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IMPLICATIONS OF THE UKRAINE CRISIS FOR THE MIDDLE EAST

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On first sight the Middle East seems to be far away from Ukraine and not directly involved in the escalating events around Crimea's secession and subsequent annexation by Russia. Yet Ukraine crisis is carefully watched in the region. It could have an impact on oil and gas prices, the Middle East's most important export goods. Russia and Ukraine are also major food exporters to the region and an important market for Turkish construction and manufacturing businesses. The crisis offers opportunities, too. As Western Europe feels a renewed urgency to diversify its energy supplies, Middle Eastern suppliers could seize business opportunities and Turkey could sharpen its profile as a gas-trading hub.

The crisis can also have political effects in the Middle East. Tension in Ukraine is diverting global attention away from Syria and a more assertive Russia is likely to strengthen the positions of hardliners in Tehran and Damascus. Above all the crisis raises concerns about Western security guarantees in a region that is characterized by turmoil, shifting alliances and a bid for regional hegemony with sectarian undertones by Saudi Arabia and Iran.

Economic Threats: energy prices, food security and Turkey's vulnerable economy

The Russian economy is heavily dependent on exports of raw materials and of oil and gas in particular. Apart from arms it has few manufactured goods that are competitive on world markets. Like many countries in the Middle East Russia needs a high oil price to finance domestic spending. With *\$117 per barrel its estimated breakeven price for a balanced budget* is considerably higher than in Saudi Arabia, where the threshold currently hovers around \$80-90. Russia has a much larger population to care for and less foreign reserves. Hence its vulnerability is higher than in the Gulf countries and comparable *to Iran, which needs a \$140 oil price to break even* and has been badly hit by sanctions over the last two years, which led to a sharp reduction of its oil exports.

If Russian oil exports declined because of sanctions or even worse military conflict, Middle East oil exporters might actually benefit. As a result of the US boom in tight shale oil and sluggish demand in the

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Any escalation of the Russian-Ukrainian stand off would increase the value of North African gas supplies for European energy security.

Israel is set to become a major gas exporter after discovery of two large gas fields and could be an interesting new supply source of gas exports from the region

Moscow will likely be more supportive of Bashar Al-Assad, who has applauded Russian policies in Ukraine.

The Ukrainian crisis will likely strengthen the positions of the Egyptian armed forces. Putin has openly supported General Sisi's bid to run for President.

Turkey's foreign affairs minister, Ahmet Davutoglu, was one of the first foreign affairs ministers to visit Kyiv when the crisis broke and since then there have been regular contacts with Tatar leaders.

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wake of the global financial crisis considerable downward pressures on oil prices exist. Limitations on Russian supplies would alleviate such pressures. However, on the other hand, high oil prices are bad news for the non-exporter countries of the regions. Egypt has turned into a net importer of oil at the end of the 2000s and energy imports are a major contributing factor to the large current account deficit of Turkey, which is the Achilles' heel of the country's economy.

For several reasons, the rising oil price scenario is not the most likely one. So far Western sanctions have been tame and only encompassed financial and travel restrictions for a few individuals and companies. Given Western European dependence on energy imports from Russia, the latter's importance as an export market for manufactured goods and its political and military weight, there is an inclination to placate Russia. Germany is Russia's largest trading partner after China and receives 39 per cent of its natural gas from there, considerably above the EU average of 31 per cent. It takes a prominent role in formulating a European stance and has favoured a measured reaction thus far. Russia is not Iran and all out sanctions on its energy sector are not very likely.

Barring sanctions Philip Verleger has argued in a *recent op-ed in the Financial Times* that Russia could be weakened by the sale of oil from the US Strategic Petroleum Reserve (SPR) via open

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market operations. Stocks in the SPR are substantially above the requirement of the International Energy Agency (IEA) to hold reserves that are equivalent to 90 days of imports. Verleger estimates that the US could sustainably sell 500,000-750,000 barrels a day over a period of up to two years without breaching its IEA obligations. As a result oil prices could decline by \$10-12. This would undoubtedly hurt Russia. Contrary to the US and the UK natural gas prices in continental Europe are typically linked to oil prices via a formula, hence Russia would not only lose out on oil, but also gas revenues.

