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The First Time as Tragedy, the Second as Farce?
Lebanon's Nascent Petroleum Sector and the Risks of Corruption

Abstract

This article analyses the risks of corruption in Lebanon's nascent governance structures established in preparation for a thriving petroleum sector. Engaging with comparative theory on the 'oil curse', the article assesses the risks of corruption in the institutional and regulatory measures and policy tools that have thus far been developed down the sector's value chain and including revenue management and expenditure. Lebanon's political settlement, or the ways in which its political decision-making process evolved since the Ta'if Accord, consistently caused disappointing outcomes when it comes to sound institution-building and countering corruption; despite signs of awareness of the large stakes involved, this tendency is once again discernible in the country's preparations for petroleum sector governance.

Further exploration still needs to confirm an anticipated 25 to 30 trillion cubic feet of gas and 440 to 660 million barrels of oil deposits off the coast of Lebanon.¹ The country's Exclusive Economic Zone (EEZ) is part of the Levant Basin, sharing territorial waters in the eastern Mediterranean with Israel, Gaza, Syria and Cyprus, that combined are estimated to hold up to four times as much in recoverable gas and oil deposits. (U.S. Geological Survey, 2010) The amount of revenues that such natural resources, if found, would generate is anyone's guess, as these would depend on highly unpredictable factors including production volumes, exploitation and transportation costs, use of the resources for local consumption and/or exports, the role of competing suppliers and accessible markets, and of course exceedingly volatile world energy prices. (Fattouh and El-Katiri, 2015) Yet proceeds would probably run in the billions of US dollars and at any rate be significant for an economy as small as that of Lebanon. In this context, many Lebanese have expressed highly pitched hopes and expectations for future economic prosperity and development in a country where political and economic conditions currently are no cause for celebration. Significant revenues extracted from producing oil and gas, or 'petroleum' to denote both, could become a source of wealth and sustained

economic growth if managed properly and in accordance with internationally tested good practices adjusted to Lebanon's political and institutional conditions. However, a large body of literature and international experience suggests that the extraction and marketing of oil and gas resources, in addition to associated revenue management and expenditure policies, are exposed to high risks of corrupt and wasteful governance. Furthermore, a windfall of natural resource rents, or even the expectation thereof, tends to encourage a scramble for resources, while (perceptions of) entrenched corruption and unjust distribution of economic opportunities and revenues may set the stage for new and/or reinvigorated intra-state conflict.

This paper presents an analysis of the risks of corruption in Lebanon's nascent governance structures established in preparation for a thriving petroleum sector. It draws primarily on unstructured interviews and discussions with Lebanese officials in relevant government institutions, stakeholders in the oil and gas sector, Lebanon's business community more generally, civil society activists, and foreign diplomats; all involved or closely following Lebanon's petroleum developments.² The key aims of this article are, firstly, to assess the general risks of corruption in connection to Lebanon's emerging gas and oil sector, and, secondly, to identify what institutional and regulatory measures and policy tools have thus far been put into place, and to appraise the extent to which these are sufficiently robust to counter or reduce corruption risks. As such, the article does not in detail discuss steps in institution building that Lebanon may take in the future if or when the country embarks on its journey down the sector's value chain. While being short on concrete policy recommendations, the core findings of this article will help to inform a growing but still rudimentary debate in Lebanon on petroleum governance. In this vein, this article aims at presenting academic analysis of the risks of corruption in a specific context of (anticipated) natural resource endowment; an effort that all too often is left to *after* corruption involving natural resource extraction has gone out of control.³

The petroleum-corruption nexus

Numerous studies have demonstrated that the extraction of natural resources generally, and oil and gas more specifically, often comes with heightened levels of corruption and malpractice in governance (e.g. Ross, 2003; Marshall 2001; Sachs & Warner 1999). This

literature developed in an attempt to identify and understand the exact causal mechanisms at work in purported correlations between natural resource abundance, variously defined, and inferior or disappointing levels of sustained economic growth and development. From this perspective, institutions are widely argued to matter in that they are tasked with formulating and carrying out vital policies to counter or prevent a host of potentially harmful economic, financial and environmental effects of extraction and associated revenue windfalls. While from this perspective the need for solid and sound institutions and policies becomes acute as soon as natural resource rents arrive, many have argued that the relative financial and technical complexity of the oil and gas industry, their state ownership, in combination with large rents controlled by state agencies and a host of political effects ascribed to them often tend to overwhelm or even undermine states' capacity to build and sustain such necessary institutional qualities (Papyrakis & Gerlagh, 2004; McPherson & MacSearraigh 2007). A lack of transparency, reduced levels of accountability, patronage substituting for political representation, and the temptation to waste rent windfalls on white elephant projects are in this context variously argued to cause systemic malpractices in governance as failing institutions cause "mother nature to corrupt" (Leite & Weidmann, 1999).

The suggested correlations and causal mechanisms involving the oil-corruption nexus continue to be fiercely disputed, as are most other dimensions of the alleged 'natural resource curse' (e.g. Brunnschweiler & Bulte, 2008; Di John, 2007; Ledermann & Maloney, 2007). For the purposes of the current article three observations in this context will steer my assessment of the risks of corruption in Lebanon's emerging oil and gas industry and related issues of governance.

First, it has been commonly observed that it matters a great deal whether a country embarking on exploitation already has solid institutions in place at the time that petroleum is discovered, in which case it is more likely that appropriate institutional adjustments are made to counter or cushion the perilous effects of the 'natural resource curse' (Frankel, 2012; Smith, Engen et al. 2012). Conversely, 'green field' countries with weak pre-existing institutional capacities and already alarming levels of pre-discovery corruption are especially at risk of falling into the oil-corruption trap. Even so, not all such countries entered a spiral of corruption when they found themselves endowed

with ample natural resources. Indeed, oil and gas producing countries, even when relatively new to the sector, show varying levels of institutional development and associated corruption.

