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*The Euro-Mediterranean energy relationship:
a fresh perspective*

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Abstract

Energy is a fundamental component of the economic relationship between the European Union and southern Mediterranean countries, largely driven, traditionally, by Europe's quest for oil and gas supplies. However, given the booming energy demand in southern Mediterranean countries and their great solar and wind potential, regional energy cooperation should also strongly focus on fostering large-scale deployment of renewable energy. This would allow southern Mediterranean countries to meet their increasing energy demand in a more sustainable way, and would also have positive economic and political benefits for Europe.

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Energy: the core of the Euro-Mediterranean economic relationship

Energy is a fundamental component of the economic relationship between the European Union and the ‘southern neighbourhood’ Mediterranean countries. This dates back to the 1960s, when discussions started on the first large-scale energy infrastructure in the Mediterranean region – a gas pipeline connecting Algeria to Italy via Tunisia. Since then, more than 6,000 kilometers of gas pipelines have been laid across the Mediterranean, to connect Algeria with Spain and Italy, and Libya with Italy. Large-scale liquified natural gas (LNG) and oil infrastructure has also been constructed all around the Mediterranean.

This infrastructure, built on the basis of bilateral state-to-state and company-to-company relationships between producers in the south and importers in the north, still channels a major part of Southern Mediterranean countries’ (SMCs) total exports to Europe.

In the early 2000s, the idea emerged of replicating the successful gas cooperation story in the Mediterranean region in the area of renewable energy. Taking a regionalist approach rather than a traditional bilateral approach to cooperation, two initiatives were launched with the objective of tapping into the vast solar and wind energy potential of SMCs: Desertec and the Mediterranean Solar Plan. These would supply clean energy to the SMCs and to Europe. Desertec was a German industrial initiative, and the Mediterranean Solar Plan was a Union for the Mediterranean flagship project. Both initiatives were supported by the European Union, which has always viewed energy cooperation as a special tool to promote political stability and economic prosperity in the region.

But these two initiatives failed in less than a decade, largely because of a lack of commercial and political realism. The initiatives’ business models were based on the export to the EU of solar and wind electricity produced in SMCs and were not commercially viable because of: i) high electricity generation costs; ii) lack of electricity interconnections between SMCs and between the northern and southern Mediterranean shores; and iii) the lack of a clear need on the EU side for additional renewable energy capacity. In political terms, the initiatives did not properly consider that the first priority for SMCs was meeting their own booming energy demand. Nor did they take sufficiently into account the overall lack of cooperation between SMCs, the group of countries with the lowest level of intra-regional trade in the world. In particular, both initiatives proved unrealistic because

they sought to adopt a one-size-fits-all approach to a region that was – and continues to be – too complex and diverse for this to work.

This experience suggests that fostering renewable energy in the region cannot be done on the basis of a Eurocentric approach. In other words, instead of the traditional focus on exporting energy from SMCs to Europe, the priority should be supporting SMCs in meeting their booming energy demand in a sustainable way. Cooperation between the EU and SMCs in terms of renewable energy should be about developing projects for the SMCs' consumption, not for Europe's. Since 2000, energy demand, especially electricity demand, has boomed in SMCs. This trend is set to continue in the future, in response to expected population and GDP growth in SMCs.

From an energy cooperation perspective, the most sensible way for the EU to respond to this challenge is to foster the large-scale deployment of renewable energy – notably solar and wind – in SMCs.

The other important component of Euro-Mediterranean regional energy cooperation, natural gas, does not need EU support in order to progress. It is a well-established sector in which progress is mainly driven by the private sector. As has been shown by the discovery and development of large natural gas fields in the offshore waters of Egypt and Israel, European energy companies – with the diplomatic backup of their respective governments – can foster vast projects without any EU intervention.

For renewable energy the situation is different. The sector is not yet well established in the region, increasing the financial and regulatory risks for European companies. This is the primary reason why a strong EU contribution in the field could foster progress.

As we will show, making progress on renewable energy in the region would not only allow SMCs to meet their energy demand sustainably – from both environmental and macroeconomic perspectives – but would also have positive benefits for the EU in both economic and political terms.

