



Lebanese Oil & Gas Initiative
المبادرة اللبنانية للنفط والغاز

Is Lebanon preordained to Become a “Presource” Curse Country?

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Foreword

Lebanon has issued licenses for oil & gas exploration with prospects of becoming a producer and exporter. These are fueling expectations, verging on irrational exuberance, that an energy windfall would jumpstart a lethargic economy suffering from political & economic mal-governance, geopolitical malaise and spillover from Syria’s war.

The critical issue, however, is the governance of Lebanon’s natural resource wealth. The main lesson from the international experience of resource-rich countries is that in the absence of good governance, strong institutions, rule of law and effective regulations, Lebanon’s oil and gas windfall is likely to lead to more corruption and capture of the resource wealth by special interest groups and politicians to the detriment of the national interest and future generations. This is the resource curse, the paradox of natural resource rich countries experiencing lower growth, less democracy and worse development outcomes.¹

More paradoxical and perverse is the pre-resource curse whereby countries with weak political institutions, corruption, with mal-governance and absence of well-structured fiscal regimes tend to over-spend and over-borrow in advance of the start of extraction and realization of revenues. Since 1988, there have been some 236 giant oil & gas discoveries in 46 countries, with a value averaging 1.4% of GDP. “On average, globally, after major discoveries growth has underperformed the post-discovery forecasts. For some countries, such discoveries led to significant growth disappointments, even compared to pre-resource discovery trends”, as well illustrated by the cases of Ghana, Mozambique and others². There were shining promises but dismal performance.

Lebanon faces a triple jeopardy and pre-resource curse risk and vulnerability: One, it has high level of public debt exceeding 155% of GDP, low economic growth, and unsustainable current account and fiscal deficits. Two, it has weak governance and political institutions, with pervasive corruption, being the 143rd most corrupt country out of 175. Three, it has weak growth prospects absent fiscal and structural reforms. These vulnerabilities make it more likely that Lebanon will suffer from the pre-resource curse, as politicians are likely to delay reforms, continue with fiscal profligacy, increase spending and borrowing –including through the promised Paris IV program- with corruption increasing given the potential of capturing oil & gas revenues.

1

See the discussion in “Can Lebanon Escape the Resource Curse?”, Project Syndicate Article, Nov 2016.

2

James Cust and David Mihalyi, The Presource Curse, Finance & Development, December 2017, and “Evidence for a Presource Curse?”, World Bank, Policy Research Paper #8140, July 2017.

What should be done to mitigate the risks of the pre-resource curse? The LOGI policy paper, “Is Lebanon Preordained to become a Preresource Curse Country?” makes an important series of recommendations aiming for a robust governance framework in advance of the exploitation of Lebanon’s exhaustible oil & gas wealth. Drawing on the lessons from other countries, Lebanon needs to (i) Manage public expectations and reduce hype; (ii) Develop and implement a comprehensive and transparent energy strategy and policy, including renewable energy; (iii) Adopt a Fiscal Responsibility Law and a Fiscal Rule to set long-lasting constraints on fiscal policy based on sustainable income, to ensure fiscal sustainability and intergenerational equity. Similar to the examples of Chile and Norway, the fiscal rule would impose that all oil and gas price windfalls be automatically saved (into a Sovereign Wealth Fund) and government spending determined by cyclically adjusted tax revenue and including a share of oil and gas revenue; (iv) Undertake the structural reforms called for under Paris IV; (v) Start an anti-corruption drive based on judicial reform. Will our politicians and policy makers heed the call?

Dr. Nasser Saidi

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List of Abbreviations

Council of Ministers: CoM

International Monetary Fund: IMF

Ministry of Energy and Water: MoEW

Ministry of Finance: MoF

National Oil Company: NOC

Offshore Petroleum Resource Law: OPRL

Sovereign Wealth Funds: SWF



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1. Introduction

Lebanon is on the uncertain road to making the first commercially viable discovery with the Ministry of Energy and Water (MoEW)'s approval of exploration plans by the Italian ENI International B.V., the French TOTAL S.A., and the Russian JSC NOVATEK consortium for offshore blocks 4 & 9 in the first quarter of 2018. The approval of the exploration plans comes 5 years after the launching of the first pre-qualification round in 2013, which was accompanied by nationwide communication campaign launched by MoEW portraying Lebanon's rosy future as a result of the revenues to be generated by the nascent petroleum sector. The heightened expectations led to hopes that the future revenues likely to be generated by the sector will alleviate the impact of the public debt which is rapidly rising above 150 percent of Gross Domestic Product (GDP)³, while Lebanon was recently granted aid pledges exceeding USD 11 billion through CEDRE Conference.

