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Fostering a Transparent Policy Making Process in Lebanon's Oil and Gas Sector

Participants of the Lebanese Center for Policy Studies (LCPS) and the Lebanese Petroleum Administration's (LPA) recent roundtable make the following recommendations that ought to be taken into account in the development of the Oil and Gas sector:

· Transparency needs to be maintained throughout the entire decision-making process, from new laws and bidding all the way to revenue management and spending.
· The state must better communicate its vision of the O&G sector to ensure that best practices are adopted.
· A progressive fiscal framework must be adopted in order to optimize the country's fiscal rewards while establishing an attractive business environment.
· The government should enable a pragmatic initial bidding process and gradually open access to Lebanon's decided blocks.
· It is necessary to formulate and implement the appropriate policies that shield the Lebanese economy from potential negative impacts of anticipated oil and gas revenues.

LCPS in collaboration with LPA held a closed roundtable discussion on the Economic and Fiscal terms in the draft petroleum Exploration and Production Agreement (EPA) that is yet to be approved by the Lebanese government. The event took place on 24 March 2014, at the Lebanese Economic and Social Council in Beirut, Lebanon. The roundtable was co-chaired by Mr. Sami Atallah, Executive Director of LCPS, and Mr. Nasser Hoteit, Chairman of the Board of LPA and Head of the Technical and Engineering Department. Among the 25 participants were the six board members of LPA, economists, bankers, academics, civil society activists and international organization representatives.

Mr. Wissam Zahabi, board member of LPA and Head of the Finance and Economics Department, presented the Economic and Fiscal terms in the draft EPA. This was followed by a presentation from Dr. Carole Nakhle, Energy Economist and Research Fellow at LCPS, who had the chance to review and reflect on the draft EPA. Following the two presentations, the floor was open for discussion and the key issues that were highlighted are as follows:

Transparency in the decision-making process must be maintained to ensure optimal policy outcomes. This must include discussion over draft laws and decrees from the bidding process all the way to revenue management and spending. The roundtable reaffirmed the importance of an active civil society that closely monitors the Oil and Gas sector as well as advocates for transparency and accountability in its governance. In turn, the LPA has expressed its commitment to ensure continuous transparency in the sector. It has demonstrated its support for a transparent bidding process as well as voiced its willingness to publish details of the contracts. The LPA is also considering joining the Extractive Industries Transparency Initiative (EITI).

The state needs to better communicate its vision of the O&G sector to ensure that best practices are adopted. After some questions were raised, clarifications were addressed on the choice of a hybrid fiscal framework for the Lebanese Exploration and Production Agreement. The LPA presented the draft EPA decree law, which they prepared in light of existing policy regimes used around the world. The LPA has made the decision to adopt a hybrid model falling somewhere between a Concession System and a Production Sharing Contract. Under the former, companies are entitled to full ownership of production and are subject to taxes and royalties. Under the latter model, companies are entitled to a share of production only. In the hybrid fiscal system chosen by the LPA, Economic and Fiscal elements will be determined by law except for the Cost Petroleum Ceiling and the Profit Petroleum Split based on R Factor which are biddable items. There were requests for explanations among participants about the value of the selected model. Dr. Nakhle argued that apart from the legal difference, the two systems can be made equivalent in terms of government take. In her opinion, the chosen Lebanese petroleum fiscal system is a typical Production Sharing Contract.

A progressive fiscal framework is important for optimizing the country's fiscal

rewards while establishing an attractive business environment. While the government often does not have direct control over many of the sector's features, such as geological factors, commodity prices and costs, it has room to manoeuvre in areas such as minimum biddable items, i.e. cost recovery and profit sharing regulations. The current main Lebanese fiscal elements include a flat Royalty on Gas, Sliding Scale Royalty on Oil, Profit petroleum using the R Factor (biddable), Cost Petroleum recoverable up to a fixed percentage (biddable) and Taxes on the Income of the International Oil Companies. Comments were made by some participants about the low level of Corporate Income Tax (CIT) in the oil and gas sector which is equivalent to only 15%. This rate has until now been applied by default from what is perceived as the generous Lebanese CIT rate. In addition, criticism was raised on the adoption of royalties, considered as “regressive taxation” as it is not sensitive to project costs and profits. Moreover, it was argued that the 4% royalty rate is low. Although the LPA agrees that royalties are regressive and not favored by oil companies, it argues that the scales were set based on international benchmarking and they are part of a full package of fiscal elements that jointly increase the total government take. It was agreed among participants that a vague or poorly articulated fiscal regime has a direct impact on the nation’s ability to secure the maximum financial reward. In order to attract investors, the overall fiscal package has to be deeply considered, keeping a firm eye on international competition while at the same time attempting to maximize the take of the state.

The government should enable a pragmatic initial bidding process and gradually open access to Lebanon's decided blocks. The LPA advised that the government starts with the 1st licensing round as soon as possible. Furthermore, the roundtable participants concurred with the LPA's recommendation that the Lebanese government adopts a gradual licensing round whereby 1st round bids are opened on a small selection of offshore blocks rather than on all of them. This gradual licensing strategy is needed to create a competitive process as well as ensure that there remains room for a full retrospect of the 1st round through the evaluation of best practices and extraction of lessons learned. Furthermore, according to the LPA, such a strategy is crucial in order to allow for the potential establishment of a National Oil Company in-between the 1st and 2nd licensing rounds.

It is crucial to implement structural and public policy reforms to shield the Lebanese economy from the potential negative impacts of anticipated oil and gas revenues. Participants urged all stakeholders to look beyond the forecasted financial wealth that the petroleum sector would bring to Lebanon, and warned against the severe negative impacts the sector could potentially have on the economy. These effects, of what is commonly referred to as the "Dutch Disease" syndrome, include an appreciation of the real exchange rate which in turn leads to a contraction of the traditional manufacturing and agriculture sectors, export concentration and macroeconomic volatility, among others. The LPA has expressed its commitment to help mitigate these undesired consequences in Lebanon and is currently working on assessing the macroeconomic implications of the anticipated windfalls. Lebanese policy makers must devote full attention to these risks now rather than later and need to carry out deep structural reforms in order to effectively manage the high levels of resource wealth and consequently curb the Dutch Disease effects.