EDC2020

[WORKING PAPER]

Energy Challenges in the Middle East and North Africa

By Edward Burke, Ana Echagüe and Richard Youngs

No. 2 . October 2008

Edward Burke is a Researcher at Fundación para las Relaciones Internacionales y el Diálogo Exterior (FRIDE), Madrid, Spain. E-mail: eburke@fride.org
Ana Echagüe is a Researcher at Fundación para las Relaciones Internacionales y el Diálogo Exterior (FRIDE), Madrid, Spain. E-mail: aechague@fride.org
Richard Youngs is Research Director of the Democratisation Programme at Fundación para las Relaciones Internacionales y el Diálogo Exterior (FRIDE), Madrid, Spain. E-mail: ryoungs@fride.org

Summary

In 2020 the European Union will be more dependent on oil and gas from the Middle East and North Africa (MENA), and will also face tougher international competition for access to the region's supplies. Within the MENA region, a rapidly increasing population, authoritarian forms of governance and an enhanced risk of further conflict in the region provide a complex set of challenges for its emerging relationship with the EU. This paper demonstrates the inextricable links between the energy trade and the future governance of the MENA region and outlines some of the related challenges to EU policies. Among the conclusions reached by the authors are the following:

- While the MENA region enjoys increasing energy wealth it also suffers from growing inequality and pockets of absolute poverty. It would be a mistake for Europe to see energy imperatives in the region as only geopolitical rather than developmental and governance-related in nature.

- The recent increase in oil and gas revenues masks ever more serious challenges to economic development and a deepening of energy poverty in the world's largest holders of oil and gas reserves. The current global economic downturn will also affect the ability of producer states to diversify their economies to provide employment and better living standards for the citizens of these countries.

- The governments of MENA region remain wedded to overly statist models of development that are yet to show concrete signs of succeeding where they have failed in the past. The bedrock of economic growth remains energy resources and the real test of the resilience of state-led diversification projects during a time of reduced oil and gas prices is yet to come.

- There is a striking lack of publicly available information regarding the energy sector and the use of state finances. This mirrors a general lack of transparency in the region and hinders investment in the MENA region.

- A comprehensive EU approach that links energy to economic and political development is at best nascent – or even, in some cases, a *more* distant prospect. The shift has not been made from focusing on the 'hardware' of energy security (pipelines, contracts etc) to its 'software' (the good governance of energy resources).

Table of Content

Energy Challenges in the Middle East and North Africa

By Edward Burke, Ana Echagüe and Richard Youngs

1 Introduction

In 2020 the EU will be more dependent on oil and gas from the Middle East and North Africa (MENA), and will also face tougher international competition for access to the region's supplies. This paper examines three preoccupying dimensions of the challenges facing EU policy in the MENA region. First, while the region enjoys increasing energy wealth, it also suffers from growing inequality and pockets of absolute poverty. Many of these problems have been exacerbated by the way in which governments have managed the increased oil and gas revenues they have reaped since 2002. It would be a mistake for Europe to see energy imperatives in the region as solely geopolitical rather than developmental and governance-related in nature.

Second, existing EU energy initiatives in the region are relatively limited. They fail to incorporate a link to development challenges; and are beset by bilateral undercutting between member states rather than constituting a common European approach based on tackling long-term and underlying impediments to energy security. Third, the link between energy policy and support for better governance has been particularly tepid in the MENA region. The likely trajectory of political fragility and socio-economic tensions up to 2020 means that the EU needs to focus more on the governance dimension of its energy policies within the MENA region.

2 Energy, Governance and Development in the MENA region

In 2002 and 2003 two landmark reports were published on the state of governance in the MENA region. The Arab Human Development Report, drafted by a group of leading Arab intellectuals, concluded that a total overhaul of governance in the region was required to move away from political and economic inertia. It argued that the region's "freedom deficit", lack of strong civil society institutions and opaque frameworks for public accountability were seriously undermining development in the region.[1]

[1] United Nations Development Programme-Programme on Governance in the Arab Region, 'Government effectiveness – 2007', New York: UNDP, 2007

The second report, published by the World Bank, stated that "the root of MENA's growth gap is its governance gap" and estimated that poor governance and a lack of public accountability cost the region 1 per cent per annum in economic growth. The report pointed to a "unique convergence" of three factors that had a corrosive effect on governance in the region: an abundance of energy resources used to buy political allegiance; a real or perceived threat of conflict in the region; and Western support for inept and repressive regimes.[2] Both reports concluded that development policies that encouraged a dominant role for the state in the economy had failed and urged governments to adopt a more facilitative role through reforms aimed at improving public sector efficiency, the rule of law, judicial process, the protection of property and transparent regulation of the private sector.

The challenges facing the MENA region are profound. The region has the youngest population in the world – 45 per cent of its citizens are under the age of 15 and 25 per cent of the world's unemployed youth resides in the region.[3] These problems are reflected in the case of one of the region's wealthier states, Saudi Arabia, whose population is expected to double by 2025 and where 30 per cent of citizens between 16 and 25 are unemployed.[4]

In recent years oil prices have reached dizzying heights (revenues are predicted to reach $653 billion for the region in 2008 alone)[5] and a new trend in the Gulf region has seen regimes invest their energy wealth to encourage economic diversification away from natural resource dependency as a means of providing long term stability and prosperity, a policy which stands in marked contrast to the squandered oil boom of the 1970s. Nevertheless, some analysts remain sceptical that revenues from this second oil boom will prove to have been better managed stating that a global economic downturn may yet have severe consequences for plans to diversify the region's economy. Unease in the Gulf Cooperation (GCC)[6] countries regarding the resilience of the region's economy has not been helped by an absence of publicly available economic data. A sizeable reduction in foreign direct investment (FDI) to the region could scuttle plans for economic diversification or as one analyst observed: "What use is the world's tallest building if the economic activity beneath it is faltering?"[7] The GCC states do however have enough financial reserves to continue vast diversification projects - the average oil price to allow governments to balance budgets in 2008 is $57 a barrel.[8]

