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LEBANON: THE NEXT EASTERN MEDITERRANEAN GAS PRODUCER?

A policy brief entitled Lebanon: The Next Eastern Mediterranean Gas Producer?, published by the German Marshall Fund and authored by Bassam Fattouh, director of the Oxford Institute for Energy Studies and professor at the School of Oriental and African Studies, and Laura El-Katiri, research fellow at the Oxford Institute for Energy Studies addresses Lebanon's challenges in its path towards natural gas production, discusses the benefits that gas production could bring Lebanon and assesses various export scenarios. The report issues recommendations for Lebanon to achieve a sound management of future gas revenues and maximize the economic benefits of its hydrocarbon wealth.

The report highlights the fact that although no exploratory drilling has been conducted yet, the wide range of estimates (varying between 25 to 95.5 Tcf of gas), is indicative of the considerable uncertainty surrounding the subject. The government is keen to diversify Lebanon's energy mix away from oil to strengthen its security of supply and to reduce air pollution, but gas production is not likely to begin before the mid- 2020s, adds the report. Currently, the share of natural gas in the fuel mix of the power sector has fallen to zero. We will summarize below the main findings of the report.

1.Domestic hurdles

The major challenge for Lebanon is the domestic political climate that has led to repeated delays in the launching of the country's first licensing round. According to the report, Lebanon's hydrocarbon sector and its institutional and regulatory framework are still in their infancy. The report identified the country's weak administration, its widespread corruption, and its poor business climate as the most challenging hurdles to overcome.

2.Partial regulatory progress

The report listed the regulatory progress achieved so far and highlighted the pending legislations to be issued for Lebanon to move forward: Lebanon adopted the Offshore Petroleum Resources Law in August 2010 (Law 132), which provides the legal and institutional framework for the exploration and exploitation of offshore oil and gas resources in Lebanon. This was followed in April 2012 by Decree

7968/2012, establishing the Lebanese Petroleum Administration (LPA) as the body responsible for the management, monitoring, and supervision of petroleum activities, including the issuing of licenses and the implementation of agreements. The LPA, however, is not an autonomous body and falls under the tutelage of the Ministry of Energy and Water Resources and, indirectly, is reliant on the Council of Ministers for key decisions regarding the hydrocarbon sector. In February 2013, the government issued Decree 10289/2013, setting out the Petroleum Activities Regulations for Lebanon, which provide the basic guidelines for Lebanon's hydrocarbon sector. The decree stipulates requirements for license applications and the scope of agreements with energy companies. The appointment of the members of the LPA and the passing of these decrees paved the way for the launch of a prequalification round at the beginning of 2013. The response to the government's call for expressions of interest demonstrates the commercial attractiveness of Lebanon's potential offshore energy resources for international investors. Some 50 international companies registered interest, which is high, especially when compared to earlier bidding rounds in Israel and Cyprus, which faced political constraint. Two decrees are yet to be issued for the country to open its licensing round. The failure to pass these two decrees illustrates Lebanon's complex domestic political landscape and the difficulty of delimiting Lebanon's EEZ, in light of the dispute with Israel, which could escalate if either country decided to award blocks in the disputed area, says the report.

3.Domestic political rivalries

Lebanon's domestic rivalries were identified by the report as the main reason for the delays in the energy sector. Exaggerated expectations created by politicians were also criticized for their detrimental effect on future decisions.

4.A pending maritime border dispute with Israel

Lebanon and Israel have overlapping claims over some 854 square kilometers. The authors of the report warn on the possibility of escalation of the conflict if licenses for exploration were awarded in the disputed area.

5.Potential benefits from the exploitation of offshore riches

The initial policy priority for Lebanon, when revenues from energy production begin to flow, will be to reduce the state's debt estimated at 146 percent of GDP in 2014. The report warns however that using resource revenues to reduce public debt may not be possible as expectations have been raised of the availability of future financial resources for public expenditure. There is also a risk that lower interest rates, resulting from reduced debt levels, would provide an incentive for borrowing, producing a credit bubble, adds the report as they benefit richer households and encourage wasteful consumption that could negatively impact the environment.

