Cure or curse?

There's nothing like the promise of untold wealth to wash away the winter blues, and as the nation awoke to a new year of crippling debt, power cuts, falling buildings and gloomy economic forecasts, it was in need of some good news. What better palliative then, than the prospect of opening a hydrocarbon jackpot under the Lebanese ocean floor?

In the wake of its neighbors' success in tapping the Eastern Mediterranean's resources, Lebanon is finally pushing forward efforts to exploit its share of the seabed in search of the spoils of oil and gas. While politicians may promise immeasurable riches for one and all to share, the sage among the crowd will be observing developments with more than a hint of healthy cynicism. What lies trapped underground offshore is far from assured and a bountiful find could easily turn from a blessing to a curse for the country's economy and body politic.

The potential stakes

In its first meeting of the year on January 4, the Council of Ministers passed an implementation decree pertaining to Lebanon's Offshore Petroleum Resources Law (Law 132), which will enable the country to move forward into the exploration stage. The move has been a long time coming and was precipitated by the enviable finds in other areas of the Eastern Mediterranean.

"Of course there is a race to explore and drill because Israel and Cyprus are already ahead of us," explains the Acting President of the Lebanese Economics Association (LEA) and Associate Professor of Economics at the American University of Beirut (AUB), Jad Chaaban.

Research has long hinted at the potential for hydrocarbons in the region's waters, with a 2010 report by the United States Geological Survey estimating an average of 1.7 billion barrels of recoverable oil and 3.5 trillion cubic meters of recoverable gas in the Levant Basin Province, a geological formation in the Eastern Mediterranean extending from Syria to the Sinai.

Whilst Lebanon lags behind in terms of exploration and drilling, it has commissioned a number of the rather coarse two-dimensional and more refined three-dimensional seismic surveys from the firms Geco-Prakla, Spectrum Geo and most recently Petroleum Geo-Services (PGS). The findings indicate a number of unexplored potential hydrocarbon hotspots including the Syrian Arc, the Levant Basin Province and the Levant Margin in the 20,000 square kilometers of deep water in Lebanon's Exclusive Economic Zone (EEZ) — the ocean area the country can claim ownership over with regards to resources from oil to oysters.

Houston-based Nobel Energy has been operating in Israeli waters since 1998 and has tapped into two massive fields in recent years. In 2009, Tamar, a 237 billion cubic meters (BCM) gross natural gas field, was successfully drilled and an additional 453 BCM of natural gas were discovered in the Leviathan field in late 2010 — the world's largest deep water gas discovery in the last 10 years. With successful drilling in December 2011 into what could amount to 226 BCM of natural gas in the Aphrodite field in Cyprus' maritime waters, the Eastern Mediterranean has very much aroused the attention of international oil companies (IOCs).

Hype vs. reality

Opposition Member of Parliament (MP) and Head of the Parliamentary Energy and Public Works Committee, Mohammad Qabbani, expresses an optimism shared by many when he says, "There is oil and gas five kilometers south of our borders — do we think God created a wall between us and Palestine? All of this area is rich in the Levantine basis."

However, successful drills in Israeli and Cypriot waters are no assurance that there is actually any commercially recoverable gas or oil in Lebanese waters. AUB's Chaaban is skeptical about the hype surrounding the industry and argues, "They are being too optimistic… It is a political statement to say the oil sector will be booming and to talk of all these revenues."

Even with extensive and promising seismic surveys, and multiple regional discoveries, attempts to quantify what is actually below the Lebanese seas are merely educated guesses at this point. "All a seismic survey tells you is that there are certain subsurface structures but they could be full of water; you have to have drilling going on to find out what is down there," explains David Aran, founder and owner of London-based Petroleum Development Consultants Limited (PDC).

The bureaucratic botch

Nonetheless, encouraged by the regional finds and goaded on by the fact that it is now years behind neighboring countries' efforts, Lebanon is finally moving toward drilling the seabed to see what is actually there. The first incremental step came on August 17, 2010 when the Lebanese parliament passed the Offshore Petroleum Resources Law, drafted by the Ministry of Energy and Water (MoEW) with assistance from the Norwegian Agency for Development Cooperation (NORAD).

However, due to the idiosyncrasies of the Lebanese political and legal systems, the law does not actually come into effect until the necessary implementation decrees are passed by the Council of Ministers, Lebanon's cabinet.