Historical institutional antecedents may partly explain such variation, but these and post-discovery institution building relevant to the oil and gas sector do not come about in a vacuum. Just as institutions more generally, they are generated, shaped, and underpinned by public decision-making processes and political struggles. This leads to a second observation. To understand—and predict—whether, why, and how institutions governing the oil and gas sector will be solid enough to withstand corruption, or not, attention should be paid to what Khan (2010) in a more general context terms the ‘political settlement’, or the power constellations and the rules (both written and unwritten) affecting and governing public decision-making on creating, sustaining, and reforming relevant institutions.

Third, economists using large-N studies and operating on highly aggregated levels of analysis involving, inter alia, ‘natural resource dependency’ and ‘corruption’ may have developed a strong nose for ‘smelling a rat’ but they do not tell us much about where, exactly, it is hiding. (Kolstad et al., 2008). Others have taken an approach that is perhaps more useful in this context as they proposed an assessment of corruption risks along the industry’s “value chain” as the latter typically involves an exploration process, a production process, and a post-production or decommissioning phase (Al-Kasim et al., 2008). Depending on the robustness of regulatory frameworks and institutions tasked with upholding them, opportunities and risks of corruption may flourish variously at all stages in the value chain. Approaching the same logic from a policy perspective, organizations campaigning for good governance in natural resource sectors worldwide have pursued a similarly disaggregated approach, proposing a “chain for change”. (Alba, 2009; Ross, 2012). Building on this, one may add the dimension of revenue management and expenditure where opportunities and risks of corruption may equally arise depending on what institutions are established to channel, spend and save revenues. (Ross, 2012)

Lebanon: Public institutions, corruption and political settlement

Upon hearing the news in of a significant petroleum endowment likely hidden off their country's coast, many Lebanese intuitively sensed the mixed blessing that this may bring. Few do not have some proposal on how to spend the expected revenues in a country that is burdened with public debt, inadequate basic infrastructure and welfare services, and suffering from sharp inequalities in terms of income and wealth (Fadlallah, 2012). Yet many commentators, Lebanese and foreign alike, already warned particularly against the risk, and for some even the inevitability, of widespread corruption in Lebanon's emerging petroleum sector. (An-Nahar, 12 April 2011; Abu Muslih, 2013; Zahi, 2013; As-Safir, 8-10 October 2015; ILPI, 2013; World Bank, 2014). In response, Lebanese politicians and officials have emphasized that corruption in the emerging governance of the petroleum sector will not be tolerated. Implicitly, relevant legal measures adopted thus far contain a similar pledge. Most importantly, the country's Petroleum Activities Regulations decree (Decree 10289, article 162) explicitly bans any form of corruption or bribery in the sector, as defined by Lebanese law and international conventions. Furthermore, former Energy Minister Jibran Bassil indicated that Lebanon intends to join the Extractive Industries Transparency Initiative (EITI), which would compel the government to fully disclose its revenues from petroleum activities and establish a multi-stakeholder group to oversee its commitments arising from membership (Executive Magazine, 17 October 2013).

From the author's discussions with public officials specializing in the issue it emerged that some dismissed views on the risks of corruption in Lebanon's emerging petroleum sector as resulting from ill informed media coverage (especially on account of the technicalities of the petroleum industry)⁴ or as being excessively pessimistic. Yet to the extent that a track record of public institution building and corruption provides a guide to a country's future ability to establish sound and corruption-free institutions governing an emerging petroleum sector—as many researchers on the topic claim—Lebanon's past performance in this regard indeed constitutes a serious source of concern. Internationally recognized indices covering (perceptions of) corruption and bribery levels in addition to numerous opinion surveys consistently suggest that extremely high corruption levels pervade Lebanon's political system, its public sector, its private sector, and society at large. Lebanon's scores on Transparency International's Corruption Perceptions Index (CPI), perhaps the most prominent index, suggest

continuously dismal and even slightly worsening perceived corruption levels.⁵ (Transparency International, 2014 and 2005).

A growing body of research carried out by social scientists and economists unanimously confirms assessments of Lebanon's corruption problem and generally found the latter to be so engrained as to have become institutionalized in all matters of public life. (Leenders, 2012 & 2004; Cammett, 2014; Stel & Naudé, 2013; Baumann, 2012; Balanche, 2012; El-Husseini, 2012; Gaspard, 2004; Kingston, 2013; and Picard, 2000). An impressive array of ongoing research projects continue to explore Lebanon's corruption and widespread 'cronyism' at various levels, scrutinizing the use of *wasta* (personal connections or intermediaries) in transactions involving the public sector, conflicts of interest in fiscal policies and reconstruction, 'cronyism' in the country's labour market, 'crony capitalism' and Lebanon's banking sector, and corruption in rural development policy, urban development and public procurement. (Egan, 2014; Mawad, 2014; Makarem, 2014; Chaaban, 2014 & 2015; Diwan & Haidar, 2015). None of their dire assessments should be uncritically or automatically applied to forecast what awaits Lebanon in terms of governing the petroleum sector and the management of its revenues. Indeed, some key policymakers, regulators, and civil society activists alike are adamant that with the expected start of petroleum activities and the arrival of their revenues Lebanon will finally turn its back to inadequate institution building and rampant corruption, and in this way embrace a rare opportunity and incentive for reform. (Author's interviews, June 2014)

Furthermore, the technicalities of the petroleum sector and the institutions created to govern the sector are mostly new, as Lebanon has never embarked on significant petroleum production before. This, one could reason more optimistically, provides Lebanon with an opportunity to this time create more efficient and less corrupt institutions. Yet such individual qualities, some good intentions and relatively anomalous features of the petroleum sector should be understood against the systemic causes of widespread institutional failure and corruption in Lebanon generally, which are still far from being addressed. However, it may be persuasively argued that an analysis of a complex phenomenon like corruption cannot be mono-causal and, by contrast, will need to be tailored to the specific sector and operations in which it occurs.

