenario that is by no means a foregone conclusion.

The potential future revenue flows from the exploitation of offshore natural gas reserves again came into play when Cypriot Finance Minister Michaels Sarris was in Moscow a few days after the Cypriot House of Representatives unanimously rejected the Eurogroup's initial bailout offer, suggesting a role for Russia in Cyprus' energy development in return for Russian aid with the bailout efforts. The initial Russian response was unexpectedly negative, even though Russian nationals represent at least a third of bank deposits in Cypriot banks. Russia has coveted a foothold on the Island for decades, both militarily (possibly a naval base, especially now that its position in Syria is in doubt) and more recently for the exploitation of Cypriot natural gas reserves, given that Russia is Europe's largest supplier of natural gas, and has as its key energy objective to keep it that way. Russia's recurring and most recent troubles with Ukraine and its annexation of Crimea only reinforce Russia's interest in Cyprus and Levantine Basin energy reserves in general.

However, any substantive revenues from natural gas is likely to be 5-8 years away at the earliest, and the development of any energy resources will now be much more difficult to orchestrate given the stark financial situation the Cypriot authorities presently find themselves in. Furthermore, Cyprus, following its recent major financial crisis, is now negotiating the future of its energy sector from a greatly weakened position. This position is further weakened by the political pressure that is put to bear on Cyprus to reach a political settlement of the Cyprus Problem. The weak economic position Cyprus presently finds itself in, has given outside interested parties an opportunity to press for a compromise in the reunification talks presently taking place between the Republic of Cyprus and the self-declared TRNC. For these outside parties, any solution is better than no solution, given the long term nature of the Cyprus problem and the constant threat of flair-ups that could draw in Greece and Turkey (fellow NATO member nations), as well as the UK (former colonial ruler) and the EU (now that Cyprus is a EU member state). Under the 1960 Treaty of Guarantee, Britain, Greece and Turkey pledged to ensure the independence and territorial integrity of Cyprus as well as respect its Constitution. Add to this chorus, the US and the UN, both of which have worked for decades, possibly for different reasons, for a Cyprus Solution. The strategy employed is once again a classic carrot and stick approach, with the potential windfall from natural gas revenues smoothing away any remaining obstructions to an overall settlement, while the current dire economic straits the Cyprus economy finds itself in making the potential costs of another failed round of negotiations for an overall settlement even greater, irrespective of whether the sought after agreement is a just one or even workable.

Furthermore, it goes without saying that the weakened economic and political position Cyprus finds itself in, further accentuates the importance to Cyprus of a close energy partnership with its neighbor Israel. What might have been a matter of strategic decision making before, is now possibly the only trump card Cyprus has to play. This trump card, however, is even more precarious as its value is primarily dependent on Israel's willingness to play its energy hand in partnership with Cyprus. In this regard, Israel has yet to declare its true intentions. Alternatively, it could also be because Israel has yet to map out for itself its long term energy path. However, a true energy partnership between Israel and Cyprus, is increasingly doubtful given that an inevitable Turkey-Israel rapprochement inches ever closer, edged along by Israel's national interest in restoring its strained relationship with Turkey, its erstwhile only non-Arab ally in the region; as well as the urgent prodding of the US, that is anxious to see its two main allies in the region restore their former military partnership. But even if the Turkey-Israel relationship is never restored, Turkey will always present an obstacle to the Republic of Cyprus' exploitation of any oil and gas reserves in its EEZ, as Turkey continues to occupy the northern third of the Island and purports to speak on behalf of and as a defender of the interests of the Turkish Cypriot minority. The role of Turkey as an obstacle to Cyprus energy development as well as its role as spoiler in the Cyprus-Israel energy relationship will be addressed subsequently.

More recently, Israel's potential energy partnership with Cyprus has been further strained by Israel's commitment in recent months to supply both Jordan and the Palestinian Authority with natural gas. These developments reduce the pressure on Israel to commit itself to an energy partnership with Cyprus at the present time. Furthermore, Egypt is also shaping up to be a potential lucrative market and strategic energy partner for Israel for a number of reasons. These latest developments have resulted in Israel placing its erstwhile energy partnership with Cyprus on the back burner pending further developments including the possible discovery of additional natural gas deposits in Cyprus' EEZ.

