

# Spoils of oil? Assessing and mitigating the risks of corruption in Lebanon's emerging offshore petroleum sector

Reinoud Leenders



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Sadat Tower, Tenth Floor  
P.O.B 55-215, Leon Street,  
Ras Beirut, Lebanon

T: + 961 1 79 93 01  
F: + 961 1 79 93 02  
info@lcps-lebanon.org  
[www.lcps-lebanon.org](http://www.lcps-lebanon.org)

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## Reinoud Leenders

Reinoud Leenders is a reader in International Relations and Middle East Studies in the War Studies Department at King's College London. His research interests and teaching are focused on Middle East politics generally and Syria, Lebanon, and Iraq in particular. His work deals with the political economy of corruption, authoritarian governance, refugee issues, and conflict. He has authored several articles in academic journals and edited volumes, and the book *Spoils of Truce: Corruption and State Building in Post-War Lebanon* (Cornell University Press 2012). He formerly worked for International Crisis Group in Beirut and for the University of Amsterdam. Dr. Leenders obtained his PhD from the School of Oriental and African Studies at London University.

## **Executive summary**

To be fully prepared for Lebanon's possible transformation into a major oil and gas producer, the risks of corruption in connection to its nascent petroleum sector need to be better understood and addressed. Given Lebanon's dismal track record in countering corruption and its chronically gridlocked political process, the risks of corruption in the country's nascent petroleum sector are significant.

This paper tracks such risks along the value chain of the country's expected petroleum production and in the context of revenue management and expenditure. It argues that the first steps in petroleum governance have been encouraging but are far from optimal. Sources of concern pertain to the Lebanese Petroleum Administration's mandate and relative insulation from political interference, sub-optimal transparency in the pre-qualification process, the envisaged non-disclosure of exploration and production agreements, and the questionable assumption that sub-contracting for offshore petroleum activities will be largely self-regulating. In addition, a range of state institutions and agencies that will be crucial to daily petroleum governance are unlikely to cope if not drastically reformed. Looking further ahead, this paper touches on a number of policy choices that will have to be made if or when Lebanon's petroleum reserves are confirmed, including the establishment of a national oil company, determining the role and management of a 'sovereign fund', and considering more radical proposals for petroleum revenue expenditure and sharing. It concludes by arguing that a lively and informed national debate on the specificities and technicalities of Lebanon's petroleum sector may help to create the very prerequisites of political change and create more favorable conditions to counter the risks of corruption.

## Introduction

The discovery of gas and oil deposits off the coast of Lebanon has yet to be confirmed but it has already inspired hope and optimism for the country's future economic viability and development. Significant revenues extracted from producing oil and gas, or 'petroleum' to denote both, indeed can 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 shows 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 lacking transparency, discretionary decision-making, unaccountability, favoritism, rampant corruption, and/or waste. Furthermore, a windfall of natural resource rents, or the expectation thereof, also tends to encourage a scramble for and brings about high competition over resources, while (perceptions of) entrenched corruption and unjust distribution of economic opportunities and revenues may set the stage for new and/or reinvigorated (violent) conflicts. Given its own troublesome past and experience of rampant corruption and civil conflict, these general risks are especially pertinent in the Lebanese context. For now, and despite clear efforts to counter corruption and increase transparency and accountability, the country's institutional capacities appear too weak to meet the heightened need for a solid framework that regulating the petroleum sector and expected windfall of revenues typically calls for. At the same time, Lebanon cannot afford oil and gas discoveries that magnify or add to its already high levels of corruption, worsen real and perceived injustice in governance, and fuel conflict.

This paper presents an analytical framework for assessing and mitigating the risks of corruption in Lebanon's nascent petroleum sector. It draws on many discussions with Lebanese officials in relevant government institutions, stakeholders in the private oil and gas sector, Lebanon's business community more generally, its civil society, and some foreign diplomats closely following Lebanon's petroleum developments. It was agreed with interviewees, unless stated otherwise, to only cite them without attribution in order to encourage a frank discussion about what are often considered highly contentious issues. It should be emphasized that the more critical observations in this paper do not suggest that corruption or cronyism has occurred or will take place; the paper merely flags the risks or probabilities of such practices if not addressed properly.