This forms an additional reason to be cautious about juxtaposing Lebanon's overall corruption record to its emerging petroleum sector.

By comparing the trajectories of various Lebanese sectors and state institutions in which corruption thrived, one can find clear trends in that they persistently lacked a clear mandate governed by procedures and regulations with robust external checks and controls to ensure accountability, in addition to a separation of public office from private interests (Ibid.).⁶ Such failings have given way to and became associated with Lebanon's "allotment state" (*dawlat al-muhasasa*) in which fierce struggles over the building of state institutions coexist with an utter disregard for the universal application of institutional rules (Ibid.) *Muhasasa* denotes a process wherein the country's political class divides highly prized resources, opportunities, and privileges accruing from the state and its prerogatives among themselves and their allies and, to some extent, they pass it on to their (sectarian) constituencies to ensure their continued political support.

Arguably, Lebanon's political settlement, or its post-Ta'if arrangement to manage multiple conflicts and generate decisions on institutions and policies, is at the root of the country's endemic failure to produce robust institutions able to withstand high levels of corruption. One of the major characteristics and indeed flaws of the political settlement was that it converted the political and military stalemate of the late 1980s into a new arrangement for public decision-making that was similarly characterized by gridlock and fragmentation of power.⁷ In brief, Lebanon's political settlement significantly shaped the process of decision-making and institution building in Lebanon's Second Republic (Ibid.). Even when the exact manifestations and relative weight of its main features have evolved and are likely to change in the future, this political settlement by and large continues to constitute the context in which Lebanon's regulatory and institutional framework for its petroleum sector has been designed, will be further developed and will be enforced.

Lebanon's first steps in petroleum governance

Lebanon already embarked on preparations for petroleum sector governance. Yet frustration has been rife about the country's enduring political gridlock, change of cabinets and ministers, and since April 2014 the crisis concerning the election of a new

president of the republic and when and how to hold parliamentary elections; all these political developments are believed to in one way or another hold back relevant policymaking on the petroleum front. Within these political constraints, parliament approved the Offshore Petroleum Resources Law in August 2010 (Law 132, 24 August 2010), which presents a general framework on how the sector should be organized, regulated, and governed.⁸ It was followed in April 2012 by Decree 7968 (7 April 2012) establishing the Lebanese Petroleum Administration (LPA), whose members were appointed on 4 December 2012. In February 2013 the Council of Ministers approved the Petroleum Activities Regulations for Lebanon (Decree 10289, 30 April 2013), which provides general guidelines for commercial involvement in the sector and their regulation. Companies were invited in March 2013 to submit their credentials for the purpose of pre-qualification, which, in turn, will allow such companies to submit their bids for the envisaged licensing round. Out of fifty-two applying companies from twenty-five countries, 12 applicants prequalified as “operators” (...) and 34 companies as “non-operators” (...). (Lebanese Republic (a), n.d.) Yet subsequently two decrees (one on delineating the ten offshore production ‘blocks’, the other on the model contract, or model Exploration and Production Agreement (EPA), continue to be held up in the Council Ministers for approval.

The Lebanese Petroleum Administration

Law 132 and Decree 7968 mandate the LPA with an advisory and supportive role in preparing and applying the technical and financial framework for the country’s emerging petroleum sector. Although separate from the Ministry of Energy and Water Resources (MEWR), the LPA falls under the ministry’s tutelage and, indirectly, is heavily reliant on the Council of Ministers in making key decisions. As such, the LPA has some of the features of a regulatory body but, arguably, it lacks sufficient institutional independence that is required to perform its hefty tasks without political interference. The LPA differs in this respect from what was initially envisaged. From the mid-2000s onward draft laws were drawn up, foremost involving advisors at the MEWR assisted by experts sent by the Norwegian Oil for Development Program, that called for a relatively independent regulator for the petroleum sector by insulating it from political interference. (Author’s interview with Ali Berro, former advisor at the MEWR, 6 June 2014 and with foreign oil expert, 20 June 2014). Some of those involved in these early

efforts stressed that a *fully* independent regulator was not considered feasible, and perhaps would even be undesirable, as it would run the risk of simply being sidelined or marginalized by the political authorities. (Ibid.) However, before adopting Petroleum Law 132 in August 2010 objections raised within the Council of Ministers caused this envisaged independence, even when relative in nature, to be watered down further. Perhaps most importantly, the LPA now lacks financial independence as it is stipulated that its budget is to be part of the overall budget of the MEWR.

The LPA board consists of six members. On the positive side, they are barred from having any private interests, directly or indirectly, in the contracts concluded by the LPA or in any company working in the field themselves or by being related through any of their relatives (up to the fourth degree). After leaving office former LPA staff are not to engage in any private sector activity pertaining to petroleum in Lebanon for at least two years. Furthermore, the presidency of the board is to rotate among the six members, which can be read as a measure working against potential abuse of power. Their high salaries, at least by Lebanese public service standards, also can be viewed as mitigating the risk of bribery, provided that one subscribes to the disputed claim that susceptibility to bribery correlates with low or more modest salaries, and vice versa (Abbink, 2000).⁹

All LPA board members were appointed by the Council of Ministers upon the recommendation of the minister of energy and water. In practice, this legally prescribed formula necessitated a grand political bargain involving key sectarian and political leaders backing their preferred candidates from a shortlist based on individual merit and experience. This pre-selection was done by a committee comprising a representative of the Civil Service Board (the state's human resources agency), the minister of state for administrative reform, the deputy-governor of the central bank (acting for the office for the minister of state for administrative reform) and the minister of energy and water resources. The committee received more than 600 applications, 18 of which were shortlisted and presented to the council of ministers. (Author's interview with MEWR official, 12 June 2014) Yet concerns remain that regardless of their qualifications the board members will be beholden to their political backers, thus making them indirectly vulnerable to such politicians' possible conflicts of interest. Should these fears prove to be founded, the LPA board members risk sharing the fate of

many other first grade public servants throughout Lebanon's public administration (Leenders 2012). In addition, there may be a risk that a lack of political agreement on future replacements (following expiration of the LPA board's six year mandate or after individual dismissals or resignations) may cause the LPA board to sustain vacancies crippling the agency, as happened frequently since the early 1990s in numerous key state agencies and ministries more generally.