6.Preliminary work for the sound management of gas revenues

The report suggests that a balanced strategy to manage future gas revenues must be put in place. A sovereign wealth fund will ensure those revenues are saved for future generations while the remaining funds should be allocated to reduce public debt, directed to public investments and transfer payments. The report stresses on the importance of managing public expectations to relieve pressure from decision-making and ensure sound and realistic decisions are taken.

7.On the export quota

The report highlights the importance of meeting domestic demand first before allocating a portion of the gas discovered to export markets. Natural gas independence will ensure a saving of up to $1.9 billion on the annual energy bill (as estimated by the Ministry of Energy) and significant environmental benefits, adds the report.

8.Interim solutions to meet domestic demand

The disruption in the flow of Egyptian gas to Lebanon led to the signing of a deal between Lebanon and Syria in 2003 to import Syrian gas at a level of around 1.5 bcm of natural gas per year, according the report. Insufficient gas production and civil unrest have prevented Syria from meeting its domestic demand and its export obligations. The report highlights that importing gas from Israel would make commercial sense for Lebanon but because of the state of war between the two countries, it is not a feasible option. Lebanon could import gas in the form of LNG but would have to incur the high costs attached to the construction of an onshore regasification terminal due to the complex geopolitical landscape that make the pipeline option complex.

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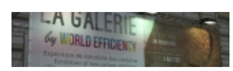

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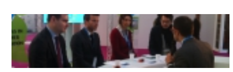

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9. Lebanon’s export options

The report highlights Lebanon’s strategic positioning, ‘with good coastal and land access’, which gives it a natural advantage for export. Many factors will contribute in deciding Lebanon’s export strategy, including as stated in the report: the size of its reserves, domestic and foreign demand, export targets, the cost of Lebanese gas production, price, and competition, as well as the availability of finance for pipelines or LNG facilities to bring the gas to market. The timing of Lebanon’s entry into the export market will also largely determine its export markets. Regional markets (Jordan and Egypt) may slip away to the benefit of Israel should Lebanon delay its entry further, warns the report. Exporting gas via LNG would offer the flexibility in the choice of the export market but largely depends on the size of the discoveries. Only substantial amounts of recoverable gas would justify a 2-train facility, explains the report. By the time Lebanon is ready to exports, new players may block Lebanon’s entry. Energy partnerships with Egypt and Cyprus could be attractive to Lebanon. Exporting gas via pipeline to regional customers (including Egypt, Turkey, Syria, Iraq and Jordan) could be an option if the size of the discoveries does not permit an LNG investment. However, Israel is currently in talks to export some of its gas to Egypt and Jordan. In the event Israel overcomes its regulatory hurdles (including a dispute with the Antitrust Authority), and those deals come to fruition, Lebanon may not be able to acquire those countries as customers.

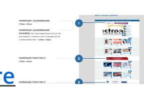
10.The benefits of the successful development of Lebanon’s gas resources

According to the report, the successful development of Lebanon’s gas resources could ensure energy security and lift the economy. The shift from heavy fuels to gas will also have environmental benefits, adds the report.

11. Challenges ahead

Establishing a sound regulatory framework and ensuring the efficient and transparent management of future gas revenues are major challenges, highlights the report. The report adds that political climate may cause further delays in exploration and production and it is questionable whether full transparency in the process can be achieved. A plan to manage future gas revenues needs to be put in place such as setting up a sovereign wealth fund. Drawing on the experience of existing energy producers (such as the US and Norway) comes highly recommended in the report. The EU is supportive of regional cooperation and can assist Lebanon in managing offshore incidents and maximizing the benefits of its hydrocarbon wealth.

You can access the report here: file:///home/chronos/u-e951b91f2f5868becda1d08e9ad67e37d6ad26bd/Downloads/Fattouh_El-Katiri_Lebanon_Feb15_web.pdf



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