The key aims of this paper are to assess the general risks of corruption in connection to Lebanon's emerging gas and oil sector,

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The paper will not cover or speculate on current or future developments in Lebanon's expected onshore potential for oil and gas, which—if confirmed—would considerably complicate the analysis and very likely further underscore the risks of both corruption and conflict.

identify what institutional and regulatory measures and policy tools have thus far been put into place and assess whether these are sufficiently robust to counter or reduce corruption risks, and formulate proposals to help inform a growing debate on how the risks of corruption and malpractice associated with Lebanon's emerging oil and gas sector—all along its value chain—can and should be reduced.<sup>1</sup>

## **I 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 (Ross 2003, 24-26; Marshall 2001; Sachs and Warner 1999, 13-38). This literature, mostly drawing on large-N quantitative methodologies, was developed in an attempt to 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 matter in that they are tasked with formulating and carrying out vital policies to counter or prevent a host of harmful economic and financial effects of revenue windfalls from the extraction of natural resources, including 'Dutch disease', the volatility of oil and gas prices, and, hence, revenue and environmental challenges. While from this perspective the need for solid and sound institutions and policies is particularly underscored and even 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 undermine states' capacity to build and sustain such necessary institutional qualities (Papyrakis and Gerlagh 2004, 181-193; McPherson and MacSearraigh 2007, 201-202). 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 and Weidmann 1999).

The suggested correlations and causal mechanisms involving the oil-corruption nexus continue to be fiercely disputed in academic debates, as are most other dimensions of the alleged 'natural resource curse' (Brunnschweiler and Bulte 2008, 248-264; Di John 2007, 970-974; Ledermann and Maloney 2007). Without intending to comprehensively review this literature, for the purposes of the current paper three observations in this context will have to suffice, as they will steer my own assessment of the risks of corruption in Lebanon's

emerging oil and gas industry and related issues of governance.

First, not all oil and gas-producing countries suffer from heightened or extraordinary levels of corruption. In this context it has been commonly observed that it matters a great deal whether the country 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, 34; Smith, Engen et al. 2012, 262). 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 countries with modest or even weak institutional capacities 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. Indeed, among these countries one can find an array of institutions and regulatory measures that had variable effects on petroleum-related corruption levels.

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 that, although perhaps sounding self-evident to some, is often neglected in the predominantly economic literature on the 'natural resource curse'. 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 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. Given countries' specific features in this context, their political settlements should be taken into account in order to both explain their respective existing institutions and to prescribe ways in which ensuing levels or risks of corruption can be feasibly mitigated.

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. This has repercussions for understanding where, how, and why the risks of corruption manifest themselves just as it reduces the utility of such studies for proposals to effectively counter more specific risks (Kolstad et al. 2008, 23). By contrast, investigative research into corruption in some countries' oil and gas sector that are most notorious



for corruption and malpractices were conducted by such organizations as Global Witness and Human Rights Watch (2004, 2010). Such studies have the advantage of identifying relevant bottlenecks in specific contexts, yet they are often highly descriptive in nature to the extent of failing to offer much transferable knowledge and insights. 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', which involves an exploration process, a production process, and a post-production or decommissioning phase (Al-Kasim et al. 2008, 203-209, 214). 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. Along these lines, Farouk Al-Kasim (et.al) focused exclusively on the regulation of the oil industry in its pre-operational and (post-) operational phases (their results are presented in appendix 1). Building on this approach, one may add the dimension of revenue management and expenditure. As Michael Ross put it succinctly, '[t]he most important political fact about oil—and the reason it leads to so much trouble in so many developing countries—is that the revenues it bestows on governments are unusually large, do not come from taxes, fluctuate unpredictably, and can be easily hidden' (Ross 2012, 6). Depending on what policy choices are made in this context and given the robustness of relevant institutions implementing them, ample opportunities and risks of corruption may arise on the revenue and expenditure side of oil and gas extraction as well.