Finally, and despite the potential avenues that all these features already hypothetically offer in terms of political interference and influence, the LPA's role is of a mainly advisory nature in relation to the overriding role of the minister of energy and water resources who, in turn, is to obtain the endorsement of the Council of Ministers for his policies and decisions. In short, within this institutional setup, and despite the rigorous process that resulted in the appointment of capable individuals, the LPA runs a significant risk of becoming subjected to political pressures and influence. This vulnerability is underscored by the power of the minister of energy and water resources to present – or threaten to present-- LPA staff to the state's disciplinary board for alleged violations of the law and neglect of duty, thereby giving the minister, at least hypothetically, a powerful tool to press or deter dissenting staff into compliance.

Officials at the MEWR counter that, even if the LPA is not fully independent, it still has important leverage in the power structure involving the MEWR and the Council of Ministers. (Author's interview, 20 June 2014) They point out that the minister of energy and water resources cannot easily diverge from the LPA's recommendations when it comes to key policies or measures in the petroleum sector, just as the minister will have to explain its position to the Council of Ministers if he does. Yet it is doubtful that this will be sufficient, as it does not shield the LPA from possible pressures from or overriding powers of the Council of Ministers, with or without collusion with the minister of energy and water resources.

In the event that the LPA would succumb to political pressure and associated malpractices in regulating and governing the petroleum sector, chances are that with current auditing mechanisms and their administrative capacities this may not be properly detected. External auditing of the LPA's activities is to be carried out *a*

posteriori by the Court of Accounts (CA), the state's financial watchdog (Law 132, Article 10). Unless this agency is to be dramatically revamped and strengthened—a necessity underscored repeatedly since the early 1990s but never seriously followed up—it will not be able to carry out this task adequately. The CA currently has no expertise on matters related to the oil and gas sector and, throughout the 1990s to date, it failed to meaningfully monitor the MEWR's operations in Lebanon's unruly petroleum imports sector. Its senior staff and auditors lost immunity since 1970s from dismissal by the president of the republic and, under the stipulations agreed to in Ta'if, the Council of Ministers. The CA has consistently suffered from personnel shortages, political bickering over key staff appointments, political interference, and from political maneuvers to suppress the few incriminating reports that under these conditions it was still able to produce (Leenders, 2012; As-Safir, 10 July 2012). These obstacles undermined the CA's operations dramatically, thereby earning it a reputation of being overly legalistic and out of touch with the state's responsibilities.

The prequalification round

It is of course too early to say whether or how the LPA's institutional framework will affect its staff's professionalism or integrity in practice. For now, stakeholders including the international oil companies (IOCs) say they are impressed by the efficiency and transparency by which the LPA has approached the pre-qualification round, the LPA's first major accomplishment. (Author's interviews with IOC officials, May-June 2014) Others, including Lebanese journalists working on petroleum issues, expressed satisfaction with the LPA's efforts to explain its policies and operations, and answer their questions, at first without attribution and, more recently, by giving high-profile media interviews (Hoteit 2014, author's interviews with Lebanese journalists, May-June 2014). From this it seems that the regulation compelling the LPA to first obtain the prior consent of the minister of energy and water resources before making public statements (Decree 7968, article 5) is liberally applied in favor of transparency and outreach to the public, although the latter would be better realized if this stipulation would be removed.

Yet in terms of transparency and accountability, there remain a number of concerns about the pre-qualification round. According to Decree 9882 (13 February 2013), successful companies need to comply with a strict set of legal, financial, technical, and

environmental criteria designed to enable the LPA to identify serious contenders who possess relevant experience in the technically demanding business of deep-water offshore petroleum extraction and who have sufficient financial clout to carry out and sustain their tasks. (Republic of Lebanon, 15 February 2013) In this context a distinction is made between “operating companies” and “non-operating companies”, which need to meet different criteria, and which, after being pre-qualified, will be invited to present their joint bids for an EPA as a consortium comprising at least one operator and two non-operating companies. After assessing the applications, the MEWR and the LPA announced on 18 April 2013 that twelve companies had pre-qualified as operators and thirty-four as non-operators. The large number of contenders promises to encourage a highly competitive bidding process, which from an anti-corruption perspective could be viewed as placing some checks on unfair practices such as granting contracts against suboptimal terms. Crucially, however, no sufficient documentation or explanation was provided about why and how the companies had been found to meet the criteria of pre-qualification. (Lebanese Republic (b), n.d.) Sources at the MEWR told the author that it refrained from publishing such information after receiving requests from the companies to maintain confidentiality, especially when it was suggested to release data on their total capital. (Author’s interview at the MEWR, 6 June 2014)

Importantly, for the main prequalified operators such sub-optimal disclosure in this respect raises no immediate questions. After all, the twelve large companies that prequalified are all internationally and publicly renowned for having many years of relevant experience in off shore petroleum extraction. Also, as all these companies are listed on U.S. and/or European stock exchanges, especially since the U.S. Congress passed the Dodd-Frank Act in 2010 and the EU tightened similar legislation they are obliged to disclose their capital and assets just as they are normally keen to inform their shareholders about their activities. Yet such is far less evident for the pre-qualified non-operating companies. This is not to imply that unfair or shady practices did in fact occur. Yet a key concern in this context remains the extent to which Lebanese businessmen, in possible or perhaps even likely partnerships with political leaders, may gain access to the large rents associated with upstream activities by the winning consortiums. Sources at the MEWR objected in this context that such a degree of confidentiality is not uncommon in prequalification processes worldwide. (Ibid.) Perhaps so, but Lebanon’s

dismal record of corruption and its endemic blurring of public and private interests arguably calls for extra caution and full transparency.