Israel, A Nascent Energy Power

The potential for a mutually beneficial energy partnership between Cyprus and Israel is predicated on a combination of natural and man-made circumstance. In terms of the former, geographic location is paramount. Both Cyprus and Israel, border together with Lebanon, the Gaza Strip, and Egypt, what is known as the Levantine Basin. According to the US Geological Survey, the Levantine Basin is estimated to hold up to 122 trillion cubic feet of natural gas. However, until recently, this area had been neglected by major oil and gas corporations in favor of more abundant and already known sources of hydrocarbon deposits in the Persian Gulf and North Africa. This all changed in January 2009 when Israel working through a Houston-based Texas firm, Noble Energy, discovered natural gas in the Tamar field, located roughly 50 miles off Israel's northern coast. The Tamar field is estimated to hold 8.4 trillion cubic feet of gas.[24]

Gas began flowing to Israel from the Tamar field on March 30, 2013, with the Israeli Energy and Water Resources Ministry estimating that Tamar could meet between 50% and 80% of the country's natural gas needs over the next decade. The Tamar project was not intended to become a primary source of natural gas for Israel, but rather to bolster Israeli energy security by making the country less dependent on natural gas imports from Egypt. In fact natural gas provided by the Arish-Ashkelon pipeline from Egypt, brokered through the East Mediterranean Gas Company, an Egyptian-Israeli natural gas consortium in 2005, officially was shut down in April 2012, when Egypt's state-owned natural gas company announced that it would pull out of the 2005 agreement, and the Israel Electric Corporation formally followed suit. This was not an unexpected development as Israel's energy partnership with Egypt had been beset with problems from the start. Egypt, a net exporter of gas was facing its own problems with rising domestic demand and had renegotiated a price increase in 2008 when it became known that the initial price agreed to was significantly below the world market price. Further strains on Israeli-Egyptian relations resulted with the onset of the Arab Spring in 2011 which further curtailed Israeli imports from Egypt. Furthermore, militants in the Sinai Peninsula had frequently targeted the natural gas pipeline after Egypt's former president Hosni Mubarak was deposed, shutting down flows for weeks at a time, until the gas supply came to a complete stop.[25]

The fact that natural gas flows from Egypt were shut down in April 2012, and that domestic reserves of natural gas from the Mari B reservoir in the Yam Tethys field located off the coast of Ashdod were been depleted much faster than expected, led to stopgap measures including the building of a floating liquefied natural gas import terminal in 2012 by the state-owned Israel Natural Gas Lines Ltd. This floating natural gas terminal was built in record time and actually received its first shipment of liquefied natural gas from BP in January 2013. This floating import terminal was never intended to become a primary source of natural gas for Israel, but rather to bolster Israel's energy security by making the country less dependent on its pipeline with Egypt. In fact, imported liquefied natural gas costs three to four times as much as domestic natural gas. Consequently, production of Tamar natural gas serves as a stable source of energy fully under Israeli control, thus promoting Israeli energy security.[26]

The Tamar gas has proven to be of great importance for Israel's economy. As a result of gas flowing from this field, as well as other more significant offshore gas fields in the future, Israel will achieve energy independence for the first time in its history. The price of electricity is expected to decline after rising significantly following the cutoff of gas supplies from Egypt, and state coffers are expected to overflow with funds, that if directed into a special fund (i.e., sovereign wealth fund) and managed appropriately will contribute to the wellbeing of future generations. More specifically, Israel's trade balance can be expected to improve significantly, its currency will appreciate, and its economy could easily grow by an additional 1.0% per year going forward.[27]

While the long run energy picture for Israel is bright, numerous short run issues remain in achieving energy security even as the Tamar gas continues to flow. First, as in the case of the Arish-Ashkelon pipeline, we are talking about one single pipeline. This pipeline reaches Israel's coast in the vicinity of the city of Ashdod and from there supplies gas to all consumers. No matter how well guarded, all it would take is a single accident or deliberate sabotage and gas supply could be disrupted certainly for days and possibly for weeks. Second, while a second pipeline was ruled out, the erection of an additional intake terminal for the offshore gas is still a possibility; but again due to cost considerations, opposition by local residents, and opposition from defense authorities to specific locales, no additional terminal has yet to be built.