Because of their large foreign currency reserves and lower breakeven prices Middle East oil exporters could digest such declines more easily with the exception of Iran. As Gulf countries support rebel groups in the Syrian civil war, while Russia and Iran side with the Assad regime, they would undoubtedly see some geostrategic benefit in such a price decline, also because they are deeply worried about Iran's nuclear ambitions.

Energy aside, Russia and Ukraine are major food exporters and the Middle East imports about a third of globally traded cereals. The Black Sea region is the major export outlet and any supply disruptions would be disconcerting. Both countries have a particularly strong standing in barley markets and Saudi Arabia imports 40-45 percent of globally traded barley each year as feedstock for its substantial livestock industry. Egypt on the other hand is the world's largest wheat

importer and has shifted its major supply sources from North America to Russia in the 2000s. Russian grains are of lower quality and cheaper. Russia's reputation as a reliable supplier suffered greatly when it declared food export restrictions out of concern for its domestic food security in the wake of the global food crisis of 2008 and then again after a drought in 2010. The Ukraine crisis will likely add to Middle Eastern concerns about food supply security from Russia and Ukraine. This is quite worrying for governments that experienced recently how rising food prices added to the social discontent in the streets of the Arab world.

Finally, Turkey, can suffer from economic sanctions against Russia and deteriorated economic conditions in Ukraine. Its economy is already in a vulnerable situation because of its large current account deficit, resulting reliance on hot money inflows, ballooning private debt, political turmoil and the global concerns about the stability of emerging economies. Russia is importing large amounts of manufactured goods and fresh produce of fruits and vegetables. It is also a major trade and investment destination for the Turkish construction industry. Of 32 million tourists arriving in Turkey every year over 10 per cent come from Russia, being outnumbered only by Germans with 5 million. Turkey's economic links with Ukraine are also strong: Ukraine was its 14th largest trade partner in 2013, Turkish investments amount to 2 billion USD, Turkish constructors have undertaken projects worth 3.8 billion USD, and 600.000 Ukrainian tourists visit Turkey every year.

Economic Opportunities: a case for diversified energy supplies

What is a threat to Western Europe, the possible disruption of energy supplies from Russia, could become an opportunity for the Middle East. Disputes between Russia and Ukraine over pricing of gas deliveries have sent repeated shockwaves through energy markets since 2005. Ukraine is a major transit hub for Russian gas exports to the West and has an interest in subsidized domestic gas prices that date back to Soviet times. Russia in turn has an interest to converge the reduced prices for former Soviet Union members with the higher prices paid by Western consumers. It is only willing to maintain them if it receives political favours in return. Russia has reduced deliveries to Ukraine several times because of the gas pricing spat. In 2009 it cut them off completely what led to supply disruptions in the West, particularly in Balkan countries that do not have meaningful storage capacities.

To counter such threats Western Europe has sought more direct cooperation with Russia while looking for alternative supplies at the same time. The Nord Stream pipeline was inaugurated in 2011/12 and pumps gas directly from Russia to Germany via the Baltic Sea. It has been built to increase supply security by circumventing Ukraine and other transit countries. The Nabucco pipeline project of a European consortium aimed at directly accessing Caucasian, Central Asian and Middle Eastern supply sources and shipping the gas via

the Turkish transit hub to Europe, thus reducing dependence on Russian gas deliveries. The project eyed supplies from Azerbaijan, Iraq, Egypt and Turkmenistan. Iran with its large undeveloped gas reserves would have been a natural partner as well, but has been off limits because of sanctions against the country. The downsized version of Nabucco West only aimed at Azerbaijan's Shah Deniz gas field, but experienced a decisive setback when the Trans Adriatic Pipeline project of BP, SOCAR and Total S.A. managed to secure the shipment rights for the field in 2013.

Russia for its part has sought to prevent emerging new supply routes by pipeline projects of its own. With a favourable price deal it enticed Turkmenistan to route its gas exports via the Russian pipeline network and it has tried to saturate the Turkish gas market with supplies of its own to ward off alternative pipeline projects. The Blue Stream pipeline via the Black Sea to Turkey was inaugurated in 2005. Construction for the South Stream pipeline to Bulgaria started in 2012 and it will be operational in 2015. Its commercial viability has been doubted because of the high costs of the long underwater stretch. But it is buttressed by political motivations as it has been widely regarded as a direct competition to the planned Nabucco project.

