

Lebanon's gas fields, a gift or curse?

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The prospect that Lebanon may one day exploit gas reserves off its coast has triggered high hopes for the country's economic outlook. Some analysts have predicted that gas will reduce the country's energy bill, pay off the public debt, and will precipitate regional development. But in reality, gas is not a means to any of these ends. On the contrary, it has the potential to greatly undermine Lebanon's economic and political system should gas revenues be mismanaged.

Beyond addressing maritime disputes with Israel, Lebanon's primary challenge will be to translate gas revenues into self-sustaining growth, accompanied by improvements in socio-economic welfare. Many countries endowed with oil and gas have failed to do just that. For every Norway that has doubled its per-capita Gross Domestic Product between 1980 and 2008, there is a Nigeria, whose citizens have witnessed no change in their living standards; or a Saudi Arabia, whose per-capita GDP was halved over the same period. The road to effective management is mired with difficulties that could easily overwhelm the Lebanese government.

Five challenges stand in the way. The first is the ability of the government to bargain for a good deal with multinational companies. A majority of profits must be ensured for the state, as must an agreement on future prices, to reap higher returns when prices go up.

This is a daunting task for most governments, as many oil companies have greater resources and expertise in estimating the value of the gas to be extracted, and hence are in favorable bargaining positions. One way to rectify this imbalance is to create a bidding process that increases

competition between firms. The stronger the competition, the more the revenue that will be reaped by the state. However, Lebanon's record of holding a competitive process when it comes to contracting is dismal, with many of the state contracts granted to the private sector marred by cronyism and corruption.

The second challenge is how to manage the boom-bust cycle. A common problem facing gas exporting countries is the volatility in price. Over the last 18 months, natural gas prices have dropped by half. The variation in the revenues earned, not only makes planning more difficult, it also leads to volatility in spending. This provokes boom-bust cycles, where spending is high in good years followed by deep cuts in bad years.

The problem is exacerbated when governments borrow from abroad against the high price of gas, only to face major problems when prices drop and lenders have to be repaid. So instead of reducing its public debt, which is already high, Lebanon could see itself becoming more dependent on loans as a result of mismanagement.

One common way to resolve this issue is to create stabilization funds, which ensure steadier patterns of spending against gas price fluctuation. These must be enshrined with the right incentives for politicians not to abuse them.

The third challenge is managing revenues. A major misconception about gas revenues is that they are regarded as a source of income. In reality, they are not. As a non-renewable asset, the consumption of the gas revenue should be seen as consumption of capital rather than a consumption of income. Hence, the government's optimal strategy is to invest the gas revenue into financial assets and treat the interest earned as income. This can be done by implementing a national wealth fund where gas revenues are invested globally in stocks, bonds and property.

The fourth challenge is how to manage spending. The gas receipt will tempt politicians to spend more. Those whose tenure in office is uncertain will be tempted to spend the money sooner rather than later, in order to get re-elected or out of self-interest. The population will also be expecting an increase in their own welfare with the new revenues. The nature of Lebanon's political system makes irresponsible management of resources harder to contain. There is a need to develop binding rules dictating what is spent where.

The fifth challenge is how to deal with the implications of gas revenues on other sectors. Gas revenues will generate higher demand for non-tradable goods and services, such as consumer services and housing, among others. Such services can only be supplied by shifting local resources and factors of production away from the agriculture and manufacturing sectors, rendering those sectors uncompetitive. Since these sectors' contributions to the economy have dwindled since the end of the civil war, gas will only exacerbate this downward trend. One way to deal with this is to develop a plan that compensates these sectors by improving infrastructure and other types of productivity enhancing investments.

The ability of countries with gas reserves to achieve self-sustained growth remains the exception rather than the rule. A major factor that determines the ability of a government to manage its oil or gas reserves effectively is the political institutions entrusted to ensure transparency and

accountability that were in place before the discovery of these reserves. If so, Lebanon's hopes of transforming itself as a result of its offshore gas will remain illusory.

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