It goes without saying that Israel had no clear vision for exporting natural gas from the Tamar field given Israel's dire need for energy to satisfy its domestic market. However, matters began to change with the discovery of an even larger offshore gas reserve estimated at 16-18 trillion cubic feet, the Leviathan natural gas field, in December 2010, located also in the Levantine Basin, approximately 90 miles west of Haifa. Thus far, energy companies operating in Israel have discovered a total of seven offshore gas fields with a confirmed combined reserve of about 32 trillion cubic feet.[28]

While there is an obvious constituency for putting domestic interests first, it is also clear that the energy companies would only be willing to commit to developing Israel's gas industry if they could be assured of a gas export market that would be sufficiently more profitable to justify the necessary investment. In October 2011, the Tzemach Committee (headed by the director-general of the ministry of energy, Shaul Tzemach) was named to study the issue. The initial recommendation of the Tzemach Committee in August 2012 was to set aside 450 billion cubic meters (bcm) (47%) of a presumed resource base of 950 bcm of gas for Israeli domestic needs. This was subsequently changed by a Cabinet decision to a 540 bcm (60%) retention figure. This was interpreted by the Israeli media as a 40% cap on gas exports.[29] Little attention was paid to the fact that the size of the resource base itself was constantly changing, as with the discovery of the Karish gas field in July 2013, and that the resource base itself as well as Israel's domestic requirements are at best estimates. The Tzemach Committee assumed Israeli gas demand averaging 18 bcm per year over the next 25 years, yet at present, Israel consumes around 6.5 bcm a year. Presumably this provides sufficient political wiggle room for all the parties involved going forward.

Israel is presently ahead of neighboring countries in terms of natural gas exploration and drilling operations, although Egypt had a head start but has recently been beset with various difficulties both political and economic. As indicated, Israel started production in the Tamar field for internal consumption in March 2013. More recently, Israel has signed gas export agreements with neighboring countries and regions, such as the West Bank and Jordan, in an attempt to assume the main role in the regional gas industry in the eastern Mediterranean. Israel will export about 66 billion cubic feet of gas from the Tamar gas field to Jordan as of 2016 for a 15 year period. Exportation is expected to start upon the completion of the construction of a short pipeline south of the Dead Sea. In January 2014, Noble Energy signed a \$1.2 billion contract with the Palestinian Electric Company to supply the power station in Jenin in the northern West Bank with natural gas from the Leviathan gas field for the next 25 years. It must be noted that the gas to be exported to the West Bank was considered part of the 60% domestic consumption share of Israel, which is not intended for export. The Palestinian Authority accepted this agreement despite the fact that Israel is still objecting to the development of the Gaza Marine field off the coast of the Gaza Strip.[30] According to the British company BG Group, this field which was discovered in 2000, has reserves of about 1 trillion cubic feet and it can supply Palestinian power stations with gas for the next few years, thus eliminating the need to import gas from Israel. However, Israel shut down that operation in 2001, after a new Palestinian uprising began. When Hamas took over in Gaza in 2007, Israel imposed an economic boycott, causing BG to pull out of negotiations with the Israeli government and finally shutting down its office in Israel in 2008. The whole operation has been on hold since then.[31]

As noted this last agreement was deemed to fall under Israeli "domestic" gas consumption and thus leaves more for export under the "40% gas export cap" agreement. In the meantime, Israel is also promulgating the laws required for the next phase of its energy industry development, which is related to internal gas distribution through the construction of a national pipeline network. This leaves the last and most difficult phase of Israeli gas industry development, the size, method, and direction of its gas exports. Negotiations are ongoing in this regard and the final outcome is both uncertain and unpredictable. The list of issues that need to be addressed is long: the taxes it must impose on energy companies operating on its territory, the quantities of gas to be exported, the required domestic gas reserve ratio it must keep for its own energy security, the delimitation of its EEZ with its maritime neighbors (including both Lebanon and the Palestinian Authority/Gaza Strip), whether gas exports will be through fixed pipelines and if so the route(s) of such pipelines, if gas exports are to be in the form of liquefied natural gas (LNG) whether this will be via LNG terminals on Israeli territory or on neighboring Cyprus territory, or from a floating LNG platform.

Will Israel Go it Alone, or in Cooperation with Cyprus?

