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Managing Lebanon’s Gas: Pursuing a Pipe Dream?

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One major factor that determines the ability of a government to manage its oil effectively are the prevailing political institutions entrusted to ensure transparency and accountability in place before the oil or gas discovery. (Photo: Marwan Tahtah)

Recent prospects of finding gas off the coast of Lebanon have triggered high hopes for the country’s economic outlook. Some analysts predict that gas will reduce the country’s energy bill, pay off the public debt, and 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 dealing with maritime disputes with Israel, the primary challenge facing the Lebanese government is how to translate gas revenues into self-sustaining growth accompanied by improvements to socioeconomic welfare. Many countries endowed with oil and gas have failed to do just that. For every Norway that has doubled its Gross Domestic Product (GDP) per person between 1980 and 2008, there is a Nigeria, whose citizens have witnessed no change in their standard of living, or a Saudi Arabia, whose GDP per person 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 for the state must be ensured, as must an agreement on future prices, in order to reap higher returns when prices go up. This is a daunting task for most governments. Many companies have more 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 revenue 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 and 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 revenue earned not only makes planning harder but leads to volatility in spending. This leads to boom/bust cycles where spending is high in good years but followed by deep cuts during 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 require repayment. So instead of reducing its public debt, which is already high, Lebanon could see itself amassing more loans as a result of mismanagement. One common way to solve 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 how to manage the revenue. One of the major misconceptions about gas revenues is that they are considered to be a source of income. In reality, they are not. As a non-renewable asset, the consumption of gas revenues 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, property, and other sound investments.

The fourth challenge is how to manage spending. The gas receipt will give political leaders the temptation to spend more. Politicians 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 the political system in Lebanon makes this 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. These services can only be supplied by shifting local resources and factors of production from the agriculture and manufacturing sectors. This process will render these sectors uncompetitive. Since these sectors' contributions to the economy have dwindled since the end of the civil war, gas revenues will exacerbate conditions in these sectors. One way to deal with this is to develop a plan that compensates these sectors by improving the infrastructure and other types of productivity enhancing investments.

In sum, the ability of countries to achieve self-sustained growth remains the exception rather than the rule. One major factor that determines the ability of a government to manage its oil effectively are the prevailing political institutions entrusted to ensure transparency and accountability in place before the oil or gas discovery. Lebanon's institutions fall short of these standards. If this remains true, Lebanon's hopes of transforming itself as a result of its gas field will remain a pipe dream.

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