During 2007-2008 the MENA region experienced growth levels that averaged 5.7 per cent and similar levels of growth are predicted over the next three years. Inflation and higher food prices have led to demands for better government

[2] World Bank, 'Better Governance for Development in the Middle East and North Africa', Washington DC: World Bank, 2003, p. 8 and *Financial Times*, 'Arab world held back by poor governance', September 9 2003
[3] World Bank, 'The Road Not Travelled: Educational Reform in the Middle East and North Africa', Washington DC: World Bank, 2007, p.9
[4] N. Janardhan, 'Economic Diversification and Knowledge Economy in the Gulf', Paper delivered at the Gulf Studies Conference, Exeter University, 3 July 2008
[5] World Bank, '2008 MENA Economic Developments and Prospects: Regional Integration for Global Competitiveness', Washington DC: World Bank, 2008
[6] The GCC countries are Bahrain, Kuwait, Oman, Qatar, Saudi Arabia and the UAE.
[7] Andrew England, *The Financial Times*, 'Transparency is the key', October 13 2008
[8] IMF MENA Director, Mohsin Khan, quoted in *The Financial Times*, 'Gulf forecast to escape worst of the turmoil', October 21 2008

performance.[9] Despite being the world's largest producer of energy, the MENA region is not exempt from energy shortages: from 1990-2006, the regional balance of energy exports over total energy use fell from 210 to 126 per cent.[10] Non-producing states like Lebanon are currently suffering from a grave lack of energy supplies and even producers like Saudi Arabia face the possibility of gas shortages in the future.[11] Gas shortages recently prompted Oman to the Iranian government in order to secure supplies, while depletion of oil supplies and a shortage of diesel fuel in Yemen caused a series of riots which rocked the country in 2007 and 2008.[12] Similar scenes have been witnessed in Algeria, Iran and Iraq where the shortage of energy supplies for domestic consumption has fed discontent and fuelled violent protest against those countries' governments. In Egypt, sales of gas to Israel at below market-level prices during a time of energy shortages have prompted an angry reaction among the public.[13]

A widespread perception of mismanagement and corruption has alienated many of the region's citizens from their governments. Due to poor governance, energy subsidies are notoriously inefficient and frequently result in leakage to the non-poor populace. It has been estimated that 93 per cent of gasoline subsidies in Egypt benefit the richest 20 per cent of the country's citizens.[14] Few countries in the region have public mechanisms in place to ensure transparency over the use of energy resources and not a single MENA country scores above the World Bank global median for public accountability.[15] Parliaments have few independent powers or the will to hold governments to account and judicial standards in the region are also generally weak. Self-censorship is therefore widespread.

While many producer countries appear to have learned the harsh lessons of the oil booms of the 1970s and have established oil stabilisation funds in an attempt to curb inflation and the worst effects of the 'resource curse', there is a striking lack of information regarding the use of state finances available for public consumption. The MENA region ranks bottom of the world's regions with regards to public access to government information.[16] The World Bank has concluded that "countries across the MENA region exhibit a pattern of limited and reluctant transparency, which is reflected in the fact that it is the region with the least empirical data on the quality of governance."[17] This in turn leads to a striking lack of an 'evaluation' culture in the region.[18]

A debilitating feature of the MENA region is the bloated nature of its public sector workforce. In the late 1990s state employment constituted 30 per cent of Algeria's workforce and 82 per cent of that of Saudi Arabia. However, this should

---

[9] World Bank, '2008 MENA Economic Developments and Prospects: Regional Integration for Global Competitiveness'

[10] World Bank, 'Middle East and North Africa: Regional Data from the WDI database', Washington DC: World Bank, 2008

[11] *The Daily Star* 'Egypt to provide Lebanon with electricity and gas', 18 August 2008, and J. Richardson 'Running out of steam', Singapore: ICIS, 3 December 2007

[12] Arab News 'Oman-Iran gas project to come online in 2012', 12 September 2008

[13] Al-Ahram Weekly, 'Selling out', 8-14 May 2008

[14] F. Iqbal, 'Sustaining Gains in Poverty Reduction and Human Development in the Middle East and North Africa' Washington DC: World Bank, 2007, p. xx

[15] World Bank, 'Better Governance for Development in the Middle East and North Africa', p. 62

[16] F. Iqbal, 'Sustaining Gains in Poverty Reduction and Human Development in the Middle East and North Africa' p. xxiv

[17] World Bank, 'Better Governance for Development in the Middle East and North Africa', Washington DC: World Bank, 2003, p. 4

[18] F. Iqbal, p. xxiv

not be seen as merely the result of energy rentierism. Other factors are also at play, as is shown by the fact that 36 per cent of Jordan's resource-poor workforce is employed by the public sector.[19] Indeed the resource-poor countries of the region have been described as 'semi-rentier' in that they generally have low levels of productivity and are sustained by foreign aid, remittances from abroad and foreign loans which are increasingly provided by the resource-rich Gulf states.[20] The MENA region is the highest beneficiary of global aid, at $54 dollars per capita. Only a fraction of this is spent on governance projects; the World Bank allocation for 2007 governance projects amounted to only $59.8 million.[21] There is also a glaring lack of transparency in the use of funds provided by the GCC states to less developed countries in the region.