A significant decision for Israel going forward is whether to engage in its new role as an energy exporter alone, or in cooperation with its much smaller and only non-Muslim neighbor Cyprus. While this is a strategic decision for Israel as a regional power, it is of paramount national importance to Cyprus with an economy that is still reeling from the after-effects of its recent financial crisis and presently in the midst of a deep recession. Furthermore, without the protection of Israel's defense umbrella it is doubtful if any energy company would brave the threats of Turkey to prevent such developments with force if necessary.

Given Cyprus' present weak economic situation and the constant threats coming from Turkey, Cyprus' erstwhile allies within the EU, with the full support of the US and the UN, have all seized the opportunity to push for a settlement of the Cyprus Problem that would remove an international headache for the West, and the international community in general, that has been intractable these past 60 years. The proposed solution amounts to the resurrection of a version of the 2004 Annan Plan that was soundly defeated by the Greek Cypriots (76% against), although accepted by the Turkish Cypriots (65% in favor) in separate referenda. That plan would legitimize the Turkish invasion and occupation of northern Cyprus by Turkey and would de facto divide the island between Greek and Turkish Cypriots as political equals. The plan envisions a bizonal, bicommunal, politically equal federal state with a single national identity. As is usual with these proposed settlements, the devil is in the details.[32]

In reality, Israel could develop its natural gas energy export sector single-handedly (i.e., without Cyprus), given that Israeli proven gas reserves, standing at 32 trillion cubic feet, presently dwarf those of Cyprus at approximately 5 trillion cubic feet. Of course, thus far only one sector (Block 12) of Cyprus' EEZ has been fully surveyed and expectations are high that there are much larger deposits to be found, if not in that sector, in adjoining sectors of Cyprus' EEZ. However, any energy deposits, other than what has been proven, remain at best an estimate, if not pure speculation.

On the other hand, collaboration with Cyprus could prove to be quite rewarding to Israel going forward. First, the more proven gas reserves that can be pooled for development and export, the greater the economies of scale and the lower the cost of production and processing. Second, an Israeli partnership with Cyprus that is willing to provide a location for the construction of a liquefied natural gas (LNG) processing site and export terminal, would relieve Israel from the domestic debate that such a site within Israeli borders would entail. Third, this off-shore terminal location solution would reduce the environmental impact on Israel proper. However, it would add to the already large security burden such an offshore facility would present, and more so if the site was on the territory of another nation. Furthermore, it is not clear how depending on energy installations in another country necessarily increases Israel's energy independence or energy security. Fourth, Cyprus, being a EU member nation, would grant Israel with a direct political and geographic link to the vast, highly lucrative, and growing European energy market. It could thus be argued that natural gas exports from Cyprus/Israel to the EU would benefit from EU financial and political support as this would further diversify EU energy supplies and increase the EU's energy security. It would also further strengthen the EUs support of Israel vis-a-vis the Palestinians, as well as in the Israeli-Arab conflict overall. Fifth, a direct energy link between Cyprus/Israel and the EU via Greece, another EU member, would enable the EU to further its energy security and energy independence by bypassing both Russia and Turkey. Both Russia and Turkey are questionable as long-run sources of secure energy for Europe. Reliance on Russia as a secure source of energy is clearly under question as recent Russian actions in Ukraine, and more specifically Russia's annexation of Crimea, demonstrate. Finally, recent developments in Turkey are also unsettling for Israel with the present Turkish leadership under Prime Minister Recep Tayyip Erdogan, moving Turkey further and further towards a more Islamic and authoritarian regime. As already mentioned, Israel has been singled out for harsh criticism by Erdogan for its treatment of Palestinians. Following the 2010 Gaza flotilla raid by Israeli commandos that led to the death of 9 Turkish nationals and despite a formal apology by Israel with US encouragement, relations that were once warm remain cold. These same reasons should give Israeli policymakers reason to question the reliability of Turkey as a secure energy market or as a conduit for its gas exports to Europe. If anything, Israel should aim for a diversity of export outlets for its energy if security is an objective. Furthermore, it might be wise for Israel to look east to Asia as well as west to Europe to secure markets for its gas exports over the long term.

What Form should Gas Exports Take: Pipeline or LNG?