Using an inverse logic, organizations campaigning for good governance in natural resource sectors worldwide have pursued a similarly comprehensive yet disaggregated approach. For example, Publish What You Pay (PWYP) produced a 'chain for change' tracking the need for robust and transparent institutions and policies from the moment of exploration up to dismantling extractive projects (Alba 2009). Together with other organizations, including the Extractive Industries Transparency Initiative (EITI) and Revenue Watch Institute (now the Natural Resource Governance Institute), it designed elaborate recommendations to ensure transparency, accountability, and solid institutional arrangements to govern the natural resource industry in most of its aspects (Ross 2012, 249).<sup>2</sup> However, even when some of these generic recommendations may prove to be highly relevant for Lebanon, they need to be assessed for their appropriateness and feasibility, and tailored to local circumstances. Most importantly from the perspective of the current paper, such recommendations also need to address relevant opportunities and risks of corruption arising from the institutional capacities and underlying political settlement in Lebanon. It is to these conditions that we turn first.

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A common criticism in this context is that these and other initiatives focus primarily on how revenues accrued from natural resources are collected, not how they are spent.



## II Lebanon: Public Institutions, Corruption and Political Settlement

Upon hearing news of a significant petroleum endowment likely hidden off the 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 is 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. They variously suspect that high levels of corruption will follow from an unhappy mix involving international oil companies not especially reputed for fair and transparent practices; Lebanon's political class that is widely viewed as corrupt, greedy, and looked at with distrust; and a dysfunctional, divided, and gridlocked political process at best geared toward deals 'dividing up the cake'<sup>3</sup> (Abu Muslih 2013, An-Nahar 2011 and 2013). In short, a windfall of business opportunities and revenues generated by petroleum extraction is widely sensed as carrying serious risks of magnifying these various failings and lifting them to unprecedented levels. In response, Lebanese politicians and officials have emphasized that corruption in the emerging governance of the petroleum sector will not be tolerated. Implicitly, legal measures 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 Minister of Energy and Water Jibran Bassil indicated that Lebanon intends to join 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 2013).<sup>4</sup>

Some may dismiss popularly held views on the risks of corruption in Lebanon's emerging petroleum sector as ill informed (especially on account of the technicalities of the petroleum industry), excessively pessimistic, or suffering from unrealistically high expectations, or all of the above. 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—then Lebanon's past achievements in this regard indeed constitute a serious source of concern. Internationally recognized indices covering (perceptions of) corruption and bribery levels in addition to numerous opinion surveys held among the Lebanese population at large and

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'In the end everything will be divided up among the main politicians. The people won't get to see anything of it. That's trivial to anyone.' From author's interview with Lebanese academic.

4

A team within the International Monetary Fund is assisting the Lebanese authorities to prepare itself for EITI candidacy. Author's interview with international diplomat specialized in petroleum finance, 9 June 2014.

among Lebanese and foreign entrepreneurs consistently suggest that extremely high corruption levels pervade Lebanon's political system, its public sector, its private sector, and society at large (appendix 2). Those indices that have included Lebanon over a longer time also suggest alarmingly rising levels of corruption in Lebanon, especially in recent years. In comparative terms, they rank Lebanon among the worst affected countries by corruption, both within the Middle East and North Africa (MENA) and worldwide. Lebanon's scores on Transparency International's Corruption Perceptions Index (CPI) also suggest deteriorating corruption levels in 2013 compared to the years before; most likely as a result of the general erosion and paralysis of government in the context of the worsening Syrian crisis and its destabilizing effects on Lebanon (Daily Star 2013).<sup>5</sup>

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As claimed by former Justice Minister Jihad Azur in reference to allegedly rising corruption levels at the end of 2013, 'The situation deteriorated last year. The state is getting weaker and is unable to enforce any decision. As a result of this laxity, some of the employees continue this practice with complete impunity.'