3

International Monetary Fund, 2018. Staff Concluding Statement of the 2018 Article IV Mission. <https://www.imf.org/en/News/Articles/2018/02/12/ms021218-lebanon-staff-concluding-statement-of-the-2018-article-iv-mission>. Accessed 10 July 2018.

However, experience has proven that new commercial discoveries tend to heighten expectations, fueling public spending and risky borrowing. In fact, governments can fall in a "presource curse" trap, which is defined as the underperformance of economic growth after a commercial discovery and long before oil and/or gas is produced, as a result of skyrocketing expectations and a correlated increase in public spending and/or borrowing.

This policy brief questions whether Lebanon is doomed to enter the club of "Presource-cursed" countries. It also attempts to shed light on the main policy steps that could be adopted by Lebanese policymakers to avoid it.



2. Recommendations

To the Lebanese Government

- The Council of Ministers should prepare and publish a comprehensive and inclusive national strategy for the petroleum sector that would include for instance options for export, governmental strategy to resolve the maritime borders delineation, the creation of a downstream sector, etc... Such an inclusive and consultative national oil and gas strategy will ensure buy-in from relevant stakeholders, including civil society.
- The Council of Ministers should prudently account for actions that may instigate a “Presource Curse” scenario, and refrain from including inefficient public expenses – establishing institutions prematurely and that would involve additional budget expenditures - while drafting the strategy.

To the Lebanese Ministry of Energy and Water

- The Ministry of Energy and Water should prepare a comprehensive oil and gas strategy and present it to the Council of Ministers for approval.
- The Ministry of Energy and Water needs to correct its initial communication and align popular expectations with policymaking and developments in an uncertain sector to avoid any Presource curse scenarios that could be caused by elevated public expectations.

To the Lebanese Parliament

- The Lebanese Parliament ought to question the government about the reasons behind the absence of a petroleum sector strategy, and clearly ask the government to be formed, to launch an inclusive and participatory strategy drafting process.
- The Lebanese Parliament should take into consideration the uncertainty prevailing in the oil and gas sector while reviewing the draft laws on the establishment of an NOC and SWF and refrain from creating institutions that would incur additional inefficient expenses on the Lebanese budget.
- The Lebanese parliament should assess better the criteria that define the order of priorities for the draft laws presented in line with the national petroleum strategy to be drafted by the Council of Ministers.
- With the absence of a published document justifying the rationale of the NOC and SWF draft laws, and the basis on which the suggested models are as such, the Lebanese Parliament should engage with stakeholders and open a consultative process with civil society.



3. What is a “Presource” Curse?

A recent research paper published by the World Bank found that “in many cases, especially in countries with weak political institutions, economic growth begins to underperform long before the first drop of oil is produced.”

In fact, the mere hint of commercial discoveries leads to increased borrowing, consumption, and government spending, leading to IMF financial assistance, as with Ghana and Mozambique (see Box 1 and 2 below).

- Economic growth averaged 7% between 2003 and 2013.
- Two major Oil discoveries in 2007 and 2010.
- Between 2014 and 2016, growth dropped below 4%, compared to IMF 7% forecasts.
- Government behavior post discoveries characterized by heavy borrowing and increased spending.
- Ghana saved USD 484 million, but also borrowed USD 4.5 billion in international markets.
- Since 2015, Ghana has been under IMF support and surveillance programs.

Box 1 Ghana Presource Curse Scenario

- Largest Offshore gas deposits in sub-Saharan Africa discovery in 2009.
- Growth averaged 6%, and forecasts were above 7%.
- In 2016, growth dropped to 3% due to off-budget borrowing.
- IMF support suspended pending the audit results of the off-budget borrowing.

Box 2 Mozambique Presource Curse Scenario

In contrast, Tanzania has been able to avoid the presource curse altogether after large offshore gas discoveries. In fact, Tanzania’s growth rate increased from 6% to 7% as a result of sustained low levels of public debt and legislated fiscal prudence.

The cases of Ghana, Mozambique, and Tanzania highlight the potential impact of commercial discoveries on the economy, as well as the paramount importance of government performance after promises of future resource wealth are made.



4. Lebanon’s Risky Management of Expectations

The petroleum sector in Lebanon is nascent. It was only recently⁴ that the government allocated its first offshore exploration and production rights over blocks 4 & 9 to a Consortium composed of three companies, concluding the first licensing round after 3 years of bidding delays⁵. The exploration plan submitted by the Consortium was approved by the MoEW on 29th of May 2018⁶, and the drilling phase is expected to start in 2019. No commercial discoveries have been made yet.



Figure 1 MoEW 2013
Promotional Campaign

It is not possible to illustrate the benefits that could be generated by the sector.