The January 4 edict was one such decree — there are more than two dozen in total — enacting the creation of the Petroleum Administration, a prerequisite for the cabinet to enact the subsequent decrees for managing the sector, known as the Petroleum Activities Regulations (PAR).

The next hurdle to developing Lebanon's offshore 'play' — an industry term describing the activities associated with petroleum development in an area — will be in the formation of the Petroleum Administration. Determining the exact role of this body, who will staff it and its level of independence will have a sizeable impact on the evolution of the sector as a whole. Consensus is far from assured.

As *Executive* went to press the six members of the Petroleum Administration's board had not been selected, but the MoEW stated cabinet would appoint the posts by the end of January based on proposals from the Minister of Energy and Water, Gebran Bassil.

The law stipulates that the Petroleum Administration "shall enjoy financial and administrative autonomy with the Minister exercising tutelage authority," but Cesar Abou Khalil, advisor to Minister Bassil, says, "The funding is already in the budget of 2012, which has an allowance for their salaries and the minister of energy and water allows it from his budget. This is a body inside the Ministry of Energy and Water."

This raises questions regarding the independence of the Petroleum Administration.

There is also uncertainty over its role in relation to the MoEW. In a presentation by the ministry at the Lebanon Petroleum Exploration Forum 2011 last summer, the authority was labeled as a 'regulatory body' (along with the ministry). But, Abou Khalil argues: "It is not a regulatory body. It is purely consultative and is under the minister and nobody else."

Opposition MP Qabbani responds to this with an excoriating critique of Minister Bassil, claiming he seeks hegemonic control of the industry, going so far as to compare his managerial style to that of Hitler. "The minister wants to control the signature of everything," says Qabbani. "The minister is going to do his best to make sure he controls the [Petroleum] Administration and we will do our best to make sure that he can't do that."

Considering the prospect that this embryonic sector could precipitate a tectonic shift in Lebanon's economic, political and social landscapes, its governance and institutional frameworks are of primary importance. Abou Khalil claims there is sufficient governance within a three-tier system, whereby the Petroleum Administration makes suggestions to the minister who will then enact them if he is able to, and if not he will send them to the cabinet.

"The Petroleum Administration, the Council of Ministers and the Minister of Energy and Water will all regulate one another," he reasons. As for the prudence of creating an independent body to regulate the sector he simply asks: "Why do you need a regulatory body?"

Once the Petroleum Administration is appointed by the cabinet, it can begin the process of passing further implementation decrees to move the country into the early stages of the exploration phase, where companies prospect for oil or gas in Lebanese waters. The MoEW has laid down targets to enter into the first licensing round of the tender process within the first quarter of 2012, and to sign the first contracts by the end of the year.

All prospective companies will have to pass through a pre-qualification phase and only consortiums of three or more companies in an unincorporated joint venture can actually bid for tenders. Successful applicants will be granted exploration and production agreements (EPAs), allowing them to explore specific areas, called 'blocks', for potential black gold.

Lacking tools for the task

According to the law, the Petroleum Administration's role in this crucial phase will be to draft invitations for bids, assess the qualifications and capabilities of applicant IOCs and assist the minister in negotiating exploration and production agreements. AUB's Chaaban, however, frets that the Petroleum Administration will be ill-equipped to fulfill its mandate.

"We definitely won't have a qualified team to run [the Petroleum Administration]… The ministry will probably end up choosing the companies, which is not a good thing," he says. "You need an independent authority that has the ability to choose on a technical and sound basis who will get the contracts."

Not only does Chaaban raise concerns over the potential for the co-opting of the tender process by political and business interests, but he also argues that Lebanon is in a weak position to negotiate good contractual terms with prospective companies.

"I don't think any rational investor will opt for arrangements that are favorable to the local government," he says. One of the several justifications Chaaban offers for his skepticism is rooted in what he says is the Lebanese government's terrible track record in honoring its contractual agreements. He cites the telecommunications debacle in the early 2000s — the last time the networks were up for privatization — when France Telecom was awarded $266 million by an international court that found Lebanon in breach of contract.

Still interested?