Academic research carried out by social scientists and economists, both by international and Lebanese scholars, 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. In my own book I conducted a qualitative analysis of numerous corruption allegations in the context of a range of public institutions following the signing of the Taef Accord in 1989 up until 2012 (Leenders 2012). It detailed how senior policymakers and high-ranking public servants in key sectors of the Lebanese economy and governance, including transportation, health care, natural resources and energy, construction, and social assistance programs were implicated of corruption. The study is congruent with the assessments of numerous other scholars that corruption and associated practices of clientelism have permeated Lebanon's state institutions and politicians' relations with the private sector and civil society alike throughout the post-Taef period (Cammet and Issar 2010, 381-421; Cammet 2011, 70-97; Chen and Cammet 2012, 1-8; Stel and Naudé 2013; Baumann 2012; Leenders 2004; Balanche 2012, 145-8, 163; Gaspard 2004, 213, 219; Kingston 2013, 57-60, 164; Picard 2000).

None of these 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, key policymakers, highly capable 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 on inadequate institution building and rampant corruption. As one official at the MEW stated:

*The governance of the oil sector inevitably will be within the system, whether you like it or not. This leaves two options, forget about it, or create a nucleus that is relatively insulated and does something different.*

*The international oil companies demand quality. In this sense the petroleum sector provides an opportunity to establish units of new and well-qualified people in several ministries. As there is a revenue-making potential, there will be an effort to build sound institutions. Petroleum this way presents an incentive for reform.*<sup>6</sup>

6

Author's interview, 20 June 2014.

Furthermore, the technicalities of the petroleum sector and the institutions created to govern the sector are entirely new, as Lebanon has never embarked on significant petroleum production before. This, one could reason, provides Lebanon with an opportunity to this time create more efficient and less corrupt institutions. Yet, such individual qualities, 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. In this context, many rivaling explanations have been suggested (Leenders 2004, 232-235). Indeed, 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 offers an additional reason to be cautious about unreservedly 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 (Leenders 2004, 72-121). 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 (Leenders 2004, 231-232). In this context, the country's political class divides highly prized resources, opportunities, and privileges accrued 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-Taef 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. In brief, Lebanon's political settlement significantly shaped the process of

decision-making and institution building in Lebanon's Second Republic (Leenders 2004, 122-163).<sup>7</sup> Even when the exact manifestations and relative weight of each of its main features have somewhat changed and are likely to change in the future, they by and large have remained the same and jointly 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.

### III Assessing Lebanon's First Steps in Petroleum Governance and the Risks of Corruption

Over the last four years Lebanon achieved a number of milestones in its preparations for petroleum sector governance. Overall, stakeholders and observers consider the process to be reasonably transparent and promising, even when frustration is rife about the necessary steps and policies being significantly delayed because of the country's political gridlock, change of cabinets and ministers, and more recently the crisis concerning the election of a new president and when and how to hold parliamentary elections. Within these political constraints, the 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.<sup>8</sup> 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. In accordance with this emerging legal framework, 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. Decree 9882 (13 February 2013) was issued calling on interested companies to apply for pre-qualification by detailing further conditions and required documents. Out of fifty-two applying companies from twenty-five countries, twelve applicants prequalified as 'operators' and thirty-four companies as 'non-operators'.<sup>9</sup> 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) have been held up in the Council of Ministers for approval. After a new cabinet was formed—led by Prime Minister Tamam Salam—in March 2014, an inter-ministerial committee was set up to study the two draft decrees but, to date, no agreement has been reached on their exact contents for them to be passed. As a result, the actual invitation for the tender for the EPAs has been delayed, most recently until 14 August 2014.

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It did so by way of an extreme dispersal of power and associated quasi-permanent gridlock in decision-making, the predominance of the troika and the politics of muhasasa, continuous attempts to circumvent the built-in stalemates of the political arrangement laid out in the Taef Accord and the constitution, extremely weak popular support for political elites exposing them to confessionalist strategies and narrow, local agendas, and the overriding role of the interests of external powers in Lebanon, as well as their manipulation of the country's differences.

8

All laws and decrees are available at the LPA website. <http://www.lpa.gov.lb>

9

Lebanese Republic, Ministry of Energy and Water Resources, Petroleum Administration Lebanon, Lebanon's First Offshore Licensing Round—The Prequalified Companies.

