



PRINCIPLES FOR MANAGING LEBANON'S NATURAL RESOURCE REVENUES

PREPARED BY ANDREW BAUER FOR KULLUNA IRADA
AND THE LEBANESE OIL AND GAS INITIATIVE (LOGI)

May 2020

Principles for Managing Lebanon's Natural Resource Revenues

KEY MESSAGES

- The Government of Lebanon is unlikely to see any hydrocarbon revenues over the next decade. The most optimistic projections are that oil and gas revenues would start to be collected at least seven to eight years from now and will not exceed two percent of GDP even at peak production. These projections are conditional on a commercial discovery being made this year and there being no delays in field development, both of which are improbable. Additionally, Lebanon's latest energy plan calls for a large proportion of any commercial gas discovery to be earmarked for domestic energy production. In short, revenue estimates remain highly speculative and could be negligible.
- The Government of Lebanon may wish to create a special fund to allocate hydrocarbon revenues to underfunded expenditure items, similar to funds in Alabama (USA) (capital improvement and environmental protection), Alaska (USA) (cash transfers), Ecuador (social security, social projects and the environment), Texas (USA) (university education) or Timor-Leste (education and infrastructure as elaborated in the strategic development plan), or for fiscal stabilization, such as in Chile or Peru.
 - › Lebanon's oil fund can be an institution that invests in foreign assets and allocates a moving average of the interest earned, and perhaps a portion of the principal, to an underfunded expenditure item, such as renewable energy, pensions, foreign scholarships, public transport or environmental protection. Alternatively, it can be an earmarking passthrough account that directly finances these projects or sectors. Prior to establishing such a fund, it would be useful to agree on a national vision for economic development, for instance elaborated in a national development plan, in order to guide decisions on priority projects or sectors in which to invest.
 - › Lebanon could establish a fiscal stabilization mechanism anchored by a counter-cyclical fiscal rule, which might necessitate a sovereign wealth fund once public debt declines to a sustainable level.
- A pre-condition for establishing such funds is fiscal sustainability. Sovereign wealth funds that save and invest in foreign assets are only politically and economically viable in countries where the interest rate on fund savings is greater than the interest rate paid on foreign-denominated debt. This is not the case in Lebanon nor is it expected to be in the foreseeable future.
 - › As of May 2020, informal capital controls have been imposed on foreign currency accounts, several exchange rates operate simultaneously, and unemployment is rising fast. Depositors have been forced to convert part of their foreign currency earnings in commercial banks to Lebanese pounds. The central bank is rationing basics such as medication and fuel and has provided zero percent interest loans to banks to allow businesses to continue operating. The Government of Lebanon has defaulted on its sovereign debt and the government has hired a team of financial consultants to advise on debt restructuring. Most commercial banks may already be insolvent; some may have already failed. The economic pain is magnified by an additional contraction caused by the global coronavirus pandemic.
 - › Against this backdrop, a publicly-owned financial endowment is unlikely to last for long. When faced with a choice to draw down on a fund with liquid assets or risk sovereign default, governments rationally choose to seize fund balances, even if regulations prohibit such action. In recent years, Algeria, Argentina, Ghana, Mongolia and Venezuela have each faced this situation with a similar result.

› Prior to establishing an oil fund, the Government of Lebanon ought to: (1) Reduce public debt to sustainable levels; (2) Restructure, recapitalize and modify the legal framework for the banking sector; (3) Balance the budget after the crisis is over through income tax, electricity sector and civil service wage reforms, among others; and (4) Enact and enforce fiscal rules to credibly commit to fiscal sustainability in the future, for instance through ratification of a Fiscal Responsibility Act, as well as a compliance mechanism such as a fiscal council. Fiscal rules that reduce the overall debt burden, such as expenditure rules or (structural) balanced budget rules, can form the basis of a Fiscal Responsibility Act.

- In summary, countries that have benefited most from natural resource production have invested in sectors and projects that improve livelihoods for present and future generations, and smoothed year-to-year overall fiscal expenditures. Lebanon could follow examples set out by Chile, Norway, Peru and the UAE by investing in public education, productive infrastructure, and future high-growth sectors, as well as establishing a sound macroeconomic framework.



Kulluna Irada is a civic organization for political reform, engaged in setting the foundations for a modern, secure, efficient, sustainable and just state. It is funded exclusively by Lebanese citizens in Lebanon and abroad. Kulluna Irada believes transparency, accountability and citizen participation as major constituents of good governance. The organization's goal is to raise awareness on public issues and engage constituencies of the Lebanese society: citizens, NGOs, experts, municipalities, and members of Parliament and Government in order to find and implement sustainable solutions. Kulluna Irada's internal governance is based on collegial decision making and strict rules on conflict of interest: board members have vowed not to run for elections or participate in any public auction.

Kulluna Irada

Beirut Digital District
BDD 1281, Ground Floor
Syriac Patriarchate Street
Bachoura – Beirut, Lebanon
+961 1 640 020
info@kulluna-irada.org