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Egypt's Revocation of the Natural Gas Agreement with Israel: Strategic Implications

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On April 22, 2012, the national Egyptian gas companies, EGAS and EGPC, announced the revocation of the agreement to supply natural gas to Israel. The announcement was relayed via the Egyptian company EMG, which has acted as the liaison between the Egyptian national gas companies and Israeli gas consumers, chief among them the Israel Electric Company (IEC). In 2010, Egypt supplied IEC with 37 percent of its gas consumption; in 2011, that dropped to 18 percent because of attacks on the pipeline in the northern Sinai Peninsula. The gas was provided to Israel via an underwater line stretching from El-Arish to the intake facility on the coast of Ashkelon. The supply of natural gas was one of the few concrete manifestations of economic ties between Egypt and Israel.

The revoked agreement is a three-way agreement signed in June 2005 with Egypt's national gas companies, EMG, and IEC. EMG was established in 2000 in Egypt by Israeli and Egyptian businesspeople with close ties to the governments in Jerusalem and Cairo, respectively. Later it sold shares to other investors, including the Thai national gas company (25 percent), private businesspeople, and institutional clients in Israel. According to the agreement with IEC, EMG was obligated to supply some 25 billion cubic meters of gas over 15 years at an annual rate of 1.7 billion c m. The agreement gave IEC the option of extending the agreement by another five years on the same terms. The gas started to flow only in the middle of 2008; by mid June 2009, EMG had already failed to meet its commitments. The Egyptians demanded a price increase over what was stipulated in the agreement because of the large difference from the price of gas on the global market. In August 2009, IEC signed an updated agreement with EMG that met Egypt's demands. Thereafter, until the political upheavals, Egypt met its obligations. However, once the uprisings began, the Egyptian opposition demanded a halt in the supply of gas to Israel or a price increase. Concurrently, the flow of gas was interrupted several times because of attacks on the pipeline in the El-Arish area. All in all, Israel did not enjoy as steady or stable a supply of Egyptian gas as it had hoped.

Why was the Agreement Revoked?

The revocation of the agreement is a decision that was clearly made, or at least approved, at Egypt's highest political levels. Nonetheless, both Egypt and Israel are trying to downplay the political significance of the move and are claiming that it is a commercial dispute. On April 23, Egypt's Petroleum Minister Abdullah Ghorab said that the decision stemmed from commercial considerations and was unrelated to political motives, and therefore did not signal any kind of political trend. According to Ghorab, revocation of the deal signed between EMG and the national companies is permitted if the deal is violated, and the deal had in fact been violated (the Egyptian national gas company claims that EMG owes it \$56 million for the gas supplied to Israel last year). The same day, Prime Minister Benjamin Netanyahu stated: "We do not view the interruption of the supply of gas as the result of political developments." At issue are commercial disagreements between the sides, manifested in part by an international arbitration procedure instituted by EMG and its foreign shareholders against the Egyptian government because of damage they had incurred (to the tune of billions of NIS) due to interruptions to the flow of gas. IEC also announced that it is currently "involved in an international arbitration procedure against EMG and against the Egyptian national gas companies to demand compensation for the heavy damages caused to it, and that will be caused to it, due to ongoing violations of the natural gas agreements that IEC has with them."

Another explanation for the revocation of the agreement is Egypt's inability to meet the obligations it assumed because of Cairo's loss of security control in the Sinai. Since the revolution, Egypt has been unable to supply Israel with gas because of repeated attacks on the pipeline in the northern Sinai. It may be that in light of the cumulative damage Egypt preferred to revoke its contractual obligations rather than not meet them given the number of growing lawsuits.

A third explanation looks at Egypt's political environment, which in advance of the presidential elections (scheduled for May 23-24, 2012) has grown quite heated. The gas agreement with Israel is presented in Egypt as seriously corrupt, cast as an agreement made by Mubarak, his son, and their cronies for the sake of personal gain, at the expense of Egypt's economic interests. The senior partner of the gas deal, Hussein Salam, is awaiting extradition from Spain to Egypt, after having been convicted in Egyptian courts of stealing \$700 million in public funds that he earned as a result of the gas deal with Israel. The CEO of EMG, Muhammad Tawila, has been issued an injunction barring him from leaving the country.

For now it seems that the revocation of the agreement incurs few political costs for Egypt. The agreement supplying Israel with natural gas was, in fact, a commercial agreement, unlike the oil agreement between the two nations, which appears as an appendix to the peace agreement. Although the June 2005 agreement was backed by a "political umbrella," it seems that the Egyptians are not attributing much meaning to the latter. From

the beginning, the Egyptians sought to avoid deep political commitments to Israel as much as possible in order to downplay the importance of the gas agreement for normalization between the nations, and perhaps even to prepare the ground for its revocation. This theme was already apparent at the start of the contacts between Israel and Egypt in the early 2000s and seems not to have merited sufficient attention by the Israeli side.

Implications for Israel

Significant political damage: Stopping the flow of Egyptian gas puts the last nail in the coffin of one of the only manifestations of normalization between Israel and Egypt, and is yet additional evidence of a deterioration in bilateral relations because of the regime's capitulation to the pressure of the masses. It seems that even though 35 years have passed since the peace agreement was signed, it is still viewed in Egypt as a strategic necessity rather than the basis for peaceful relations.

An intermittent source of natural gas: From the perspective of Israel's energy market, the revocation of the agreement is preferable to its continuation under the current circumstances. That is, in light of the circumstances surrounding the stoppage of gas, it seems that Israel cannot rely on the Egyptian source as it did in the past. Still, should the Egyptians seek to renew it, it would be better for Israel to agree because of its political importance, provided it is limited in scope so as to avoid any dependence on Egyptian gas. Renewing the supply of gas from Egypt may even serve as a bargaining chip with local gas suppliers.

Some in Israel see a need for an immediate American response to Egypt that would generate a renewal of the gas flow, but it seems that this is not in Israel's best interests. Pressure will not enhance the relations between Egypt and Israel and may even increase tensions. Israel has large gas reserves of its own, and there is no point in placing the local energy market in the hands of an unstable energy supplier.

The need to accelerate processes to develop the new gas fields in the Mediterranean: With the start of the interruption to the supply of gas – in early 2011 – Israel should have accelerated the development of the underwater gas fields, because the old Israeli reserve (Yam Thetis, since 2002) is dwindling and the flow from the Tamar field is expected to start only in the second quarter of 2013. This situation is one of the reasons for the increased cost of electricity in Israel and the expected brownouts this summer. What is needed now is a special effort to shorten that timetable, as Tamar is expected to supply Israel with gas for many years to come.