In terms of transparency, the above can be viewed as a lost opportunity even if or when such can be largely explained by companies' insistence on confidentiality. Arguably, the incomplete transparency caused by not disclosing how and why prequalified companies met the criteria, and by not identifying their owners, was compounded by a stipulation in Decree 9882 (article 3). The latter allows non-operators to partner with other companies in their applications for prequalification as long as at least the main applicant (and not necessarily its partners) can prove that it meets the prequalification criteria, including having relevant experience in the sector and possessing at least \$500 million in total assets. One Lebanese lawyer specializing in the petroleum sector argued in this context that this stipulation may be viewed as sitting uneasily with the general principle set out in Law 132, and explicitly mentioned in Decree 9882, that only capable and experienced companies may take part in petroleum extraction. (Author's interview, 2 June 2014.) After all, now companies with no relevant experience whatsoever may join the consortiums by partnering with an established company in the sector and jointly prequalify. Sources within the MEWR explained that the council of ministers had added this option to an earlier draft of the pre-qualification decree, prepared by the LPA, in order to allow for Lebanese participation in the consortiums and promote the country's private sector. (Author's interview, 6 June 2014) They stressed that the main company that decides to partner with other companies retains full legal responsibility and liability in any joint application for prequalification, and that as such the provision contains no risks.

Yet if (Lebanese) companies lacking relevant experience in petroleum may still be viewed as desirable partners to other (foreign) companies that do meet these criteria, why would fully skilled and solvent foreign petroleum companies want to associate themselves with (Lebanese) companies that cannot or do not necessarily demonstrate a relevant track record? It is quite conceivable that foreign companies wish to partner with Lebanese partners in order to be better placed, for example, to meet the legally prescribed criterion to employ at least 80 percent Lebanese citizens among its workforce or to better navigate the country's institutional and economic landscape

generally by virtue of incorporating local knowledge and expertise. Yet another conjectural suggestion, and therefore risk, may be that companies this way prepare the ground for gaining *wasta*, or influence peddling judged beneficial or necessary in future dealings with the Lebanese authorities.

Of course, there are ample alternatives for foreign non-operating companies to allow for or encourage direct or indirect Lebanese participation, for example by selling stock or by establishing credit relationships with Lebanese banks. None of this is necessarily illegal or even circumspect. On the contrary, there are some good economic and practical reasons to encourage Lebanese participation. Yet in Lebanon's climate of fundamental distrust involving the relationship between business and politics, the above also points up to the imperative that any future access by (Lebanese) businessmen to the consortiums' sizeable royalties and shares of oil revenues should at least be made fully transparent and known to the public. Despite efforts to make the pre-qualification process as transparent as possible, this requirement is still to be met.

Toward tendering for the exploration and production agreements

Concerns about the transparency of the prequalification process may become critical in the process of bidding for and signing EPAs and in the context of their envisaged confidentiality. Sources within the MEWR say that the "model contract" will be disclosed as it will be subject to a decree that is currently under examination by a ministerial committee. (Author's interviews, 30 May and 6 June 2014.) In their view, this will make it unnecessary to disclose the actual EPAs concluded with the bidding consortium(s) as the final contracts will not significantly differ from the model EPA. In this context the difference between production-sharing contracts and the main alternative, that of licensing, is of importance. While in the latter all financial stipulations—such as royalties, taxes and 'profit oil' and 'cost oil' (see below)—are set by law, production-sharing contracts contain certain 'biddable items', i.e. agreements on ways to share petroleum proceeds. For reasons of transparency, the licensing system is generally preferred (if certainly not always practiced, not even in countries subscribing to 'best practices'), primarily because all financial or fiscal agreements will this way be made public and be more difficult to change by way of negotiation. (Author's interview with international diplomat specialized in petroleum finance, 9 June 2014) If kept

undisclosed, production-sharing contracts will cause agreements on such crucial issues to remain unknown to the public. Lebanon has opted for a hybrid system whereby some fiscal items are set by law (taxes and royalties to the state) but others (including 'costs oil' to reimburse the right holders, and a percentage of the remaining oil split between the state and the producer) are left to be determined in the final EPAs; so-called 'biddable items'. (LPA, n.d.) For now there are no legal obligations for the EPA contracts to be made public, although former Energy Minister Jibran Bassil made a promise to this effect (Executive, 17 October 2013). Sources within the MEWR argue that it is the companies who are insisting on confidentiality, as the contracts will contain sensitive geological and production data that will be of great interest to their competitors. (Author's interviews, 30 May and 6 June 2014.) This, however, is no good reason for the Lebanese authorities to not at least release the fiscal details in the EPAs or to redact the latter to the same effect (PWYP, 2012). If this does not happen, financial disclosure requirements of international oil companies falling under U.S. and European jurisdictions will only be partially helpful in extrapolating what the fiscal agreements within the EPAs may have looked like. For now, international oil companies are not obliged to disclose the contracts they sign; neither would the Lebanese government be under current legislation, and not even if it were to join the EITI.