### a The Lebanese Petroleum Administration

The Lebanese media have generally welcomed the establishment of the LPA as a positive step toward competent and responsible institution building in a country that has lacked such qualities for a long time. One MP, a member of the political bloc (the Free Patriotic Movement) to which former Minister of Energy and Water Jibrán Bassil belongs, went as far as to claim that 'the new petroleum administration is the first proper public institution created since the times of [former President] Fu'ad Chehab.'<sup>10</sup>

Law 132 and Decree 7968 essentially mandate the LPA with an overall advisory and supportive role in preparing and applying the technical and financial framework for the country's emerging petroleum sector. Although separate from the MEW, 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.

In this the LPA differs from what was initially envisaged. From the mid-2000s onward draft laws were drawn up, foremost involving advisors at the MEW assisted by experts sent by the Norwegian Oil for Development Program from 2007 onward, that called for a relatively independent regulator for the petroleum sector by insulating it from political interference, whether by the MEW or the Council of Ministers.<sup>11</sup> 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 political authorities.<sup>12</sup> However, before adopting Petroleum Law 132 in August 2010 objections raised within the Council of Ministers caused this envisaged independence, even if relative in nature, to be watered down further. Perhaps most importantly, the LPA lacks financial independence as it is stipulated that its budget is to be part of the overall budget of the Ministry of Energy and Water (MEW).

The LPA board consists of six members. On the positive side, they are barred from having any personal interests, directly or indirectly, in the contracts concluded by the LPA or with any company working in the field 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 sector standards, also can be viewed as mitigating the

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Author's interview, 3 June 2014.

11

Author's interview with Ali Berro, former advisor at the MEW, 6 June 2014 and with foreign oil expert, 20 June 2014.

12

Ibid.



13

Such reasoning does not seem to have been a prime factor in the decision to place LPA salaries at higher than usual levels. Instead, salary scales prevailing in the worldwide petroleum sector generally were viewed as necessitating higher salaries for LPA staff in order to attract and retain qualified people. Author's interview with MEW official, 20 June 2014.

14

Author's interview with MEW official, 12 June 2014.

15

Ibid.

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).<sup>13</sup>

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. The committee received more than 600 applications, 18 of which were shortlisted and presented to the Council of Ministers.<sup>14</sup> Most agree that the selection process was unusually rigorous and transparent, and that the six selected candidates are highly capable and experienced, as some have been drawn from renowned international petroleum companies. Concerns remain, however, 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 2004, 224). 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.<sup>15</sup>

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 who, in turn, is to obtain the endorsement of the Council of Ministers for his/her policies and decisions. In short, within this institutional setup, and despite the rigorous process that resulted in the appointment of individuals with the highest qualifications and right intentions, 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 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 dissenting staff into compliance.

Officials at the MEW counter that, even when the LPA is not fully independent, it still has important leverage in the power structure involving the MEW and the Council of Ministers.<sup>16</sup> They point out that the minister of energy and water cannot 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 his/her position to the Council of Ministers if he/she 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.

In the hypothetical 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, *Diwan al-Muhasaba*), the state's financial watchdog (Law 132, Article 10). Unless this agency is dramatically revamped and significantly 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 MEW's operations in Lebanon's unruly petroleum imports sector. Its senior staff and auditors lost immunity since the 1970s from dismissal by the president and, under the stipulations agreed to in Taef, the Council of Ministers. The CA has consistently suffered from personnel shortages, political bickering over key staff appointments, political interference, and from blatant political maneuvers to suppress the few incriminating reports that under these conditions it was still able to produce (Leenders 2004, 164-167; As-Safir 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.

#### **b 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 concerned international oil companies (IOCs) say they are impressed with the efficient and transparent way in which the LPA has approached the pre-qualification round, the LPA's first major accomplishment.<sup>17</sup> 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).<sup>18</sup> Based on this it

16

Author's interview, 20 June 2014.

17

Author's interviews with IOC officials, May-June 2014.

18

Author's interviews with Lebanese journalists, May-June 2014.



seems that the regulation compelling the LPA to first obtain the prior consent of the minister of energy and water 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 fully realized if this stipulation was removed.