It is increasingly apparent that political liberalisation has stagnated in much of the region as governments prove unwilling to move beyond an increased tolerance of dissent to a genuine transfer of powers to elected institutions. There is a trend in many countries towards establishing more efficient and transparent institutions to monitor and encourage growth and even tolerating a degree of criticism that exposes flagrant corruption by lower officials. However, these institutional reforms have been very top-down. In Bahrain, Oman, Saudi Arabia and the United Arab Emirates, there have been efforts to ameliorate the standards of the judiciary in commercial law, but this has not been translated over to other areas of legislation that affect civil liberties.

Not all trends are entirely negative. Despite its poor overall score on most transparency indexes, the MENA region was also the most improved region globally in 2007 in relation to public accountability, owing to moves to encourage private sector investment. Administrative hurdles have been removed and some governments have begun to limit corruption. Tariffs on imports to countries in the region have been reduced from a simple average of 20 per cent in 2000 to 12 per cent in 2007. Egypt topped the World Bank's table for economic reforms in 2007, an achievement that has yet to translate into tangible success for that poverty-stricken country.[22] Use of oil largesse varies considerably across the region. Recalling the shock of the economic downturn of the 1980s which stemmed from falling oil prices, GCC states are striving to use their energy revenues to wean their economies away from natural resource dependency and, in recent years, have commissioned projects worth $1.3 trillion aimed at economic diversification. These efforts have already met with some success - in less than eight years, GCC non-hydrocarbon exports have more than doubled.[23] A customs union has been introduced between the six GCC member states and there are plans to introduce a single currency. Public sector reform has also been undertaken in several of the GCC states, most successfully in the United Arab Emirates where the public sector workforce of Abu Dhabi was cut from 64,000 to 11,000.[24]

---

[19] C. Pissarides and M. Véganzonés, 'Labour markets and economic growth in the MENA region', Washington DC: World Bank, 2005, p. 9
[20] North Atlantic Treaty Organisation (NATO), Parliamentary Assembly Conference Proceedings 'Development of Civil Society and Economy in the MENA region' Brussels: NATO, December 2007
[21] World Bank, 'World Bank, 'Annual Report 2007: Middle East and North Africa', Washington DC: 2008
[22] World Bank, '2008 MENA Economic Developments and Prospects: Regional Integration for Global Competitiveness', Washington DC: 2008, p. xxiii
[23] S. Hertog, 'EU-GCC relations in the Era of the Second Oil Boom", Munich: CAP Working Paper, December 2007, p. 7
[24] N. Janardhan, 'Economic Diversification and Knowledge Economy in the Gulf'

In contrast, Algeria and Libya have failed to devise and implement plans to significantly diversify their economies. Algeria has spent a significant part of its oil revenue providing short-term public sector employment while Libya, with the largest oil reserves in Africa, has not delivered on its promise to reduce its public sector workforce by one third and increased its budgetary spending by 60 per cent in 2008 – which, without careful planning, will most likely lead to further inflation.[25] Algeria is belatedly taking steps to promote growth in its non-oil sector but it is working from a very narrow base – hydrocarbons currently constitute 98% of its export revenues.[26]

Saudi Arabia also faces significant problems in curbing its bloated public sector and it remains to be seen whether the ambitious new 'economic cities' being constructed in the country will provide the necessary employment for the country's youth. Nevertheless, the Saudi government has made tangible progress in diversifying the economy in recent years. Exports of non-oil based products increased at a rate of 20 per cent annually between 2000 and 2006 and inward investment of Gross Fixed Capital Formation (GFCF) has soared from 1 per cent for much of the 1990s to 32.1 per cent in 2006.[27]

In Iraq corruption remains endemic and the country's oil wealth has been heavily directed towards arming and maintaining the support of militia. Failure to agree a hydrocarbons law that addresses Sunni concerns over the sharing of oil revenues from fields in predominantly Shia and Kurdish regions may yet plunge Iraq once more into a downward spiral of violence. There are also concerns that Yemen's dwindling oil supplies, from which the government draws 75 per cent of its revenue, could weaken the intricate patronage networks which create a semblance of stability, albeit a precarious one, in the country.

To some degree, the relationship between energy and its effect on governance in the MENA is more complex than has sometimes been claimed. Although political reform has generally stagnated in the region, economic performance has been more varied. Amid a general lack of political opening, the degree of economic reform varies between states. The UAE, Oman, Kuwait, Qatar and Saudi Arabia number among the most effective and least corrupt countries in the region.[28] The UAE has led the way in successfully using its energy wealth to diversify its economy and other states in the region have been quick to try and emulate the success of Dubai, Abu Dhabi and Sharjah. The GCC states have looked east to the Asian model of Singapore for inspiration rather than west to the EU, and the Gulf is a region that many Arabs look to with envy for having "…transformed itself in just decades from a largely barren backwater to a dynamic engine of Arab economic investment, efficient planning and execution, orderliness and modernity."[29] However, the market liberalisation and increased efficiency of this region is being led from the top-down; indeed, it should be observed that in

[25] World Bank, '2005 MENA Economic Developments and Prospects', Washington DC: p. 41 and Zawya, `Libya's oil revenue projected at $35.5 bn in 2008 budget', April 2008
[26] Energy Information Administration, 'International Energy Data and Analysis for Algeria', Washington DC: Department of Energy, 2008
[27] ISN ETH Zurich, 'Saudi Arabia's Economic Liberalisation', 12 December 2007
[28] UNDP-POGAR, 'Government effectiveness – 2007', New York: UNDP, 2007
[29] R. Khouri, 'The Gulf states, change you can invest in', *The Daily Star*, 27 August 2008

certain cases where democratic institutions have been granted tangible powers, such as in Kuwait, there has been a tendency to move towards protectionism.