4

Lebanese Petroleum Administration, 2017. Presentation of the 1st Offshore Licensing Round Results to the Media. <http://www.lpa.gov.lb/news2017.php>. Accessed 10 July 2018.

5

Reuters, 2017. Bids on Lebanon Offshore energy blocks closed. <https://goo.gl/ENjiBy>. Accessed 10 July 2018.

6

Reuters, 2018. Lebanon begins offshore Oil and Gas Exploration. <https://goo.gl/FfH2n9>. Accessed 10 July 2018.

7

Cyprus Mail Online, 2015. *ENI needs time out after second dud.* <https://goo.gl/FdHRHA> Accessed 11 July 2018.

8

Marcel, V. and Obeid, J., 2018. *Is Lebanon Set for an Oil Bonanza?* <https://www.chathamhouse.org/expert/comment/lebanon-set-oil-bonanza> Accessed 11 July 2018.

9

Idem.

Uncertainty is, without a doubt, an inherent characteristic of resource wealth exploration and development. Prior to making discoveries, Lebanon cannot assess the quantity of commercially viable sub-soil resources, nor is it able to estimate potential revenues from a discovery, especially that sector is subject to price volatility. Therefore, it is not possible to illustrate the benefits that could be generated by the sector, especially that this would not only depend on the quantity and quality of commercial discoveries, but also on the underlying governance structure of the sector. Sub-soil natural resources will not necessarily become assets. The recent failures of ENI to find hydrocarbons in Cypriot offshore Block 9 illustrate this⁷. Uncertainty requires extremely prudent communications from decision makers in charge of the sector's development so as to manage expectations.

Unfortunately, the Lebanese state's track record of managing expectations is weak. In 2013, The Lebanese MoEW launched a promotional nationwide campaign advertising the benefits of becoming an "Oil producer country" as showed in Figure 1. In addition, and when signing the 2 contracts with the winning consortium in February 2018, the MoEW conveyed an unrealistic message of certainty by stating that Lebanon has entered the Club of oil producing countries.⁸

In an article published in IMF's Finance and Development in 2013, Paul Collier presents the examples of Nigeria, Kenya, and Mongolia, as cases where popular expectations have driven governments to take ineffective decisions. Collier illustrates the rising populist claims as a result of oil discoveries. In 1975, the Nigerian government was pressured to raise public wages by 75%, the Kenyans acted similarly in 2012. The Mongolian government distributed half of the national income, more of what was generated in terms of revenues.

During the last eight years, several statements and positions from political figures have contributed to elevated expectations through a discourse exaggerating the expected outcomes of the sector⁹. While it is legitimate for any state to attract investments by sending signals of promising business and development opportunities, the Lebanese state has delivered a wrong message by elevating expectations of the Lebanese public in a sector generally perceived as correlated with wealth and enrichment, and where uncertainty is intrinsically well rooted.

5. Lack of Consensus in Parliament is Deepening With The Absence Of An Oil And Gas Strategy

On November 28th, 2017, a joint meeting of six parliamentary committees -- a fast track process -- were convened by House Speaker Nabih Berri to discuss four draft laws that had been submitted to parliament, in particular the draft law for establishing a National Oil Company (NOC), the draft law for establishing a Sovereign Wealth Fund (SWF), the draft law for establishing the directorate of petroleum assets at the ministry of finance, and the draft law for onshore oil and gas exploration. This move triggered conflicting reactions among the ministers and parliamentarians of different political factions especially with regard to the establishment of an NOC and an SWF.

It is true that the submission of the NOC and SWF draft laws can be considered as problematic in terms of timing. In fact, article 8.1 of OPRL stipulates that *“The Council of Ministers sets forth the State’s general petroleum policy, particularly that related to the management of its petroleum resources and settles differences between concerned stakeholders.”* In other terms, the CoM is responsible of the overall development of the sector and is in charge of setting the sector’s strategy. And since there has been no signs that the presented draft laws fall within the sector strategy and the process adopted is fast track in nature, the parliament could be voting rapidly on laws that could negatively affect public finances in the short term, long before any oil and/or gas is produced.

As a matter of fact, article 3.2 of the Offshore Petroleum Resources Law (OPRL) states that *“The net proceeds collected or received by government arising out of petroleum activities or petroleum rights shall be placed in a sovereign fund.”* However, the exploration of Lebanon’s offshore resources will require in the most optimistic scenario no less than 7 years to produce revenues, which renders the establishment of an SWF in the coming years a premature move, since Lebanon did not make any viable commercial discoveries.

On a similar note, to date no official comprehensive governmental strategy has been developed for the sector. However, the legal setting provides some clarity with regards to establishing an NOC: article 6.2 of OPRL states that *“When necessary and after promising commercial opportunities have been verified, the Council of Ministers may establish a national oil company on the basis of a proposal by the Minister based upon the opinion of the Petroleum Administration”*. In practice, the parliament has clearly defined the process by which an NOC can be established and gave the CoM the mandate to propose its creation, since its establishment embeds a strategic aspect as per article 6.2 stated above.