The current Ukraine crisis will reinforce European concerns about the security of Russian supplies via Ukraine. Several Middle Eastern countries stand to benefit from a renewed interest in alternative supplies and distribution networks. Natural gas is not a fungible commodity like oil, which can be shipped freely via tankers and trades on a global market with a single price. Natural gas transport via pipeline locks buyers and sellers into long-term cooperation agreements and leads to segmented markets with widely differing prices. However, Liquefied Natural Gas (LNG) has captured an increasing share of global gas markets over the past decade. While it also encourages long-term buyer seller relationships and is not as fungible as oil, it has led to more liquid spot markets for gas and offered new supply alternatives. However, LNG deliveries from the Middle East face higher transportation costs than comparable pipeline projects.

Qatar has developed into the largest exporter of Liquefied Natural Gas (LNG) globally and is a major supplier to the UK. Other European countries might follow suit and build up LNG import capacities of their own. This might benefit Dubai, which has tried to build up an LNG trading hub that would broker different LNG qualities and would make them more tradable. Qatar is also host to the Gas Exporting Countries Forum (GECF). Some have feared that the GECF might aim at acquiring similar market power like OPEC for oil. Because of the relative non-fungibility of gas this is highly unlikely if not impossible.

Algerian and Libyan gas supplies to Italy have declined in recent years, only Spain saw growth in Algerian deliveries. Demand has slowed because of the economic crisis in southern EU states, while supplies from Libya dropped dramatically as a result of unrest in the country. As markets have been

well supplied that did not matter much, but any escalation of the Russian-Ukrainian stand off would increase the value of North African gas supplies for European energy security, especially if the EU should decide to expand gas corridors via Spain and Italy. However, technical production challenges in Algeria and the political situation in Libya might prevent the two countries from capitalizing on these strategic revaluations.

Israel is set to become a major gas exporter after discovery of the large gas fields Tamar and Leviathan in 2009 and 2010 respectively. Tamar started production in 2013 and the Leviathan is expected to follow suit in 2015-17. Israel plans to export up to 40 per cent of production and is currently evaluating possible outlets. They include the construction of LNG plants on Cyprus or an underwater pipeline to Turkey that would raise territorial concerns of the latter. Lebanon also continues to claim rights to part of Leviathan while differences over Tamar have been settled. Israel could become an interesting new supply source of gas exports from the region after once hopeful Egypt has developed into a gas net importer and even had to resort to LNG emergency deliveries from Qatar in recent times.

Iraq was scheduled to become a major supplier to the failed Nabucco pipeline. It has ambitious plans to increase oil pro-

Energy aside, the Ukraine crisis will likely add to Middle Eastern concerns about food supply security from Russia and Ukraine.

duction to up to 9 million barrels per day by 2020 from currently 3 million barrels per day. The semi-autonomous Kurdish region in the North has finished the construction of its own pipeline in 2013. Amidst continuing controversies with Baghdad over revenue sharing and the Iraqi oil law that is pending since 2008 Iraqi Kurdistan now aims to export oil on its own account to Turkey. Iraqi oil production growth will likely be much lower than the ambitious targets given the security situation in the country, political infighting, lacklustre response of international oil companies to offered contract terms and lack of domestic capacities, yet even a smaller increase will lead to growing production of associated gas. Kurdistan has also substantial reserves of unassociated gas. Iraq could thus develop into a gas exporter.

Iran has common interests with Russia as both support the Assad regime in Syria and Russia has shown some willingness to oppose Western policies that are directed against Iran's nuclear program. In the context of the Crimean crisis Russia has even threatened to withdraw cooperation with Western powers on the Iranian nuclear file without offering specifics. Yet Iran is the Middle Eastern country that stands to gain the most from any changes in the energy security calculus of Europe. It is an open secret that its vast underdeveloped natural gas reserves would have been an ideal candidate for filling the Nabucco pipeline. Sanctions, political infighting and domestic inefficiencies have prevented the development of these reserves, which are the second largest in the world after Russia. This might change

if the current negotiations over its nuclear program with the five UN Security Council Members plus Germany led to a lifting of sanctions. Iran would also be a good transit country for supplies from Turkmenistan and other Central Asian countries. Transit via its territory would be cheaper and more easily achieved than via underwater pipelines through the Caspian Sea where disagreements between riparian countries over sovereign rights over the seabed exist.