The energy producer states in the rest of the region are beginning to recognise that they too must move to adopt improved standards of economic efficiency. Due to a rapidly growing population, the old methods of rentierism and semi-rentierism are unsustainable. The UAE was perhaps the first country in the region to recognise this, but it is becoming obvious that countries like Egypt, Saudi Arabia and perhaps even Libya are keen to follow. Some countries continue to cling to past habits – Algeria has made little progress, for example, and Sudan, Iraq and Yemen are too fractured and weak to attempt reforms to increase efficiency. For now, with perhaps the exception of Kuwait, the GCC states have proved that governance reforms that encourage economic liberalisation and public sector efficiency do not need to threaten the power status quo; essentially they have successfully decoupled economic from political reform. The coming years will tell whether maintaining the political status quo is tenable in rapidly evolving societies in the region. It may be a model of reform that the rest of the world will have to adjust to.

3 EU Energy Policies in the MENA region

Despite the rise of other energy producers, the MENA region remains pivotal to European energy interests. In 2005, 31.7 per cent of EU oil imports and 26.8 per cent of EU gas imports came from the Middle East. Spain and Italy import significant quantities of gas by pipeline from the region; Belgium, France, Italy, Spain and the UK depend on significant quantities of Liquified Natural Gas (LNG). However, a significantly lower share (under 20 per cent) of US oil and gas imports come from the region. The MENA region's share of world oil production is predicted to increase from 30 per cent in 2001 to 49.2 per cent in 2030; its share of gas production from 9 to 23.9 per cent over the same period.[30]

The MENA region's oil is set to be drawn increasingly towards Asia. In 1980, two thirds of the region's oil went to Europe and the United States; by 2004 this share had declined to one third. Saudi Arabia's search for a dominant position in the Chinese market is leading it to offer low prices to China and to divert supplies away from European customers - with China apparently promising in return to sell the kind of military equipment that Europeans have not been prepared to sell.[31] China also has been quick to consolidate investment opportunities in Iran as US and EU competitors baulk at the obstacles and risks of doing business there given the current dispute over Iran's nuclear enrichment process - at the end of 2006, Sinopec concluded a $100 billion deal for investment in Iran. Moreover, as Gulf populations expand and become increasingly wealthy, there is also increasing pressure for more oil to go to domestic energy consumption in the region and for the development of nuclear capacity.

---

[30] For figures see Commission of the European Communities, 'European Energy and Transport Trends to 2030' – Update 2007, Brussels: Commission of the European Communities, 2007, p. 27
[31] P. Roberts, 'The End of Oil: The Decline of the Petroleum Economy and the Rise of a New Energy Order', London: Bloomsbury, 2005, p. 257

Notwithstanding such trends, the EU's energy strategies appear less well developed in the MENA region than in some other producer regions. One associated policy weakness is the failure to adequately incorporate development efforts as part of a long-term vision for energy policy.

A number of energy initiatives have been developed, especially in **North Africa**, under the rubric of the Euro-Mediterranean Partnership (EMP). A Euromed Energy Forum has run for several years. From 2001-2006, 14 million euros of MEDA funding[32] was allocated to energy related projects.[33] The Commission and a number of member states advocate the signing of an EU-Mediterranean energy treaty or charter. Bilateral energy partnerships have been negotiated with Egypt and Algeria. Energy co-operation has also been made a priority issue under the new Union for the Mediterranean and President Nicolas Sarkozy has spoken of a "common energy policy between the north and south of the Mediterranean."[34]

The focus of these initiatives is more regulatory rather than being aimed at comprehensive economic and political development. Dialogue on and support for the sub-regional integration of energy markets is a particular focus. Through such an approach, the EU aims to export its own regulatory frameworks for energy market reform. In November 2007, energy regulators from 23 Mediterranean states – including France, Italy, Spain, Cyprus and Malta from the EU – created a working group to approximate regulatory frameworks with EU energy rules.[35] The EMP energy action plan for 2008-2013 aims to harmonise regulatory frameworks and support energy sector reform in Arab partner states.

The other main use of European funds is for infrastructure designed to boost exports. Loans from the European Investment Bank (EIB) have increased and have assisted a number of large scale projects, such as the construction of the Medgaz pipeline between Spain and Algeria. In November 2007, the Italian government sealed a new gas pipeline deal with Algeria for the import of 8 billion cubic metres of gas a year into Italy. A meeting with Mashreq states in May 2008 promised an increase in EU funding towards linking the trans-Arab pipeline into the projected Nabucco line and thence onto European markets.

No common EU view exists on the link between energy, development and European security interests in the MENA region. For southern member states, the energy issue is reason to increase aid to North African states; while for northern 'like-minded' donors, the increased energy revenues of these producers is reason to shift aid resources out of the region. Although Spain and France have increased aid to Algeria, Algiers is also the lowest per capita recipient of MEDA aid and receives little other bilateral European development assistance.[36] Egypt is allocated large amounts of social development funds, but diplomats acknowledge that these long-standing transfers derive mainly from Egypt's importance in relation to the Arab-Israeli conflict and general regional stability.

---

[32] Until 31 December 2006, EC assistance to the countries of the European Neighbourhood Policy was provided to the southern Mediterranean region under a programme called MEDA.