10

Statement of MP Jaber during the 3rd Regional Oil and Gas Conference hosted by the Lebanese Center for Policy Studies in October, 2017.

11

Ernst & Young, 2014. *Spotlight on Oil and Gas Megaprojects. Oil and Gas Capital Projects Series*, 13 pp.

Elaborating a strategy for the sector should underpin laws that would build the institutional and legal framework within which the strategy would be operationalized. Given that such laws need to be, ideally, aligned with the sector's strategy, the timing of the submission of the two respective draft laws and the parliamentary process adopted for their review had the effect of undercutting the CoM's mandate and responsibilities and of potentially straining the Lebanese budget if financial resources are to be allocated to the establishment of the NOC and SWF at this stage of the sector's development.

The defenders of this move, among whom are MP Yassine Jaber, argue for the necessity of starting early on a parliamentary discussion about the establishment of two critical institutions as "*law voting process in Lebanon takes time.*"¹⁰ The detractors are fearful that fast-tracking will not enable an in-depth and inclusive discussion and concertation and concerned about the effect of increasing public expenditures on the budget by establishing prematurely two public institutions. In addition, the establishment of an SWF and/or an NOC at an early and uncertain stage may also incur additional, unanticipated expenses on its budget. A survey by Ernst & Young in 2014¹¹ showed that 73% of oil and gas projects around the world are characterized by schedule delays, and Lebanon is not necessarily safe in that regard given the maritime borders dispute that will need to be resolved.



6. The Need to Manage Expectations

Botswana has been effectively able to manage its citizens expectations. “We have nothing, so let’s agree that anything we do find belongs to everybody,” stated Botswana President, Ian Khama when meeting with the different factions in the country, effectively managing public expectations about newly discovered mineral wealth.

In that light the Ministry is ought to reconsider its over-optimistic communication approach. Indeed, a realistic discourse can help rationalize expectations from the expected benefits of the petroleum sector in Lebanon, and reduce any potential pressure to increase public expenses as a result of heightened expectations. In fact, according to the 2017 “Citizen Budget” publication by the Ministry of Finance (MoF), 42% of the budget expenses were related to wages and maintenance, and 35% compose the payment of the debt service¹².

Similarly to the prudent approach adopted by the Lebanese state in the first licensing round by not financially participating, and the establishment of a fiscal regime that balances risk and reward on investment, the MoEW is in a position to elaborate a communication plan that aligns expectations with a the more realistic outcome that the sector can yield, while contributing to the creation of a safe and attractive environment for private investments.

In fact, the Lebanese government has adopted a pragmatic licensing strategy, even if hindered by an overall weak governance structure¹³. The government decided as well not to participate as an investor for the first licensing round. This indicates judiciousness with regard to the management of sector in general, and a restrictive behavior in terms of inflicting additional expenses over the Lebanese budget.

12

Ministry of Finance and Bassil Fuleihan Institute, 2018. Citizen Budget 2017. <https://goo.gl/wCRqix>. Accessed 14 July 2018.

13

Lebanon has a poor record and weak ranking under the World Bank World Governance Indicators – WGI. <https://goo.gl/92CGCv> Accessed 14 July 2018.

7. The Need to Build Consensus over the Sector's Strategy

The fast tracking of NOC & SWF draft laws took could backfire. Discussions about the establishment of institutions that play a critical role in resource revenue management should not only be well informed but consultative. Moreover, the process used to tackle the creation of an SWF and NOC does not reflect a consensus among the different political factions. Only a consensus-based strategy that is attentive to long term goals of growth and development, and that minimizes uncertainty can lead to a sustainable development of the sector and benefits to the polity as a whole.

The drafting of a comprehensive and inclusive strategy can contribute to an effective management of expectations as well. Any decision that would inefficiently increase public expenses can have a negative effect on growth, making Lebanon a potential candidate for "Presource Curse" before even any commercial discoveries are made.

Currently, Lebanon's public debt is around USD 80 billion, about 150% of GDP, and Lebanon has committed during CEDRE conference¹⁴ to embark on a fiscal reform program that would reduce the fiscal deficit-to-GDP ratio by 5% for the five coming years. Such a reduction can only be reached by rationalizing spending and reducing public sector employment, among other factors. This could be part of signaling to the international community that Lebanon is serious about economic reforms.

14

Fransabank, 2018.
Study on CEDRE
Conference. [https://
goo.gl/8gewa2](https://goo.gl/8gewa2).
Accessed 15
July 2018.





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