

Israel's Zero Gas Game

Written by Gal Luft

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When natural gas was first discovered off of Israel's coast, analysts and pundits, myself included, identified the finds as a "[geopolitical game changer](#) ." Some even went as far as to refer to Israel as an emerging energy superpower – a Qatar in the making. The country's vibrant society was euphoric and consumed with speculation about how the windfall of natural gas revenues would be used and how natural gas exports to Asia, Europe and even to neighboring Turkey and Jordan might improve Israel's strategic posture. Such discussions were not meritless. The natural gas discoveries, nearly 900 billion cubic meters, were among the world's recent largest, and the involvement of a competent Houston-based company, Noble Energy, in the recovery process instilled confidence in the prospects of turning Israel into a non-trivial part of the global natural gas landscape. After six decades of total dependency on foreign sources of energy Israel was suddenly not only on the cusp of an era of energy self-sufficiency but also well on its way to becoming a net energy exporter and the proud owner of natural gas revenues and a derived \$100 billion sovereign wealth fund. This vision is drifting further away by the day. Israel has made all the right moves to squander its gas bonanza and scare off foreign investors to a point that the celebrated gas discoveries might turn into a huge missed opportunity.

Drilling for oil and gas in deep waters is the most risky endeavor in the energy industry. Doing so on a rig in the Eastern Mediterranean within the range of Hamas and Hizballah missiles is doubly risky. Working in Israel also carries a political price for companies vying to work in oil-rich Arab countries. No wonder international energy companies showed little enthusiasm for participating in exploration activities in Israel's economic waters. But instead of giving the royal treatment to the few dare devils that did take the risk, Israel chose to give them a hard time.

Shortly after gas discoveries were made public in 2009, civil uproar began due to a sense that the public would not get its fair share of the revenues to come. Responding to pressure, in 2010 the government of Israel appointed a national commission to examine the royalty structure for oil and gas companies and to find ways to increase the public's gain from the country's natural resources. The following year, the commission recommended a repeal of the depreciation allowance and the introduction of a progressive tax between 20-60 % on oil and gas profits in addition to the existing 12.5% royalty level. By international standards these were not draconian measures but changing the rules midgame had a chilling effect on energy companies considering to follow Noble Energy's footsteps. After all, if rules can change once who is to say they won't change again?

It was only the beginning. A new controversy quickly emerged: how much of the gas should be reserved for the domestic market and how much should be allowed for export? The answer to this question would determine the willingness of companies to invest billions of dollars in developing the large 500 billion cubic meter (bcm) reservoir called Leviathan as well as in the infrastructure required to export the gas as LNG. The Israeli market is too small to absorb vast amounts of natural gas, and without a guaranteed market - which exports would provide - such an investment makes no sense. Thus a new governmental commission to determine the export allowance was formed. After a year of deliberations the commission decided to cap exports at 53% of reserves, but succumbing to public pressure the cabinet reduced the figure to 40%.

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This was not the end of it. The Israeli Supreme Court was inundated with appeals to repeal the cabinet decision, blocking exports altogether, and no resolution of the matter is in sight.

The international response was swift and painful. Australian energy giant Woodside Petroleum which had agreed to buy a 30% stake in the Leviathan project under the assumption that at least 50% of the natural gas would be allocated to exports got cold feet and held off on its \$700 million payment. To make matters worse, in June 2013 Israel's Minister of the Treasury Yair Lapid, under the influence of the social protests and the mounting pressure to identify new sources of income to balance the national budget, appointed yet another commission to reexamine – again – the public's share in natural resources. The commission is scheduled to present its recommendations by June 2014, but its deliberations were postponed due to an appeal to the Israeli Supreme Court on the grounds of insufficient representation of women in it.

All these flip-flops, time delays and bureaucratic hurdles by consecutive Israeli governments seriously damaged Israel's appeal as a target of investment in the eyes of the multi-trillion dollar energy industry. This would have been tolerable had Israel been the only player in the East Med theater. It isn't. Cyprus, Lebanon and Turkey all have access to the same geological formation and with more gusto and decisiveness could overtake Israel in siphoning the gas, building infrastructure for export and locking-in long term supply contracts with gas importing countries. In fact, in spite of the economic basket case as it is, Cyprus has already signed deals with France's Total, Italy's Eni, South Korea's Kogas and Noble Energy to explore the island's new-found gas potential. After losing faith in Israel, Woodside is considering joining a consortium to build an LNG export terminal there.

All this to say that Israel, the trigger for the East Med gas rush and the front-runner in its potential to bring gas to market, is rapidly losing its competitive edge, and its dreams of energy grandeur may soon evaporate. The combination of hyperactive, overly regulated democracy, an increasingly vocal green movement, and a socialistic streak in society preferring not to have natural gas revenues at all rather than see a few risk taking "tycoons" become richer, is proving fatal for the nascent Israeli energy industry.

While much damage has been done hope is not lost. Israel can still snap out of its bureaucratic paralysis, restore investors' confidence and show the world it is open for business. In the coming months the government and the legislature must present a clear vision for the country's energy sector, articulate the rights and responsibilities of foreign investors and trim down, rather than add, regulatory hurdles. Most importantly they should set rules and stick to them. Failure to do so will fizzle the Israeli gas dream. The gas will be left in the ground and the startup nation will be more worthy of the title 'shutdown nation'.

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