"Lebanon's bad reputation is true," says Salah Khayat, chief executive officer of the nascent firm Petroleb, the local partner in a consortium that is being put together for a potential bid in Lebanon's offshore play. But, he adds, "that has a lot to do with who was running the country in the past. There is a huge difference now and things are being done right this time."

Salah's uncle Tahseen Khayat is a media magnate who has had an openly caustic relationship with the previous governments of both Rafiq, and later Saad Hariri. Khayat says, however, that this is not reflected in his assessment of the current Lebanese administration. "We are very business orientated, we do not look at any political side of the story… Does my uncle have anything to do with this? We have his full blessing," he stresses.

Khayat says his own prospective consortium, whose members he declined to name specifically, includes a major company from the Gulf — where his immediate family have decades of experience in the petroleum industries — and three other international players. He argues there has been a high level of global interest in the incipient sector which is confirmed by Sverre Strandenes, executive vice president multi-client for PGS (the company that has conducted the most detailed seismic studies of Lebanon's seabeds). He says, "There has been good interest [in data on Lebanon's fields]."

Minister Bassil has also alluded to “serious interest” from Chinese, European, American and Russian firms, while the Iranian news agency Fars has reported that Tehran is seeking greater cooperation with Lebanon in the energy sector, especially regarding exploration.

Negotiating the nitty-gritty

Whilst the IOCs are now analyzing their data, forming their alliances and devising their strategies, they will soon knock on the door for access to Lebanon’s waters. When this happens the government will find itself at the bargaining table with some seasoned and incredibly powerful players. In the coming months the PA and the MoEW will be detailing the mechanisms by which the prospective consortiums and the government will divvy up the spoils of any discoveries using a combination of royalties, concessions and Product Sharing Agreements (PSA) — the method of sharing extracted resources between the government and oil companies.

PDC’s Aran shares Chaaban’s view that Lebanon will have to play smart if it is to seal deals that will ultimately benefit the nation. “PSAs are like any market with a buyer and a seller. Lebanon is a seller so they have got to attract the companies. They will need to have low taxes and low royalties. If you are [the government] sitting in Angola, the Gulf or Khazakstan, somewhere very highly prospective, you are going to say virtually all of the money is going to come to us. Lebanon is in a weaker position,” he argues.

Aran does however also argue that Lebanon has some trump cards it can wield to lure in prospective companies. Perhaps most important is an easily accessible and sizeable market for any future production. As Petroleb’s Khayat explains, “Gas infrastructure is rather expensive. The price of gas is in its transportation.”

Lebanon is itself in dire need of cheaper more efficient fuel supplies for its dysfunctional energy sector, which is almost entirely dependent on fuel imports. In the first ten months of 2011 alone the Ministry of Finance reimbursed Electricité du Liban (EDL) LL2.1 trillion ($1.37 billion) for fuel and gas purchases, marking a 44 percent increase on the same period the previous year. Making matters worse, the finance minister has predicted the total deficit of EDL at $2 billion.

To service this domestic market Lebanon already has the infrastructure in the Beddawi and Zahrani plants to burn natural gas, and for the export of any excess reserves it is connected to the Arab Gas Pipeline (although the viability of this depends on political and security developments in Syria).

Development of the natural gas infrastructure features highly in a 2010 policy paper for the MoEW. The establishment of a Liquified Natural Gas (LNG) terminal, the conversion or building of most power plants to run on natural gas and the construction of a coastal natural gas pipeline running between Beddawi power plant in the north and Zahrani power plant in the south are among the projects planned.

Lebanon’s somewhat colorful history of internal strife and regional conflagrations is always going to sit pretty high on a prospective investor’s risk assessment, which is further compounded by Lebanon and Israel’s disagreement over where the boundaries of their EEZs fall. Add to this a lack of proven reserves and questions over governance, and “there are enough reasons not to invest,” in the words of consultant Aran. In such an environment the attractive markets for future discoveries are a strong bargaining chip. “It’s a sales job. You are in competition for exploration dollars. It’s like selling a house. If you have a small garden you say, yes but it’s a lovely view,” he reasons.

Casting a glance several years down the line beyond the exploration phase lie perhaps the greatest uncertainties and potential for ruin. Whilst the fate of any drilling expeditions cannot be realistically foretold, the prospect of a massive hydrocarbon windfall is very real. Based on a price of $120 per barrel, independent energy consultant and Secretary General of the World Energy Council’s (WEC) Lebanon Member Committee, Roudi Baroudi, predicted in a 2008 study that Lebanon could expect to enjoy a bounty of LL211 trillion, ($140 billion dollars) over a 20-year period from its offshore oil and gas reserves.