Maybe one of the first decisions Israel (and Cyprus for that matter) has to make is whether to rely on pipelines or LNG (or possibly compressed natural gas, CNG) for its gas exports. If initial cost is the number one issue, clearly pipelines are a more cost effective option. In that regard, and up until very recently, a pipeline to Turkey was considered to be the major contender. Turkey is relatively close by; its economy is growing and it is expected to see domestic demand increase from 43.5 bcm in 2012, to as much as 60 bcm by 2020. Furthermore, Turkey has only secured 6 bcm of the additional 16-17 bcm of gas it will need to import from Azerbaijan, and that will not start till 2018-19.[33] Over the past three years, Turkey has experienced some of the fastest growth in energy demand of countries in the Organization for Economic Cooperation and Development (OECD). Unlike a number of other OECD countries in Europe, Turkey's economy has avoided the prolonged stagnation that has characterized much of the continent for the past few years. The country's energy use is still relatively low, although it is increasing at a fast pace. According to the International Energy Agency (IEA), energy use will continue to grow at an annual growth rate of around 4.5 per cent from 2015 to 2030, approximately doubling over the next decade.[34]

However, a pipeline to Turkey could prove to be a political nightmare for Israel. More than likely the Israeli foreign ministry likes the idea because it would help improve ties with an important neighbor, and the defense ministry likes the idea of improving security ties with what recently was a close military ally. However, it is not clear if a pipeline to Turkey is possible without first settling important maritime boundary issues between Israel and Lebanon, or even a full solution of the Cyprus Problem. One thing is for sure, any land pipeline through Lebanon and Syria or along their shallow seabed would reduce both operating and construction costs. However, such a route would entail unacceptable political and security risks for Israel, not to mention the open hostility to such an option by both Lebanon and Syria, both of which remain formally in a state of war with Israel.

Thus, any pipeline east of Cyprus would have to run through waters that are Cypriot, unless Lebanon and Syria acquiesce to a path through Lebanese and Syrian waters. Cyprus and Israel (2010) have delineated their EEZ boundaries as has Cyprus and Lebanon (2007), although Lebanese legislators have yet to ratify that agreement. Cyprus had already delimitated its maritime boundary with Egypt in 2003. All three are model agreements based on the application of the median line and with a third party dispute settlement provision, between an island state and its continental neighbors in accordance with Regime of Islands, Article 121 of the 1982 United Nations Convention on the Law of the Sea (UNCLOS III). The United Nations defined the land border between Lebanon and Syria in 2000, but not the delimitation of their maritime zones (territorial sea, contiguous zone, exclusive economic zone and continental shelf).[35]

As it turns out the respective claims of Israel and Lebanon overlap by about 860 square kilometers (332 square miles) in a potentially rich portion of the Levant Basin close to already proven Israeli and Cypriot gas fields.[36] Although the potential path of any pipeline east of Cyprus may be in Cypriot waters (according to UNCLOS and international law), in reality any route taken by a pipeline from Israel to Turkey to the east of Cyprus would also have to pass through waters controlled not by the Republic of Cyprus but by Turkey (and the TRNC).

Nonetheless, veteran observers of the region were not surprised when the Israeli media announced on March 23, 2014, that more than 10 companies had submitted bids for the tender of a proposed undersea pipeline that would export natural gas from Israel's offshore Leviathan field to the Turkish port of Ceyhan, a distance of 450 kilometers (280 miles). What is also interesting is that the pipeline would run from a floating production, storage and offloading (FPSO) ship, avoiding for the time being the decision on a land terminal either on Israeli or Cypriot territory. However, the proposed pipeline would lie totally in Cyprus' EEZ, averaging a depth of 2,000 meters (6500 feet) and costing in the vicinity of $2.25 billion, thus bypassing both Lebanon and Syria, as well as avoiding the disputed maritime boundary between Israel and Lebanon. Of course, a pipeline of such depth would require significant engineering and technical expertise rivaling other pipeline initiatives such as North Stream (Baltic Sea) and South Stream (Black Sea).[37]

The technical obstacles of course pale in comparison to the political obstacles that the Cypriot coast line route present. Such a route would require the consent of the Republic of Cyprus, which, based on long-standing positions held by the Cypriot government, would be out of the question without a political solution to the de facto division of the Island, between the recognized

Greek-dominated Republic of Cyprus in the south, and the Turkish-occupied, TRNC, recognized solely by Turkey.

