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LEBANON'S BUMPY ROAD TOWARDS GAS PRODUCTION

Natural Gas Europe has had the pleasure to speak with Bassam Fattouh, director of the Oxford Institute for Energy Studies and professor at the School of Oriental and African Studies, University of London. Dr Fattouh discusses the challenges facing Lebanon's hydrocarbon industry and the eventual benefits from the successful development of the resources. Dr Fattouh also explains the conditions for Lebanon's entry into the export market as a net natural gas producer and the various possible export options. This interview was largely inspired by a policy brief authored by Bassam Fattouh and Laura El-Katiri, research fellow with the Oil and the Middle East Programme at the Oxford Institute for Energy Studies (OIES). The policy brief, entitled [Lebanon: The Next Eastern Mediterranean Gas Producer?](#), was published by the GMF in February 2015 and is part of Foreign and Security Policy paper series. You can access it [here](#).

How will the discovery of offshore gas in Lebanon benefit its economy and improve its energy security?

The successful development of Lebanon's gas resources could bring substantial economic benefits to an ailing economy and strengthen the country's energy security. The development of its hydrocarbon reserves would enable Lebanon to reduce its dependence on imports of oil products, which in 2012 constituted more than 97 percent of its total primary energy supplies. In 2013, Lebanon's imports of oil and its derivatives amounted to \$5.11 billion, representing 11.4 percent of its GDP. It would also allow Lebanon to reduce the state's debt, estimated at 146 percent of GDP in 2014. 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.

What are the main challenges that may impede the commercial development of Lebanon's offshore hydrocarbon reserves?

The commercial development of Lebanon's hydrocarbon reserves faces many internal and external challenges. Lebanon's hydrocarbon sector and its institutional and regulatory framework are still in their infancy. Deadlock in Lebanon's sectarian political system has led to long delays in the country's



hydrocarbon development and produced a volatile regulatory environment. The country suffers from weak administration, widespread corruption, and a poor business climate.

What is the reason for the repeated delays in launching the country's first licensing round?

The prolonged failure of the Lebanese parliament to elect a new president and the formation in February 2014 of an unstable government made up of rival political groups has paralyzed the decision-making process. As of February 2015, the Lebanese government has failed to pass two decrees that are essential for tendering Lebanon's offshore acreage. One of the missing decrees would delimit Lebanon's territorial sea and exclusive economic zone, an awkward matter as some blocks straddle a disputed area between Lebanon and Israel. The other decree would stipulate the provisions of future Exploration and Production Agreements (EPA). The EPA determines the way in which future revenues are to be shared between the state and the investors that provide capital, technology, and expertise.

How must Lebanon manage future gas revenues?

The government needs, without further delay, to formulate a plan to manage the country's potential oil and gas wealth, even though it may be many years before exploration, production, and monetization reach a decisive stage. The Offshore Petroleum Law requires part of these revenues to be placed in a fund for the benefit of future generations. Article 3 of the law stipulates that the "statute regulating the Fund, the rules for its specific management, the principles of investment and use of proceeds shall be regulated by a specific law, based on clear and transparent principles for investment, and use of proceeds that shall keep the capital and part of the proceeds in an investment fund for future generations, leaving the other part to be spent according to standards that will guarantee the rights of the state and avoid serious, short- or long-term negative economic consequences." 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, beginning with the most risky liabilities: external debt denominated in foreign currency. Lebanon should avoid distributing future resource revenues as energy subsidies since these distort pricing signals and result in misallocation of resources. Although energy subsidies constitute an important social safety net for the poor, they are regressive in nature because in many instances richer households capture the bulk of subsidies. Energy subsidies also have a negative environmental impact by encouraging wasteful consumption of fossil fuels. There is scope for increasing public investment in infrastructure such as electricity and transport. Infrastructure constraints pose a serious barrier to competitiveness. Investment in public infrastructure would yield a relatively high rate of return and benefit the population. But the quality of public spending is critical. If public investment is directed toward poor quality projects or affected by corruption, there would be few benefits for the economy or the public at large. In the period before offshore resources come on stream, which could be a decade or more, it is important to work out a balanced strategy for managing the resulting revenues.

Should Lebanon make successful encounters of natural gas under its seabed, will the gas be reserved for domestic use or allocated for exports?

Lebanon's natural gas should be used initially to meet domestic demand, replacing fuel oil in power generation. If sufficient quantities are discovered to permit exports, these should, in the first instance, be through pipeline sales to countries in the region, such as Syria, Egypt, and Jordan, rather than through LNG. A joint LNG export facility with Cyprus might become feasible in the medium to long term if both countries discover considerable additional quantities of gas. The viability of such a project, or of an LNG facility in Lebanon itself, will depend on the amount of gas available for export, price, demand, developments on international gas markets, and Lebanon's investment climate. If the recent fall in oil and gas prices is sustained, Lebanon's competitive position, as a high cost producer that has come late to market, will be adversely affected. If exploratory drilling confirms commercially recoverable offshore resources in Lebanon, the balance between the use of gas to meet domestic demand and for export will need to be determined.

Should Lebanon become a net exporter of natural gas, which markets will Lebanon be selling the gas to and will Lebanon export gas via pipeline or in the form of LNG?

Lebanon's location in the Eastern Mediterranean, with good coastal and land access, gives it a natural advantage for gas exports. The border with Israel is closed but Lebanon has a number of other regional trading options. Lebanon's eventual export strategies will depend on 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



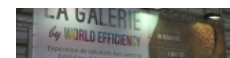
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market. The timing of the first Lebanese gas exports is important in view of gas market dynamics. Continued delays could close various market opportunities for the country. The commercial potential of regional exports to Egypt and Jordan is attractive but [Israel](#) may have a first-mover advantage. Because of its flexibility, LNG is probably the most attractive export option, both for the government and for international investors, provided sufficient quantities of gas are available. By the time Lebanese LNG might be available — not before the mid-2020s — Lebanon will be competing with new entrants with considerably more market weight. Given likely production costs, Lebanon may also find it difficult to compete on price. Sharing LNG export facilities with Egypt, or potentially Cyprus, would offer significant cost savings if technical, commercial and political obstacles could be overcome. Joint monetization between Lebanon and Cyprus, with a view to LNG production, might become viable at a much later stage, depending on the size and location of any new discoveries offshore Lebanon and Cyprus. Pipeline-Export Options to Turkey, Jordan, Egypt, Syria, and Iraq Pipeline options might be feasible if Lebanon's reserves prove sufficient to permit exports but insufficient to attract investment in the necessary infrastructure for LNG. Pipeline exports to Jordan and Egypt could be made through the existing Arab Gas Pipeline (AGP). The AGP, which previously transported Egyptian gas to Jordan and Lebanon, could be used for reverse flows to both markets. This would require a relatively inexpensive link to be built between Lebanon and the pipeline. But many uncertainties affect the viability of this option. The route is long and subject to disruptions. Lebanon could also consider gas exports to other countries in the Middle East, particularly Syria and Iraq. While these countries may eventually become self-sufficient producers of gas, both face medium term supply gaps. This might create opportunities for Lebanese gas in the late 2020s. But both countries face a high level of violence and instability, making any assessment of their potential as export markets for Lebanon hypothetical.

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