Political threats: regional Cold War dynamics and eroding trust in Western Security guarantees

The immediate effect of the Ukrainian crisis is that it has diverted attention away from Middle East affairs in general, and from the three-years old conflict in Syria in particular. However, this does not mean that the Middle East will become less important for international security. On the contrary, there is a serious risk that the Ukrainian crisis will result in a more assertive and far less cooperative policy of Russia, which might be tempted to make a stand against Western interests in the Middle East via proxies.

Who are the winners and losers in this new scenario? Unless Russia is seriously weakened as a result of sanctions, Moscow will likely be more supportive of Bashar Al-Assad, who has

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applauded Russian policies in Ukraine and will be carefully watching how consistent the US and its allies act on red lines. What remains to be seen is whether backers of the various factions of the opposition would ramp up their support in turn. The US-Russia cooperation on the dismantling and destruction on Syria's chemical weapons could also be affected.

Regarding the Iranian nuclear program, a division among the five permanent members of the UN Security Council, will not help to bring negotiations between Iran and the 5+1 countries forward. For the moment, they have not been harmed by the Ukrainian crisis, but Russia has vaguely threatened that it might reconsider its stance. Russia is not interested either in Iran becoming a nuclear power. However, the negotiating position of Iran is now stronger as the risks of a non-agreement are higher for the US and the European powers, particularly if this implies the possibility of an Israeli military action against Teheran that could further destabilise the region. Simultaneously, the current situation provides further incentives for Russian-Iranian cooperation, if the negotiation process derails. Iran would then seek Russian support in the UN Security Council to avoid new sanctions or punitive action. As former Iranian nuclear negotiator Sayed Hossein Mousavian wrote in *Al Monitor*: "If the Ukrainian crisis continues and Iran faces excessive demands and pressure from the West during the nuclear negotiations, Russia will move closer to Iran and the two states could form a power pole in the region".

The Ukrainian crisis will likely strengthen the positions of the Egyptian armed forces. The new Egyptian authorities have intensified relations with Russia since the military takeover of July 2013. Putin has openly supported General Sisi's bid to run for President. The most evident result of this rapprochement is the 2 billion dollar arms deal that was signed few weeks before the Ukrainian crisis broke out. The indirect effect of the growing presence of Russia in Egypt is that the US cannot afford to lose a key ally in the region and, consequently, will likely continue to turn a blind eye to new forms of authoritarianism and human rights violations in Egypt.

Turkey is in a less comfortable position: Ankara opposes the Crimean annexation but does not want to antagonise Russia. Next to the need to protect Turkey's energy and trade interests, the Tatar issue is a main driver of Turkey's policy towards the Ukrainian crisis. Tatars are culturally and historically linked to Turkey and want in their large majority that Crimea remains part of a European Ukraine. Turkey's foreign affairs minister, Ahmet Davutoglu, was one of the first foreign affairs ministers to visit Kyiv when the crisis broke and since then there have been regular contacts with Tatar leaders. Turkey considers the Crimean referendum and its result illegitimate. Turkey is also worried of a domino effect in the whole Eurasian region and is afraid of a scenario of communitarian violence in Crimea that could force her to be more

active in this crisis. Vladimir Putin has understood Turkey's concerns. He has suggested to enlarge cultural rights of the Crimean Tatar population and offered to support the return of those Tatars who are still in Cen-

tral Asia. It seems that Russia looks at Turkey as a mediator in this specific aspect of the crisis and that Turkish authorities are willing to play this role. Because of the centrality of the Tatar issue and the strong political and economic relations with Russia, Turkey will try everything it can to avoid involvement in a new crisis in its neighbourhood.

Israeli authorities have been silent regarding the crisis despite, or precisely because of, the large number of Israeli citizens from the former USSR and particularly from Ukraine. With its silence, Israel's government attempts not to take sides in an issue that can divide the Israeli population, while preserving relations with Russia at a moment in which Israelis feel that they cannot exclusively rely on the US. The response of the US and its allies to this crisis will also be carefully scrutinised in Israel because the issue of security guarantees is part of the Kerry-led negotiations to establish a framework agreement to move the Middle East Peace Process forward.