The need for disclosure of Lebanon's EPA contracts and its fiscal details, in addition to full transparency on the ownership of all right holders in the extraction of petroleum has only become more pertinent in the Lebanese context of continuous political bickering over the two 'missing decrees' that still need to be adopted before tendering can start. In the Lebanese media and in conversations with the author, the disagreements in this respect have been explained in reference to the preference of former Energy Minister Jibran Bassil to auction only a few specific blocks out of ten delineated while Speaker of Parliament Nabih Berri purportedly prefers to open all of them at once to receive bids. The pros and cons of both proposals are beyond the scope of this article but are framed as different strategies to gain maximum leverage vis-à-vis oil companies or kick start extraction at maximum levels. However, it is questionable whether such technical details of substance really constitute the core of the disagreement. Indeed, Berri does not seem to argue that all blocks opened for bidding will in fact need to be awarded to companies. (Author's interview with MEWR official, 6 June 2014) This has prompted

speculation that Lebanon's political leaders are resorting to their engrained practice of *muhasasa* and that their quarrels are, in fact, about dividing up the revenues and/or business opportunities associated with the emerging petroleum at large. (As-Safir, 8-10 October 2015)

Upstream subcontracting

When or if the EPAs will have been signed and the consortiums will start operating, large scale subcontracting is expected to take place to service and supply the operators, primarily onshore. Such upstream activities will range from hiring security companies, supplying equipment, and purchasing or leasing land for petroleum installations, to building and servicing them. Operators are in this context legally obliged to give "preferential treatment to the procurement of Lebanese originating goods and services when such goods and services are internationally competitive with regard to quality, availability, price, and performance." (Decree 10289, article 157) Undoubtedly, this obligation is aimed at giving Lebanese private sector companies a much-needed boost. Accordingly, scores of Lebanese companies are already preparing themselves for the petroleum industry. Yet at the same time it has been rightly noted that in the Lebanese context, and indeed perhaps generally, the risks of corruption and clientelist practices in subcontracting will be significant. (Author's interviews with Lebanese businessmen and at the Beirut Chamber of Commerce, June 2014; CDL, June 2014). Lebanese petroleum officials seem to expect that the operators will be largely self-regulating in this respect as the latter are assumed to pursue efficiency targets that are at odds with favouritism and corruption, and because as a consortium its members will keep each other in check. (Author's interviews with MEWR officials, 6 and 12 June 2014) In congruence with this, sources within Western major oil companies that prequalified confirm their strong and self-interested intention to refrain from unfair practices and bribery, fearing costly corruption cascades. (Author's interviews, May 2014) It is perhaps against this background that the regulations or mechanisms being put in place or envisaged to mitigate the risks of corruption in upstream subcontracting do not include unusual or overly drastic measures or place stringent disclosure obligations on the consortiums. The operators are expected to subject "major procurement contracts" to public tendering, to submit a list of prequalified bidders to the LPA, justify the selection of the supplier, and let themselves being scrutinized by an external auditor (Decree 10289,

article 157). As such, these requirements certainly meet international best practices and the Lebanese authorities should be lauded for adopting them.

Yet, even when strictly enforced, such legal measures will still not necessarily result in reduced levels of corruption or cronyism. Ironically, one could argue in this context that Lebanon's general conditions of heightened corruption risks call for more drastic measures than called for by best international practice. For one, the Lebanese market is characterized by strong monopolistic and oligopolistic tendencies, particularly in the petroleum imports and distribution sector that is likely to sweep up many subcontracting opportunities (Traboulsi, 2014; Leenders, 2012). Sources within the MEWR understandably argue that they "are not into the business of market regulation", at least not across all sectors. (Author's interview, 6 June 2014) But, for now, neither is any other Lebanese public agency as attempts to adopt and effectively implement anti-trust legislation have thus far been unsuccessful. In combination with Lebanon's blurred boundaries between business ownership and politics, this forms a source of apprehension as far as petroleum subcontracting is concerned. Furthermore, it is not fully clear from existing legislation on the emerging petroleum sector to what extent and how exactly the LPA will monitor and screen the subcontracting process, and what powers it would have if any irregularities were to be detected. The less than optimal degree of the LPA's political insulation generally adds to the risk that even when it intends to be pro-active in this field it may ultimately not be fully successful to effectively counter corruption in upstream subcontracting. Under existing legislation, public oversight or scrutiny in this respect, by media and/or civil society, does not appear to be in the cards as neither operators or the authorities seem to be under any obligation to publicly disclose information on tendering, let alone disclose ownership details of winning companies. Indeed, such details may not be released due to possible confidentiality clauses in the EPAs covering the formalities of subcontracting.

When offshore subcontracting will provide lucrative business opportunities, risks are that it may be subjected to pressures of *muhasasa*. It is possibly the anticipation thereof that currently constitutes one factor in holding back political agreement on the two missing decrees. Depending on the blocks that will be put up for auction and will first start production, onshore locations that are closest to the terminals are likely to witness

a boom in construction, services and business generally. To the extent that drawing analogies provides any guidance, Lebanon's wartime control over several clandestine ports by sectarian militias and illegal seaside properties held by major politicians since, there is a risk that such onshore locations may be viewed as political-confessional fiefdoms (Leenders, 2012; Al-Akhbar, 10 December 2012). That, in turn, could place serious political and confessional constraints on competitive bidding and fair practices in operators' upstream subcontracting.