An alternate route that would avoid the Lebanon/Syria problem altogether would be a pipeline overland Cyprus and from there to Turkey. If distance, engineering and cost were the only consideration, this might be the best option. This would entail a subsea line from the Israeli and Cypriot gas fields to Vassiliko, on the southern coast of Cyprus, then an overland pipeline to the northern coast, followed by a subsea pipeline to Turkey. Unfortunately, at the moment this remains a pipedream that is even less probable than the route east of Cyprus, baring the solution of the Cyprus Problem, given that laying a pipeline from the southern Government controlled coast of Cyprus to the Turkish occupied northern coast is at the present time politically impossible.

A third pipeline route option would be to lay a pipeline west of Cyprus to Crete and from there to mainland Greece and on to Europe. This would avoid the Israeli-Lebanon-Syria problem and would avoid the Cyprus-Turkey problem but would need to pass through waters that are even more diplomatically murky and of course much deeper, up to 3000 meters, thus more difficult from an engineering point of view, not to mention of much greater distance (1040 kilometers versus 450 kilometers), and of course at much greater cost (estimated at approximately $15-20 billion).[38] The problem with this option is that Greece, Turkey, and Cyprus have yet to declare what their respective EEZs are in this area, let alone reach an agreement on the delimitation of their maritime borders. However, two important consequences of a pipeline west of Cyprus are first, it bypasses turkey altogether, both as a market for gas exports but also as an energy route to the European market. And second, an Israeli partnership with Cyprus and Greece would provide Israel with a direct geographic and political link to the very important EU energy market; given that both Cyprus and Greece are EU member nations.

A straightforward interpretation of the Regime of Islands, Article 121 of the 1982 United Nations Convention on the Law of the Sea (UNCLOS III) would give Cyprus a common boundary with Greece's EEZ, thanks to the Greek island of Kastelorizos off the coast of Turkey.[39] While much is been made regarding the importance of EEZ boundaries, and rightfully so, it must be noted that UNCLOS does not give nations the right to prevent third parties from laying pipelines, phone lines, etc., thru their respective EEZs, but it does require the approval of the host nation of the actual pipeline path, thus effectively giving the host nation veto power over pipelines through its EEZ. However, more than likely in this case, Turkey would want to claim a common boundary with Egypt's EEZ by discounting the existence of the Greek island of Kastelorizos. This was shaping up to be a difficult problem for Cyprus and Greece, given the fact that Turkish Prime Minister Erdogan was a strong supporter of President Mohamed Morsi of Egypt and it was not clear what position Egypt would take in this matter. However, things changed quickly when President Morsi was deposed in a military coup. The present Egyptian regime headed by Abdel Fattah el-Sisi, cannot be pleased with the support that Turkey under Erdogan gave the Morsi government and is likely to now side with Cyprus and Greece on this matter, especially if this political alignment might provide access to the vast EU market for Egyptian gas in the future. However, in the short run, it appears that Egypt is more likely to be an importer of Israeli natural gas rather than an exporter of natural gas to Europe or anywhere else for that matter, due to Egypt's growing domestic demand and serious Egyptian gas production and distribution problems under both the Mubarak and Morsi regimes. Access to Levantine Basin natural gas that would alleviate the current energy shortage in Egypt would also reduce the political pressure, both domestic and international, on a less than democratic Egyptian military regime that is still trying to suppress opposition from the Muslim Brotherhood and establish its legitimacy.

For the time being neither Athens nor Ankara seem to wish to deal with this very hot EEZ issue as it relates to Cyprus, which is just as well given the fact that they have yet to delimit their maritime boundaries in the Aegean, an issue which is considered even more problematic and has not been directly addressed due to its obvious sensitive nature for both sides. Of course there is the possibility, though slight, that this problem might be avoided altogether if a pipeline route to Crete and mainland Greece could be found through Egypt's EEZ. Either way, a pipeline to Greece for Israeli and Cypriot gas (and maybe even Egyptian gas) would be even more complex than a route east of Cyprus to Turkey. It would require state of the art technology to lay pipes at depths of 3000 meters or greater, and at a cost significantly more than that of a pipeline to Turkey, generally estimated at $15-20 billion.[40]/[41] Thus, cost alone might rule out such a project, unless, of course, Greece finds gas in the vicinity of

Crete or some other convenient intermediate location; or Cyprus finds significantly larger gas deposits in its remaining EEZ.