[33] Commission of the European Communities, 'Commission Staff Working Document – Annex to the Green Paper, A European Strategy for Sustainable, Competitive and secure Energy', SEC(2006), 317/2, Brussels: Commission of the European Communities, 8 March 2006, p. 43

[34] 'Press Conference at the European Council Summit in Brussels', 13 March 2008', in CEPS Neighbourhood Watch 36, Brussels: Centre for European Policy Studies, March 2008, p. 2

[35] Platts 'EU Energy', 30 November 2007, p. 13

[36] ENPI, op. cit., p. 55

Overall, there has been little discernible direct focus on 'energy poverty' within the Middle East itself. Increased funds for economic and social development are available under the European Neighbourhood Partnership Instrument (ENPI), as well as through increases in French and Spanish bilateral aid programmes. But concerns have arisen within the development policy-making community that funds may be drawn away from traditional poverty reduction initiatives. Indeed, the Commission's new aid programme for 2007-2013 identifies as priority areas for aid funding the integration of European and Maghrebi gas markets; support for the extension of the Energy Community Treaty to the southern Mediterranean; and the integration of Libyan energy markets into the broader regional framework.[37] The aim is to increase the *share* of the Neighbourhood Investment Facility going to energy projects.[38]

Moreover, the most prominent issue within EU deliberations on North Africa is the increasingly 'securitised' link made between migration and counter-terrorism. Energy debates remain low profile by comparison within CFSP policy-making on the MENA region. While the possibility of new development and energy co-operation funding to Libya has been discussed in Brussels, large sums of member states' money now go to providing equipment to Libya to stem illegal immigration into Europe.

In addition, while policy is ostensibly based on common EU market norms, in practice bilateral deals are still pre-eminent in the region, often sitting uneasily with declared approaches based on integration and development support. The EU's bilateral partnership with Algeria appears to cut across much of the *acquis* of its own regional EMP Energy Forum. For France and Spain, the bilateral dimension continues to predominate in relations with Algeria, with Paris signing a new energy treaty with Algeria in 2006. Spain signed a bilateral co-operation treaty with Egypt in February 2008 which is strongly focused on energy, with tied aid linked to this.[39] Meanwhile, the Spanish government is complaining that Algeria's recent deal with Gazprom was reached with the active support of French and Italian energy firms.[40]

While the Commission's September 2007 proposal on 'reciprocity' was dubbed the 'Gazprom clause', it also engendered a hostile reaction from Algeria, who perceived this clause as a reaction to Sonatrach's increasing downstream activity in Europe.[41] Spain has slowly moved to open up its energy market to Sonatrach, but there have been limitations to this process and it is still subject to court cases initiated by Spanish companies. Algeria itself has rejected the offer of a European Neighbourhood Action Plan, emboldened by increased energy revenues into adopting a more assertive foreign policy that sees little attraction in accepting European energy market rules.

---

[37] ENPI, 'Regional Strategy Paper (2007-2103) and Regional Indicative Programme (2007-2010) for the Euro-Mediterranean Partnership', Brussels: European Neighbourhood and Partnership Instrument, pp. 31–2

[38] Commission of the European Communities, 'A Strong European Neighbourhood Policy', COM(2007) 774, Brussels: Commission of the European Communities, 5 December 2007

[39] *El País*, 5 February 2008

[40] J. Farés and F. Pérez, 'España en la Génesis de una Nueva Política Europea de Energía', Working Paper, Barcelona: Observatorio de Política Exterior Europea, Universidad Autónoma de Barcelona, March 2008, p. 4

[41] Global Insight Daily Analysis, 21 September 2007

Beyond North Africa, the EU's energy policies have been even weaker and the links to economic and political development even more limited. No systematic and productive energy dialogue has been established between the EU and the GCC. The GCC's benign role within international markets was seen to render separate initiatives on energy unnecessary, while these states' overall high levels of wealth rendered a development-driven EU presence redundant.[42]

The Commission has proposed extending the structure of both the ENP Energy Treaty and the Euro-Med Common Energy House to the GCC states, as well as offering the latter the kind of energy agreement offered to Algeria and Egypt. However, the continued impasse in trade negotiations between the EU and the GCC undercuts the prospects for other aspects of policy co-operation. Although the EU and GCC announced almost twenty years ago that they would seek to establish a free trade agreement (FTA), negotiations to conclude such an agreement continue to flounder. While all technical issues seem to have been resolved, the standard EU clause on political and human rights issues is proving to be a sticking point. Some European diplomats in the region have privately expressed their frustration that this clause should constitute the key stumbling block towards such an agreement, noting that it has never been invoked with regard to other EU FTA agreements. GCC representatives also complain that EU protectionism weakens their enthusiasm for broader energy partnership and exposes the EU's rhetoric of 'extending the internal market' as hypocrisy. The EU has proposed a Memorandum of Understanding on energy co-operation; the GCC states have rejected the idea, insisting that an FTA is the precursor to deepening other areas of co-operation. A long-standing bi-annual EU-GCC energy experts meeting has been diminished rather than expanded in recent years, with officials of a lower level than was previously the case presiding on both sides. EU-GCC co-operation on energy is set to focus on alternative energy issues, such as solar energy and carbon capture and storage technologies. The GCC has also emerged as a very significant aid donor in the region, but EU-GCC dialogue on harmonising development policies remains nascent.

A small amount of funding has been made available for energy co-operation projects in middle income states like the GCC countries under the 2007-2013 EU budget, and in July 2008, the European Commission made a grant of almost €100.000 for research into sustainable and clean energy policies and technologies.[43] In another positive development, recognising the limitations of an EU presence in the region, the European Commission is currently considering creating a specific energy post in the EU delegation in Riyadh.[44] The Commission has also proposed supporting the construction of pipelines across the Arabian peninsula to reduce the amount of oil that has to pass through the vulnerable Straits of Hormuz.[45] In general, however, EU financial resources count for little in the Gulf, despite pockets of poverty persisting and infrastructure improvements being required for both domestic and international supplies.