The consequences of possible corruption, market concentration, and/or politically induced inefficiencies in subcontracting arrangements cannot be discounted in the context of the 'cost oil' arrangement foreseen in the EPAs. (Decree 10289, article 72) This allows the operators to be reimbursed for their "recoverable costs" in kind. As explained above, this constitutes a 'biddable item' and, hence, if the EPAs are not disclosed, it may never become known to the public what exact arrangements were put in place. Equally, and if not strictly monitored, regulated, seriously capped and publicly disclosed, the 'cost oil' provision may challenge the overall assumption that operators will be driven by efficiency concerns in their subcontracting. IOCs and their non-operating partners may ideally seek maximum efficiency and cost savings, but the need to overcome political constraints and boost expediency may at times rival such basic incentives. Indeed, experiences elsewhere, including in India, suggest that operators may at times fail to show self-restraint when their subcontracting is not bound to very strict rules, oversight, and limitations, both by hosting authorities and the public at large. (Achong, 2009/2010; Livemint & The Wall Street Journal, 9 September 2011) In short, market concentration, favoritism, corruption, and measures that fall short of drastically regulating, policing, and disclosing 'cost oil' provisions will constitute a risk of Lebanon's petroleum revenues being skimmed even before they reach the state's treasury.

Establishing a national oil company

Law 132 (article 6 -1) stipulates that "when necessary and after promising commercial opportunities have been verified, the Council of Ministers may establish a national oil company on the basis of a proposal by the minister based upon the opinion of the petroleum administration." Accordingly, a future option was created for an NOC to

operate on the production side of the petroleum sector. Yet the legally enshrined requirement of such an NOC's commercial viability and the explicit need for the LPA's endorsement appears to be as much designed to prevent its immediate establishment. (Author's interview with MEWR official, 20 June 2014) Regardless, the idea already prompted some controversy as some Lebanese observers suspect that the running of a Lebanese NOC will be riddled with corruption and struck by inefficiencies, akin to the unhappy experience with *Electricité du Liban* (Takieddine, 2013; ILPI, 2013; Sarkis, 2014; Uherova-Hasbani, 2011). They also point out that NOCs worldwide, and especially in the Middle East, have often been prone to corruption. Lebanese common skepticism vis-à-vis an assertive role of the state, and 'statism' more generally, is echoed by International Financial Institutions and some IOCs who have their own reasons to counter the worldwide trend toward establishing NOCs and "resource nationalism" (Ross, 2012). Yet analogies with seemingly similar and corruption-ridden institutions, within Lebanon or in other petroleum producing countries, can be as helpful as they are deceptive. With the creation of any new state institution vested interests and long-established expectations of entitlement will be less engrained. This does not remove the risks of corruption but it does offer new opportunities to break with 'business as usual'. In the longer term, an NOC is likely to promote Lebanon's high-end human capital to be employed in the sector while it will allow for higher returns on petroleum production. While aiming for these goals, a Lebanese NOC could cooperate, partner with, and learn from IOCs that have both the capital and expertise to spearhead offshore petroleum activities. From a perspective of corruption control, the NOC's initial and inevitable dependency on the IOCs, possibly by way of taking part in a consortium, would generate some important checks and balances on the Lebanese NOC as its partners are unlikely to tolerate systemic and loss-making mediocrity, corruption, and cronyism.

The 'Sovereign Fund'

Law 132 (article 3) mentions that net proceeds arising out petroleum activities or rights will be placed in a "sovereign fund", leaving it to another law to prescribe its specific management. However, it does already specify that the fund as such will be designed for saving purposes, and as such it shall keep the capital and part of the proceeds "for future generations", and only make available the dividends from investments for other, current purposes. From a perspective of international best practice, the very mentioning of the

fund is congruent with the widely accepted notion that petroleum is a depletable resource and that, as such, there is no moral justification to spend it all by the generation that happens to stumble upon it. However, other motivating factors come into play as well, including policies to counter ‘Dutch disease’ effects and stabilizing sharply fluctuating revenues associated with high price volatility in petroleum prices, intentions to use the dividends for developmental purposes and economic diversification (World Bank, 2014). For the topic of the current article, the idea that such funds can be helpful in insulating revenue management from day-to-day politics and the risk of waste and corruption is most relevant. Such considerations have also informed the Lebanese intention to establish a petroleum fund. (Author’s interview with MEWR officials, 12 June 2014)

The problem is that worldwide experience learns that ‘sovereign wealth funds’ often have done little to advance the goals for which they were established. In fact, they can even worsen the risk of corruption. (Revenue Watch, 2014; Bulte & Damania, 2008). In this context, of course, it is essential that there exist strict rules for withdrawals, clear and legally bolstered criteria or earmarks for expenditure, and high levels of transparency and accountability.

Even so, more often than not, as one scholar on petroleum governance found, “politicians sweep aside institutional constraints to gain control over how a valuable resource is allocated and regulated—giving them the power to use it for patronage or corruption.” (Ross, 2012). ‘Fund raiding’ is the most striking example of this as, for instance in Libya under Muammar al-Qadafi billions of dollars were siphoned off for luxury purchases, spent on white elephant projects and other dubious investments, or simply vanished in private bank accounts abroad. (Global Witness, 2012) While such excesses cannot be ruled out in non-dictatorships or even (semi-)democracies, it is striking that blatant and massive ‘fund raiding’ appears to be a trademark of heavily centralized and coercive authoritarian regimes. Given Lebanon’s unruly, fragmented, or pluralist political system (or, as one author called it less euphemistically, its “authoritarianism by diffusion”) (El Khazen, 2003), the probability of fund raiding appears to be less acute except, perhaps, as the hapless experience of the Lebanese central bank shows, in times of full-scale civil war (Al-Ayyash, 1997). A much greater

risk, however, is that by design, or by reflecting the lowest common denominator of the Lebanese political class' demands and preferences, the institutional checks and balances on Lebanon's sovereign fund will be too diluted and too weak to withstand escalating political pressures to make withdrawals, for instance to achieve or restore a 'confessional balance', or indeed to create opportunities for grand corruption (Eifer et al., 2003). Such concerns resonate with Lebanon's experience with special funds and public sector agencies supposedly insulated from political bickering and interference; the Council for Development and Reconstruction, the Council of the South, the Fund for the Displaced all suffered from constant political interference, wasteful expenditure and corruption. (Leenders, 2012)

Even with effective management, a sovereign fund will not be a guarantee that all resources that it releases will be effectively spent without waste, cronyism, and corruption. For one, such will be dependent on the implementing agencies including line-ministries, especially if at least part of the revenues will be allocated, for instance, to infrastructural projects, initiatives enhancing social welfare provision and poverty alleviation. Partly due to Lebanon's dismal record of institutional weakness, political interference, *muhasasa*, and corruption in public procurement and public welfare provision, some have already suggested radical alternatives to circumvent this problem. These include proposals to use petroleum revenues entirely to pay off Lebanon's large public debt (CDL, 25 January 2012), and spending petroleum revenues on direct cash transfers to all adult Lebanese citizens (Chatah, 2012), as is done in various ways in the oil-rich US state of Alaska, in Bolivia, East Timor, and Mongolia (Gillies, 2010; Ross, 2012).