Unfortunately for Cyprus, recent developments have made any pipeline plans for Cyprus natural gas exports even more remote as Israel is looking for an intermediate solution to its energy future by developing further its regional energy market by adding Egypt to its list of neighborhood clients that already include Jordan and the Palestinian Authority. Not only does this reduce the transportation cost due to proximity but such short distances can easily be traversed with relatively inexpensive pipelines and in the case of Egypt, connected to the existing Egyptian pipeline network.

While this development might appear surprising to outsiders, this might prove to be both a politically wise and economically sound energy option for Israel. First, Egypt is facing a domestic natural gas shortage and thus presents a nearby market for Israeli natural gas. Second, the decrease in Egypt's natural gas production has resulted in under-utilized existing LNG plants, reducing the needed new investment in energy infrastructure. Third, the existence of existing LNG plants and existing pipeline network in Egypt opens up the possibility of Israeli natural gas reaching the Asian market, where LNG fetches twice the price the EU pays. Fourth, the close proximity of Egypt together with the existing Egyptian pipeline network would reduce the transportation cost of Israeli natural gas to a fraction of the cost of constructing any pipeline to Turkey. And to make things even more difficult for Cyprus' energy future, any pipeline from the Levantine Basin to Turkey would cost a fraction (estimated at $2.2 billion) of any such pipeline linking Israel and Europe by way of Cyprus and Greece, the so-called South-East Corridor (estimated at $15-20 billion).[42]

Liquefied Natural Gas (LNG) Option

In as far as where this leaves Cyprus' energy options, given the political problems all pipeline routes would entail, as well as the significant cost of an Israel-Cyprus-Greece pipeline, it would appear that liquefied natural gas (LNG) would be the preferred option for Cyprus, but should also be an option that Israel pursues in tandem with its pipeline plans. While LNG is clearly the preference of Cyprus, Israel has yet to commit to this option. In theory, the LNG option could proceed irrespective of an overall solution to the Cyprus Problem.

It could proceed without a return to full normal relations between Israel and Turkey. It could proceed without Cyprus having to deal with Turkey, which does not accept the legitimacy of the Republic of Cyprus. It would not require the declaration of EEZs and delimitation of the maritime boundaries of Cyprus and Greece, Cyprus and Turkey, or Greece and Turkey. It would also avoid any conflict with Turkey (or possibly Egypt) that any pipeline option would entail. It would also strengthen and cement Cyprus' position as a regional energy hub, especially if the LNG plant/terminal is located, as planned, at Vassilikos on the southern coast of Cyprus. This plant would be connected by subsea pipelines to the Israeli Leviathian gas field and the Cyprus Aphrodite gas field, as well as any future gas fields yet to be discovered.

For Israel, it would avoid any domestic opposition to situating the LNG terminal on Israeli territory given the potential environmental threats and the heightened threat of sabotage such a target would present if located in Israel proper. Given Cyprus' dire economic situation and its precarious political circumstances and the ever present Turkish military threats, any fears of sabotage are likely to fall on deaf ears in Cyprus. Of course Israel would have to extend its naval presence and defense umbrella to encompass the southern coast of Cyprus but this is in line with Israeli defense planning in any case. However, the cost of building a new LNG facility will also be high, although less than the projected cost of a pipeline to Greece. Building costs are estimated at $10 billion for the initial terminal and one liquefaction unit, with the cost increasing by an additional $8b and $6b, if in the future a second and third unit is added respectively.[43]

But there are other benefits to LNG over pipelines for both Israel and Cyprus over the long run; namely, reliability and thus the security of their export markets. Much has been made of Israel-Cyprus-Greece providing a southeastern energy corridor for Europe which would diversify European energy supplies and contribute to European energy security by providing Europe with an alternative to Russian energy sources and supply lines (especially bypassing Ukraine), as well as an alternative to a Turkey-Greece-Bulgaria energy corridor (thus bypassing Turkey). However, with rapidly increasing world natural gas energy supplies and the diversification of natural gas energy sources, including the growing availability of US LNG directed for export, it behooves both Israel (and Cyprus) to look both east and west for their natural gas exports. Not only is the demand for natural gas in Asia growing at 3.3% per year versus 0.7% per year for Europe[44] but the price is 50% higher.[45] Unless, Israel is prepared to construct a pipeline to the Red Sea, a highly unlikely proposition given the experience with the Egyptian pipeline, the export of natural gas through the Suez Canal to markets in Asia would have to be in the form of LNG. Of course any Israel-Egypt energy partnership would preempt a Cyprus LNG option in the short-run, but it is doubtful that the Israeli defense establishment would agree to an export strategy that relied solely on Egypt even if backed by the current Egyptian leadership under el-Sisi.