---

[42] A. Baabood and G. Edwards, 'Reinforcing Ambivalence: The Interaction of Gulf States and the European Union', *European Foreign Affairs Review* 12/3, 2007, pp. 537–54

[43] A. Echagüe, 'The European Union and the Gulf Cooperation Council', FRIDE Working Paper *39*, Madrid: Fundación para las Relaciones Internacionales y el Diálogo Exterior, May 2007

[44] Remarks made at a FRIDE conference, 'Energy, Democracy and Development: the case of the Middle East and North Africa', Madrid: October 3rd 2008

[45] G. Luciani, 'The Economics and Politics of the "Dire Straits" ', GRC Security and Terrorism Research Bulletin 6, Dubai: Gulf Research Centre, August 2007, p. 15

Even more than in North Africa, in the Gulf, competitive, national policies of EU member states prevail. A number of member states complained when the UK reached a bilateral LNG agreement with Qatar in 2006, lamenting that this undermined efforts to conclude a regional FTA. UK officials argue that the EU dimension of policy towards Saudi Arabia is unlikely to play a primary role, as the real key is how Saudi actions relate to broader international market structures since Saudi Arabia's importance, in a sense, takes it beyond the standard regional frameworks typically promoted by the EU. There is an apparent contradiction between the statements made by several member state governments in their respective capitals and those at EU level on streamlining relations with the region through the EU, which only serves to exacerbate confusion among MENA governments over the subject of engaging with Europe in the future.

In **Iran**, it appears that the EU has opted to prioritise the nuclear issue over energy co-operation. Incipient development aid to Iran has dried up to exert pressure on Tehran to demonstrably limit its nuclear programme to civilian capacity. The EU imposed a range of sanctions against Iran in December 2006; these were broadened in March 2007 and again in March 2008. Such sanctions have begun to bite in Iran's energy sector, decreasing both export potential and domestic supplies – Iran currently has to *import* petrol. Most member states have discouraged European companies from investing in Iran. An exception is the Italian government's backing for its energy companies to sign concrete contracts: in January 2008, Italy and Iran signed a gas deal for Edison to pump Iranian gas to Europe.[46]

At the same time, the EU has not imposed a formal US-style investment ban on its energy companies. If US measures are designed specifically to choke off the development of Iran's energy sector, European measures seek to exert pressure without completely choking off energy ties. The EU has held support for economic development and deeper energy ties as a potential 'reward' for Iranian co-operation on the nuclear programme – the latter in particular through accepting Iranian supplies for the Nabucco pipeline. Many diplomats insist that exerting greater pressure on President Ahmadinejad is also necessary to assist development, to the extent that he has increased populist promises of expenditure from the oil investment fund in a way that draws resources away from long-term development needs.

In post-Saddam **Iraq**, the EU has declined to design the kind of comprehensive, development-oriented 'failed state' strategy implemented elsewhere. Co-operation in the energy sector has been hampered by Iraq's unsettled political process, with a hydrocarbons law still to be agreed.[47] The Commission allocated 720 million euros of aid to Iraq during the period 2003-2007 through the World Bank trust fund – of which the Commission has been the largest funder. The vast majority of this aid has gone to humanitarian relief. There has been little linkage with energy security. Energy co-operation was identified as a priority for new aid initiatives after 2006, but limited progress has been made on the ground, despite a Commission delegation being opened in September 2006. Commission aid allocated to Iraq registered a significant drop in 2008, to only 75 million euros.

[46] *New Europe*, 4 January 2008.
[47] *The Economist*, 19 January 2008, p. 36.

At a third round of negotiations for an EU-Iraq trade and co-operation agreement in early 2008, an energy chapter was signed, promising EU support for infrastructure development and the transfer of technical know-how. With the Iraqi oil minister visiting Brussels in February 2008, Andris Piebalgs talked of support for Iraq linking into the trans-Arab pipeline and from there connecting to Nabucco, bringing it to European markets.[48] A Memorandum of Understanding on energy co-operation was agreed between the EU and Iraq in April 2008. However, it remained unclear how Iraq would provide the promised 10 billion c.m of gas to Europe. Moreover, Iraqi ministers argued that the quid pro quo for such supplies must be increased European development assistance for Iraq – a commitment that most member states are reluctant to deliver on.

4 Misreading Governance

At the rhetorical level, governance reform is presented as a key link between energy imperatives and development policy. The Commission calls for 'coherence between the internal and external aspects of energy policy, and between energy policy and other policies that affect it, such as external relations, trade, development, research and environment."[49] In the words of the Commission, EU external energy policy "must also be consistent with the EU's broader foreign policy objectives such as conflict prevention and resolution, non-proliferation and promoting human rights."[50]

Even rhetorically, key figures have sometimes questioned such linkages. In the words of Javier Solana: "We may have to deal increasingly with governments whose interests are different from our own and who do not necessarily share our values. Sitting on huge reserves of oil and gas gives some difficult regimes a trump card. They can use energy revenues for purposes which we may find problematic. And it shields them from external pressure. Thus, our energy needs may well limit our ability to push wider foreign policy objectives, not least in the area of conflict resolution, human rights and good governance."[51]

In 2005 the EU agreed to apply the Policy Coherence for Development approach in 12 policy areas, one of these being transport and energy. This approach commits the Commission and member states to tightening coherence between aid efforts and the range of other EU policy concerns. The European Consensus on Development presents governance reform and development efforts as the principle means to improve security goals, such as those relating to energy supplies.

[48] Platts, 'EU Energy', 8 February 2008, p. 32
[49] Commission of the European Communities, 'Communication from the Commission to the European Council. External energy relations – from principles to actions', Brussels: Commission of the European Communities, 2006
[50] Paper from the Commission of the European Communities/SG/HR for the European Council 'An External Policy to Serve Europe's Energy Interests' Brussels: Commission of the European Communities, 2006
[51] Address by Javier Solana EU High Representative for the Common Foreign and Security Policy at the EU Energy Conference 'Towards an EU External Energy Policy', Brussels: 20 November 2006

In 2007 an EU progress report on Policy Coherence for Development recognised that the capacity to turn these commitments into reality is often still lacking; that there is a need to enhance dialogue with developing countries on the effects of non-aid EU policies; and that in most policy areas the positive impact of EU policies depends on parallel efforts by national governments.