The Ukrainian crisis has also heightened already existing concerns about the reliability of Western security guarantees in Saudi Arabia and other Gulf countries. They do not have a formal defence treaty with Western powers, but US CENTCOM is stationed in Qatar, the American 5th fleet in Bahrain and France entertains a naval base in the UAE. Since western arms manufacturers have been reeling under the lack of domestic demand after the end of the Cold War, the Gulf has developed into the most attractive export destination

for them. Such deals and the kickbacks that come with them have helped to cement crucial alliances. Hence, western security guarantees exist all but in name and have materialized in the past when Allied troops repelled Saddam Hussein's invasion of Kuwait. They are also needed: Gulf countries are ruled authoritarian with no formal democratic legitimacy. They are afraid of spill-over effects of the Arab spring and a perceived Iranian bid for regional hegemony. Despite multi-billion weapons purchases, their military capabilities are widely regarded as weak as training, maintenance and coordination between Gulf countries States is lacking.

For several reasons Gulf countries are not so sure anymore about such security guarantees. They are concerned that the strategic interest of the US in the region will decline as a result of its domestic shale boom. That the Middle East will always remain a crucial factor for price discovery on global, fungible oil markets, even in the unlikely event of total US self-sufficiency should alleviate such fears, but it doesn't. Gulf countries also noticed that the US tried to stay out of the Libya intervention, preferring to lead from behind only and that such a relatively limited intervention pushed European military capacities to their limit. They saw how the US let Mubarak fall unceremoniously. They expected a more decisive reaction against the Assad regime after it had crossed Obama's self-declared red line and used chemical weapons against its own population. Saudi Arabia has staunchly refused to cooperate with Maliki's government in Iraq, *who King Abdullah called an "Iranian agent" that he did not trust according to a wikileaks cable*. America's grudging support of the Maliki regime against Sunni insurgents is unlikely to alleviate such concerns at a time when Gulf countries are anxious that a grand bargain between the West and Iran might settle the standoff over the latter's nuclear file and support its regional influence.

As a result they have tried to build a more independent and assertive foreign policy that has been thin skinned and erratic at times. Saudi Arabia has refused membership in the UN Security Council after lobbying for it for years, protesting politics in Syria and Israel in a petulant statement. The GCC countries have offered membership to fellow Arab monarchies Morocco and Jordan with inconclusive results. Saudi Arabia has flaunted the idea of a more comprehensive Gulf Union with a strong security component, a proposal that was promptly turned down by Oman, which traditionally has relatively close relations with Iran and has recently signed a gas treaty with it. Saudi Arabia has given \$1.5 billion to Pakistan as a "gift" for military support for Syrian rebels and against the Huthi rebellion in northern Yemen. The Saudi royal Turki al Faisal who currently does not hold office has stated repeatedly that Saudi Arabia would acquire a nuclear weapon if Iran succeeded in doing so and Saudi Arabia has negotiated the purchase of Chinese rockets that would fit nuclear warheads in an apparent bid to diversify its sources of arms procurement. Persistent rumours point to

a *secret deal with Pakistan* over sharing of its nuclear umbrella, if not outright transfer of nuclear weapons. Except for Qatar, Gulf countries under Saudi leadership were enthusiastic supporters of the army coup in Egypt under general Sisi and the re-establishment of authoritarian rule there.

The way in which the Ukrainian crisis will be resolved will also send a message to those who are in charge of the nuclear talks in Teheran. A toothless response by the US and the EU can offer arguments to hardliners in Iran. In 1994 Russian, British and US leaders signed the Budapest Memorandum and committed themselves to the integrity of Ukraine's borders in return for dismantling its arsenal of nuclear weapon. Neither the US, nor the EU, have an interest in using force in Crimea and when asked about the Budapest memorandum they might argue that the text does not specify the means to defend Ukraine's territorial integrity or that the US senate has not ratified it. Yet, until this crisis broke out, Ukraine was often presented as a model of successful denuclearisation in front of the Iranian negotiators who may now wonder whether a nuclear Ukraine would have been able to retain Crimea.

In sum, the Ukrainian crisis has severe repercussions beyond the borders of Europe. In the Middle East it will have an impact on fragile economies of the region even though its energy

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exporters might be able to derive benefits from higher prices and a recalibration of European policies on energy security. Above all it will affect the strategic calculations of actors in the Middle East. Gulf countries and Israel already show reduced trust in Western security guarantees. Syria, Iran and Egypt might find opportunities to take advantage of global power rivalries as they did during the Cold War era. Turkey, finally, will likely focus on manoeuvring the threats and opportunities that emanate from the Ukrainian crisis, as long as it sees the rights of the Tatar minority safeguarded.