Current renewable energy developments in SMCs and future prospects

The SMCs are richly endowed with solar and wind energy resources, which are estimated to be among the best in the world. Solar photovoltaic (PV) potential is widespread in the region and can be tapped at both household and utility levels. Concentrated solar power performs optimally in utility-scale projects situated in the region's deserts, where the intensity of solar irradiation is among the highest in the world. Wind power also has great potential for the SMCs, given the favourable wind conditions that characterise all these countries.

In recent years, the SMCs have started to exploit this potential, but wind and solar still provide a minor contributor to SMCs' primary energy mixes – with shares well below 5 percent in all countries.

In the context of the Paris Agreement, all SMCs have adopted post-2020 plans, known as Nationally Determined Contributions (NDCs), to reduce their greenhouse gas emissions. While countries' NDCs differ considerably in terms of their levels of ambition, they do share a common feature: linking action to external support. The SMCs have committed to only modest greenhouse gas reductions through their own efforts and have promised much more substantial action only if external technical and financial support is made available.

International climate finance thus has a crucial role to play in fostering the implementation of the Paris Agreement in the SMCs and, consequently, in fostering the large-scale deployment of renewable energy.

On their side, under the Paris Agreement, developed countries committed to mobilise from various sources – public and private, bilateral and multilateral – \$100 billion per year by 2025 to support developing countries in their efforts to reduce emissions. The EU play a key role in this field, being the world's largest contributor of climate finance to developing countries.

Linking climate finance to better renewable energy governance

Scaling-up renewable energy in the SMCs in line with the countries' NDCs will be costly. For instance, the World Bank Group estimates that Egypt, Jordan and Morocco alone would need around \$100 billion in investment in renewable energy generation between 2016 and 2030 to meet their NDC targets.

International private investment is essential to meet this large investment need. However, various barriers in SMCs continue to prevent international investors from becoming more engaged in SMC renewable energy sectors. Two key barriers stand out.

First, legal and regulatory barriers. All SMCs have renewable energy targets, but achieving them ultimately relies on the presence of sound and stable renewable energy regulatory frameworks. On this front, much remains to be done in the SMCs. For instance, frequent changes in feed-in-tariff schemes and fossil-fuel subsidies are a concern for investors in several countries, while the lack of an independent regulatory authority is also a key concern for investors. The lack of a fully developed regulatory framework also continues to hinder investments in different countries.

Second, financial barriers. Currency convertibility, inflation and lack of foreign reserves are concerns for investors in almost all SMCs. The cost of financing and the limited availability of debt from commercial sources for renewable projects represent a general challenge in all SMCs, though to different degrees. These barriers are felt either through non-availability of finance or inflexible grace periods that are not adapted to the characteristics of such investments.

SMCs must take action to overcome these barriers, in line with their respective national circumstances. That is, the governments of SMCs should act first and reform their energy sectors in order to unleash private investment.

Europe meanwhile could incentivise this process by offering individual countries more ambitious climate financing, aimed at cutting the cost of capital for renewable energy projects and leveraging more private investment.

But such action should be conditional on the implementation of the reforms necessary to attract further private investment. To be clear, these reforms should not be aimed at replicating in the

SMCs the European frameworks and rules, but to find in a cooperative manner pragmatic solutions to specific legal, regulatory and financial bottlenecks.

The positive implications for Europe

Providing support so that SMCs can meet their energy demands in a sustainable way would benefit not only the SMCs themselves, but also Europe.

Supporting sustainable energy development in SMCs would indeed imply opening up new business opportunities for European energy companies to operate in rapidly growing markets and promoting the export of European renewable energy technologies. This is notably the case for wind power, a sector in which SMCs rely almost exclusively on imported European technology.

Furthermore, this would guarantee the stability of future gas exports from the region to Europe, by allowing these countries to meet their growing electricity demand with renewables instead of gas. This is important for Europe because these gas exports are an important element of the EU's gas security-of-supply architecture.

Finally, this would allow to promote a more rapid economic development in SMCs, which is a key prerequisite for expanding the region's economic and trade relations with Europe, with the positive geopolitical repercussions this naturally entails.



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