Reference to governance within energy policy is often relegated to being a by-product of improvements in investment conditions in general, which the EU hopes will contribute to energy investments and more transparent relations. The Commission stresses that "due attention needs to be paid to the investment climate, in particular the framework of regulation, legislation and the rule of law, in which EU companies operate."[52] The Commission's approach is to incorporate regulatory co-operation within formal contractual agreements. It is argued that the EU must seek improved governance in the energy sector in order to create open, transparent, non-discriminatory and stable legal conditions. In addition to improving production and export capacities in producer countries, the Commission also stresses the importance of improving the climate for European companies' investments and opening up markets for the production and export of energy resources to EU industry.[53] There is also some nervousness regarding the transparency and management of energy-income derived Sovereign Wealth Funds (SWFs) that are invested in the EU, but the sensitivity of governments in the region towards discussing this issue as well as the heightened need of EU member states for external investment, will most likely result in most member states taking few concrete steps to address these concerns. As if to highlight the complexity of this issue a leading member of the ruling family of Saudi Arabia, Prince Turki al-Faisal, recently expressed his outrage at proposals made by Italian Prime Minister Silvio Berlusconi to prevent SWF investments owning more than 5% of Italian firms, which he said raised questions as to whether Europe was "closed and hostile" to investment by Arab countries.[54]

External Relations Commissioner Ferrero-Waldner professes a commitment "to work, when and where possible, on the extension of the principles of the Energy Community Treaty that currently covers countries with an enlargement perspective in South East Europe to our neighbourhood countries in Eastern Europe, the Caspian region and the Mediterranean. In a second step the Gulf region could also be included. This will extend transparency, efficiency and certainty beyond the EU's frontiers – crucial to helping the long term investments necessary for our energy security." [55] One governance-energy link can be found in the EU's push for North African countries to create independent regulatory agencies.

Nevertheless, it can be concluded that promoting governance reforms in order for revenues from oil, gas and minerals to be better utilised to foster economic growth and development is not prominent in EU Middle East policy. A Priority

[52] Commission of the European Communities, 'Communication from the Commission to the Council and the European Parliament on the development of energy policy for the enlarged European union, its neighbours and partner countries', Brussels: Commission of the European Communities, 2003
[53] Commission of the European Communities, 'An External Policy to Serve Europe's Energy Interests': Paper from Commission/SG/HR for the European Council, Brussels: Commission of the European Communities, 2006
[54] Speech by Prince Turki al-Faisal to the Eurogolfe Forum, Venice, 17 October 2008
[55] Benita Ferrero-Waldner, Commissioner for External Relations and European Neighbourhood Policy Opening address at the conference 'Towards an EU external energy policy to assure a high level of supply security', Brussels: Commission of the European Communities, 20 November 2006

Action Plan for Euro-Med Energy Cooperation for 2008-2013 makes no mention of good governance and the EU prefers to concentrate on applying pressure on producer states to allow access to their energy markets. There continues to be limited interaction between energy and governance policy-makers. Support for the Extractive Industries Transparency Initiative (EITI), which aims to ensure that the revenues from extractive industries contribute to sustainable development and poverty reduction, would be an obvious starting point. To date, the major producers in the region have declined to commit to this process.

Governance initiatives have taken the form of co-operation projects aimed at legal and regulatory harmonisation. At no point is the possibility of using development aid leverage to encourage governance improvements considered. While in theory the Transparency International Corruption Index is among the criteria used in establishing ENPI country aid allocations, in practice this does not seem to have played any tangible part in determining aid allocations. Democracy-backsliding Egypt has, for instance, been the main beneficiary of EU loan assistance through the EIB.

The focus on governance is even more limited in the Gulf. There is an energy dialogue between the EU and the GCC and some small co-operation projects have been launched, such as a technical energy centre in Saudi Arabia. With Gulf states not eligible for mainstream development aid, it is difficult for the EU to make inroads in the field of governance, aside from the regulatory and transparency measures which would result from the signature of the long awaited FTA. Moreover, realism clearly prevails and the UK's decision not to investigate kickback allegations related to the Al Yamamah arms deal does not bode well for the credibility of the EU in terms of governance standards. In contrast, the US has scored some significant successes in tying reforms to greater access to US markets for the region with both Bahrain and Oman introducing changes to labour legislation to meet US FTA agreement criteria.

All this stands in contrast to energy relations with Africa. Here the EU promotes a twin-track approach focused on access to energy through the European Union Energy Initiative and raising the profile of energy efficiency in development programmes.[56] Energy has become one of the focal areas for development co-operation under the €23 billion European Development Fund. This is not to say that such an approach has already been significantly implemented in that region. But it does reveal how at least in the formal design of policy, a link is made to development and governance challenges in a far tighter and more holistic manner than in the MENA region. The link between energy security and the kinds of internal political challenges outlined in the first section of this paper remains unduly tenuous in the elaboration of European strategy.

[56] Commission of the European Communities, Green Paper: 'A European Strategy for Sustainable, Competitive and Secure Energy', Brussels: 2006

5 Conclusion

Some MENA governments have undertaken a degree of economic diversification and introduced initiatives aimed at the better governance of energy resources. But overall, the tighter international energy market has distorted equitable and sustainable development processes in the MENA region. The general increase in oil and gas revenues masks ever more serious challenges to economic development and a deepening of energy poverty in the world's largest holders of oil and gas reserves. While trends in the region are varied and some positive developments are apparent, in overall terms energy resources have still failed to usher in robust political or economic modernisation. The region's regimes remain wedded to overly statist models of development that are yet to show concrete signs of succeeding where they have failed in the past. The bedrock of economic growth is still energy resources and the real test of the resilience of state-led diversification projects during a time of low oil and gas prices is yet to come.