Conclusion

Given Lebanon's consistently disappointing performance in the past when it comes to sound institution-building and countering corruption, it certainly does not have a good head start for good petroleum governance. Many understandably fear that due to the country's inability to learn from its checkered record of post-war reconstruction, abundant resources made available by a nascent petroleum sector would cause Lebanon's history of rampant corruption to repeat itself, the first time as a tragedy and the second as farce.¹⁰

By tracing already erected institutional and legal structures for the sector's prospective path down the value chain this article identified various vulnerable locations and areas of specific concern, thereby giving ample grounds to be wary about the risks of corruption. In doing so, the article adopted a qualitative approach to assessing risks of corruption along the sector's value chain; a perspective that was argued to better locate and understand such risks than large-N quantitative analyses are able to. It added revenue management and expenditure dimensions to this approach, showing that opportunities for and risks of corruption may equally arise depending on what institutions are established to channel, spend or save revenues. The adopted approach has the added advantage of being intimately tuned to the local context of relevant institution building and the political settlement that undercuts it. As such, the framework proposed in this article may be useful for timely and informed assessments of the risks of corruption among (prospective) green field producers generally, both in the Levant Basin and beyond.

To be comprehensive, of course, the analysis should be extended to any further institutional and policy steps Lebanon will take in the future, perhaps including the use of petroleum revenues to pay off the country's public debt and/or for direct cash handouts. In addition, if or when petroleum governance structures develop further, an appraisal is necessary of the task of building and reforming a range of state institutions and agencies that are less directly involved in petroleum activities and yet crucial to their daily governance, including custom agencies, the judiciary, spending line-ministries, and environmental protection agencies.

In the end, much will come down to the volume of petroleum that will be extracted and the revenues that will be obtained from them. Beyond this what will matter a great deal is the Lebanese government's discipline in what is for now sensibly designed as a gradual and phased approach to assigning the offshore blocks and opening them for production. This would not only make sense in terms of countering the risk of 'Dutch disease' and bureaucratic overstretch, but also to mitigate the risk of widespread corruption bankrolled by large rent windfalls.

Even when the risks of corruption need to be underscored, it should be noted that Lebanon's recent legislation and establishment of new relevant institutions, such as the LPA, suggest a degree of awareness of the complex issues involved and a determination by some to address them. Yet what has thus far been put in place or foreseen in terms of maximizing transparency and accountability is far from perfect let alone corruption-proof. The greatest challenges in this context—given Lebanon's awkward political settlement—will be to sort out the right politics to improve and strengthen the institutions and policies relevant to the sector that have already been put in place. Urgent attention in this respect should be granted to those links in the prospective industry's value chain that this article showed to be already vulnerable to corruption.

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Notes

¹ According to Lebanese government estimates and British geological surveyor Spectrum (Naharnet, 10 May 2013; EIA, 2014).

² It was agreed with interviewees, unless stated otherwise, to cite them without attribution in order to encourage a frank discussion. An additional imperative for doing so concerned the public servants interviewed for this article who did not want to be cited by name due to legal and political limitations.

³ An important exception whereby rich academic research informed petroleum governance debates involved the Chad-Cameroon Pipeline project. Worryingly, even here corruption and misuse of natural resources followed as policymakers overruled the governance structures built on sound policy advice and expertise. (Pegg, 2009)

⁴ On inaccurate reporting by the Lebanese media on the oil and gas issue see Samir Kassir Foundation (2014).

⁵ Lebanon's country score (on a scale of 0 – highly corrupt- to 100 –very clean) was 27 in 2014 and 31 in 2005.

⁶ Making this argument, Leenders (2012) analyzes the Lebanese Central Bank as a control case sustaining relatively developed institutional guarantees and a far less checkered post-Ta'if history of corruption.

⁷ Other key features of Lebanon's post-Ta'if political settlement are: a predominance of a 'troika' of key policymakers and its politics of *muhasasa*; continuous attempts to circumvent built-in stalemates and veto points laid out in the Ta'if Accord; extremely weak popular support for political elites and ensuing confessionalist and narrow, local agendas, and; the overriding role of Syria – and, after 2005, multiple foreign countries-- in policymaking. (Leenders, 2012)

⁸ All laws and decrees are available at the website of the Lebanese Petroleum Administration. <http://www.lpa.gov.lb>

⁹ LPA board members' salaries and allowances reportedly average around USD 200,000 per year (Now., 28 December 2012). In comparison, judges are among Lebanon's best-paid state employees; yet even the highest-ranking and –experienced judge does not earn more than USD 43,344 per year (albeit excluding allowances). (Republic of Lebanon / Ministry of Finance, December 2011)

¹⁰ Karl Marx's famous expression was similarly used in an article by Jim Quilty and Lysandra Ohrstom (2007) who, based on their analysis of widespread corruption and cronyism in Lebanon's 2006

reconstruction, argued that the country was already experiencing a farcical repeat of flawed reconstruction policies throughout the 1990s.

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