Oil’s curse

For a country with a national debt of more than $50 billion — exceeding 130 percent of gross domestic product — and a near complete reliance on fuel imports to meet its energy needs, the discovery of oil or gas might sound like a panacea. The pitfalls of transitioning into a resource dependant economy, however, are significant.

The major worry is that Lebanon may catch a variant of what is called 'The Dutch Disease', which, broadly speaking, is the decline of other economic sectors — usually manufacturing and agriculture — associated with the increased exploitation of natural resources. The basic premise is that increased resource revenue will inflate the value of the local currency and make other exports less competitive, while at the same time economic emphasis in that one area will undermine development in other sectors.

"The economy will be geared towards one sector which will absorb all the resources and expertise and the attention of policy makers, which would make investments in industry and agriculture even less than now," says economist Chaaban.

Nigeria is among the textbook examples of a resource boom gone wrong: narrow economic focus on oil exploitation through the later half of the last century led to a steep decline in agriculture and other economic sectors, such that today the country's GDP is actually in the range of what it was in the 1960s. So while there has been little net gain in overall national wealth, what has happened is wealth and wealth generation have become highly concentrated in and around the oil industry, leaving the vast majority of the country much worse off than they were before the resource boom.

Securing the piggy bank

Abou Khalil at the MoEW says the ministry has incorporated the creation of a sovereign wealth fund (SWF) into the Offshore Petroleum Resources Law so as to counter the threat of Dutch Disease, fiscal profligacy and political manipulation of the revenue.

In a January 23 meeting with the Association of Banks in Lebanon, Prime Minister Najib Mikati announced that the revenues from the fund will go towards reducing the public debt-to-GDP ratio to 60 percent — it currently exceeds 130 percent — before fulfilling any other expenditures. While the stipulation for an SWF is welcomed across the board as a necessary measure, the politicians are in no hurry to realize its creation.

"It isn't a very imminent question… I strongly believe we have time," says Abou Khalil, and in a rare note of agreement opposition MP Qabbani states: "There won't be any funds for the coming six or seven years, why fight over [the SWF] if there won't be any funds in that time."

Their aversion to tackling the thorny questions over the nature of the SWF and its management is understandable due to the political wrangling that is bound to ensue. Deciding where such a potentially handsome hoard of cash will reside and under whose purview will certainly set a cat amongst the pigeons in the circus of Lebanese politicians. So, to get the current Offshore Petroleum Resources Law passed, the issue has essentially been kicked into the long grass.

Some argue, however, that the creation of the SWF is a pressing concern that should not be avoided. Energy consultant, Baroudi, says, "The most important [decree] is to pass a law to create the sovereign wealth fund. This should not wait. It is not important just to explore and produce but you need to protect the wealth."

Ashby Monk, a visiting research associate at the University of Oxford School of Geography and the Environment and co-director of the Oxford SWF project, is a global authority on SWFs. He concedes that while it is not necessary to have people "twiddling their thumbs" at the SWF now, "You would want the legal framework set up before hand. That is an ideal. The earlier you articulate the regulatory framework, where it is going to be housed, etcetera, the better."

An SWF is also not a cure-all for potential abuses derived from hydrocarbon revenues, as there are ample examples globally of mismanaged SWFs. In compiling a SWF scoreboard for his book, 'Sovereign Wealth

Funds: Threat or Salvation?', Edwin Truman found that around 57 percent of the funds had guidelines integrating the use of their earnings, but only around a quarter consistently followed them.

The prospective future

Even in the most optimistic assessments, Lebanon will not be reaping the fruits of its labor in the hydrocarbon sector for two to three years, and in reality it is more likely to be five to 10 (assuming there are actually commercially viable fields to be drilled).

The allure of the petrodollars may be a dizzying prospect, but its capacity to further empower corruption in the nation's politics and blight other sectors of the economy are grave threats that cannot be ignored. As the nation careens ahead on its hydrocarbon adventures there is an urgency to ensure that the ship is setting sail on course. There will be no second chance.