So far, EU policy does not appear to have grasped the nature or scale of these challenges. European energy initiatives remain technical and regulatory. A comprehensive approach that links energy to economic and political development is at best nascent – or even, in some cases, a more distant prospect. The shift has not been made from focusing on the 'hardware' of energy security (pipelines, contracts etc) to its 'software' (the good governance of energy resources). Other security issues are still pursued in a way that cuts across energy security. The holistic approach has failed to gain traction above all in Iran and Iraq. The EU retains an overly benign perspective on the region's internal politics and economics. Crucially, where a focus on good governance has taken shape, it equates governance with better and more secure access for foreign investment rather than with a more effective use of energy resources for development.

Bibliography

Commission of the European Communities, 'Communication from the Commission to the Council and the European Parliament on the development of energy policy for the enlarged European union, its neighbours and partner countries', Brussels: Commission of the European Communities, 2003

- 'An External Policy to Serve Europe's Energy Interests': Paper from Commission/SG/HR for the European Council, Brussels: Commission of the European Communities, 2006

- Green Paper: 'A European Strategy for Sustainable, Competitive and Secure Energy', Brussels: Commission of the European Communities, 2006.

Echagüe, A. 'The European Union and the Gulf Cooperation Council', FRIDE Working Paper *39*, Madrid: Fundación para las Relaciones Internacionales y el Diálogo Exterior, May 2007.

Ferrero-Waldner, B. Commissioner for External Relations and European Neighbourhood Policy Opening address at the conference 'Towards an EU external energy policy to assure a high level of supply security', Brussels: November 2006.

Energy Information Administration, 'International Energy Data and Analysis for Algeria', Washington DC: US Department of Energy, 2008.

Hertog, S. 'EU-GCC relations in the Era of the Second Oil Boom", Munich: CAP Working Paper, 2007.

Iqbal, F. 'Sustaining Gains in Poverty Reduction and Human Development in the Middle East and North Africa' Washington DC: World Bank, 2007.

Janardhan, N. 'Economic Diversification and Knowledge Economy in the Gulf', Paper delivered at the Gulf Studies Conference, Exeter University, 3 July 2008.

Luciani, G. 'The Economics and Politics of the "Dire Straits"', GRC Security and Terrorism Research Bulletin 6, Dubai: Gulf Research Centre, 2007.

NATO Parliamentary Assembly Conference Proceedings 'Development of Civil Society and Economy in the MENA region' Brussels: 2007.

Pissarides, C. and Véganzonés, M. 'Labour markets and economic growth in the MENA region', Washington DC: 2005.

United Nations Development Programme (UNDP), 'Arab Human Development Report 2002', New York: UNDP, 2005.

United Nations Development Programme-Programme on Governance in the Arab Region, 'Government effectiveness – 2007', New York: UNDP, 2007.

World Bank, 'Annual Report 2007: Middle East and North Africa', Washington DC: World Bank, 2008

- 'Better Governance for Development in the Middle East and North Africa', Washington DC: World Bank, 2003

- 'Middle East and North Africa: Regional Data from the WDI database', Washington DC: World Bank, 2008

- 'The Road Not Travelled: Educational Reform in the Middle East and North Africa', Washington DC: World Bank, 2007

- '2005 MENA Economic Developments and Prospects', Washington DC: World Bank, 2005

- '2008 MENA Economic Developments and Prospects: Regional Integration for Global Competitiveness', Washington DC: World Bank, 2008.

EDC2020

EUROPEAN DEVELOPMENT CO-OPERATION TO 2020

European Association of Development Research and Training Institutes (EADI)
Kaiser-Friedrich-Strasse 11
53113 Bonn
Germany

Tel.: (+49) 228 . 2 61 81 01
Fax: (+49) 228 . 2 61 81 03
www.eadi.org

Over the next decade, Europe's development policies will have to act on a combination of old and new domestic issues and substantial changes in the global landscape. Change in Europe's internal architecture – with implications for development policy – takes place in times of wide-ranging global shifts, and at a time when questions of European identity loom large in national debates. A key questions is: How will the EU, how will "Brussels" and the member states be working together on common problems? Global challenges include three issues increasingly facing EU's development policy agenda:

- The emergence of new substantial actors in international development,
- The linkage between energy security, democracy and development and
- The impact of climate change on development.

Public and policy-making debates need to be informed about future options and their likely effects; and decisions need to be based on good research and sound evidence. EDC2020 seeks "to improve EU policy-makers' and other societal actors' shared understanding of the above named emerging challenges facing EU development policy and external action." EDC2020 will contribute to this shared understanding by promoting interaction across research and policy-making, aiming at establishing links to share perspectives across different arenas, and mutual learning. To this aim, EDC2020 will provide policy-oriented publications, a shared project website and high-level European policy forums.

The three-year consortium project EDC2020 is funded by the 7th Framework Programme of the European Union. More information about our the EDC2020 project can be found at **www.edc2020.eu**

SEVENTH FRAMEWORK PROGRAMME

Project funded under the Socio-economic Sciences and Humanities theme

EADI

d·i·e
Deutsches Institut für Entwicklungspolitik
German Development Institute

FRIDE
FUNDACIÓN PARA LAS RELACIONES INTERNACIONALES Y EL DIÁLOGO EXTERIOR

IDS Institute of Development Studies

SID
Society for International Development

odi
Overseas Development Institute