In fact, LNG is exactly the intent of the memorandum of understanding signed with the government of Cyprus on June 26, 2013, by the Delek Group and Noble Energy, the companies currently developing the major offshore gas fields discovered so far in both Israeli and Cypriot waters. The Memorandum of Understanding (MoU) aims to put in place the basic terms of a formal agreement to develop a joint two-train LNG plant at Vassilikos on the southern coast of Cyprus, with operations to start in 2018-19. However, it is not clear what the intentions of Israel are at the present, given that Israel has since the signing of that agreement proceeded to accepted bids for a pipeline to take gas to Turkey east of Cyprus (March, 2014). More than likely, Israel is keeping all its options open and will not reveal its true or final intentions till it chooses to.

However, no nation has yet approved the construction of a LNG plant primarily designed to serve its own resources but to be located in another country. It would certainly raise security questions and inevitably increase the cost of providing de facto military security for such an installation as well as security in the naval region stretching from the coast of Israel to the southern coast of Cyprus where the Israeli and Cypriot gas fields lie. Not only are there logistical and technical concerns for such a prototype arrangement, but undoubtedly a significant financing commitment would be necessary on the part of Israel as the cost of such a LNG processing plant and terminal would be in the range of $10-15 billion plus. A project of such proportions is clearly beyond the means of Cyprus to manage single-handedly, even if it was not beset by its recent financial woes. However, even if financing was not a constraint, Cyprus proven natural gas reserves thus far cannot justify the cost of a LNG processing plant and terminal plus additional supporting infrastructure. Without Israeli gas and Israeli financial participation, Cyprus' energy future is less than encouraging. It would also require international energy companies to weigh their commitment to such a project given that Turkey has threatened to deny these companies access to Turkish investment projects if they participate and even resorting to military action. Given the size and rate of growth of the Turkish 'emerging market' economy in comparison to the non-existing economic clout of the Cyprus economy, Turkish economic threats will no doubt be studied closely by all concerned.

Of course there is still the option for Israel to go it alone, an option that increases in probability the longer an agreement between Cyprus and Israel fails to materialize, but that would require building a LNG plant in Israel itself, which, given its limited Mediterranean coastline, would likely cause serious environmental protests. Another option would be to develop floating LNG terminals or floating production, storage and offloading (FPSO) ships, which again are not free of environmental dangers, and of course either option would constitute an obvious target for missile attack and sabotage. These domestic options undoubtedly would come at no lesser cost than the Cyprus LNG option for Israel.[46] Such a decision on the part of Israel to go it alone with its energy development would constitute a severe blow to Cyprus' energy future and of course to the resuscitation of the Cyprus economy.

Conclusion

Partnerships between disparate parties are never easy and the potentially mutual beneficial energy relationship between Cyprus and Israel is a case in point. While there are many benefits to such a partnership, it remains precarious and elusive for the time being. Israel is clearly the dominant partner in this relationship; and Cyprus, while attempting to appear decisive and bold in its declarations, is in fact treading water awaiting decisions taken in Jerusalem and not in Nicosia. However, time does not stand still, forcing short run actions on the part of both Cyprus and Israel, which are in their respective national interests but which might not be mutually beneficial or in the long run interests of a Cyprus-Israel energy partnership. Cyprus on the one hand feels more threatened and vulnerable than at any time since the Turkish Invasion of 1974, coming off its recent financial and economic crisis and pressured by European and US allies to compromise on the Cyprus Problem; while Israel is emboldened by its new-found energy position and fast growing economy, the weakness of any Palestinian opposition, the on-going Syrian civil war, the dysfunctional Iraqi state, and more broadly the unraveling of the Arab Spring revolution particularly in Egypt.

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