In terms of transparency and accountability, there remain a number of concerns about the pre-qualification round. According to Decree 9882, 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.<sup>19</sup> 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. Accordingly, companies submitted their pre-qualification applications between February and March 2013. After assessing the applications, the MEW 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.<sup>20</sup> Sources at the MEW told the author that it refrained from publishing such information after receiving strong requests from the companies to maintain confidentiality, especially when it was suggested to release data on their total capital.<sup>21</sup>

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 offshore petroleum extraction. Also, as all these companies are listed on US and/or European stock exchanges, since the US Congress passed the Dodd-Frank Act in 2010 and the EU adopted similar legislation they are obliged to disclose their capital and assets just as they are normally keen to inform their shareholders about their activities. Such is far less evident for the pre-qualified non-operating companies. As one observer put it, ‘so, ok, the LPA says it found that these companies have met the criteria and they listed their names, but give me one reason to trust them.’<sup>22</sup> This is not to imply that unfair or

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Republic of Lebanon, Ministry of Energy and Water, Petroleum Administration, Lebanon First Offshore License Round, 15 February 2013.

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The information brochure released on the occasion only provided the names of the companies and very general company descriptions provided by the companies themselves. See Lebanese Republic, Ministry of Energy and Water, Petroleum Administration, Lebanon’s First Offshore Licensing Round, the Prequalified Companies, n.d. However, at the press conference on 18 April 2013, the MEW and LPA explained orally why the companies involved prequalified in reference to their capital assets and other qualities. Author’s interview with MEW official, 20 June 2014. Strikingly, Lebanese media showed no interest in such key data as they failed to include these in their coverage of the event.

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Initially some companies even objected to us printing their logos in the brochure listing all pre-qualified companies.’ Author’s interview at the MEW, 6 June 2014.

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Author’s interview with Lebanese petroleum geologist, 8 June 2014.

shady practices did in fact occur. Indeed, MEW officials stress that the prequalified companies all met the legal, financial, and technical criteria.<sup>23</sup> 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. From this perspective, the failure to release full ownership data on the prequalified (non-operating) companies reduced the value of what otherwise seems to have been intended as a fully transparent pre-qualification process. Sources at the MEW objected in this context that such a degree of confidentiality is not uncommon in prequalification processes worldwide.<sup>24</sup> 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 an unused 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,<sup>25</sup> that only capable and experienced companies may take part in oil extraction.<sup>26</sup> After all, now companies with no relevant experience whatsoever may hypothetically join the consortiums by partnering with an established company in the sector and jointly prequalify.<sup>27</sup> Sources within the MEW 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.<sup>28</sup> In addition, they stressed that the main company which 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.<sup>29</sup>

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

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Author's interview, 12 June 2014.

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Author's interview at the MEW, 6 June 2014.

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Annex 4, 4.1 'Eligibility criteria' (2).

26

Author's interview, 2 June 2014.

27

Ibid.

28

Author's interview, 6 June 2014.

29

Ibid.

track record? Again, there is no suggestion made here that dishonest practices in this context did occur. Indeed, 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. 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.<sup>30</sup> None of this is necessarily illegal or even circumspect. On the contrary, there are some good economic and practical reasons to encourage Lebanese participation as much as possible. However, in Lebanon's climate of fundamental distrust involving the relationship between business and politics, the above also points 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 has yet to be fully met.

**c Toward Tendering for Exploration and Production Agreements**

Evidently, concerns about the transparency of the prequalification process may become critical in the process of bidding for and signing contracts, or EPAs. In addition, there are a few concerns regarding the envisaged confidentiality of these EPAs. Sources within the MEW 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.<sup>31</sup> 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.<sup>32</sup> Yet, in this context, the difference between production-sharing contracts and the alternative, that of licensing, is of importance. While in the latter case all financial stipulations—such as royalties, taxes, and 'profit oil' and 'cost oil'—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

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It is this additional possibility for Lebanese participation that made LPA members decide not to object to the Council of Ministers amending Decree 9882 (article 3), 'even when this was not ideal.' Author's interview with MEW official, 20 June 2014.

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Author's interviews, 30 May and 6 June 2014.

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Ibid.

of negotiation.<sup>33</sup> 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; the so-called 'biddable items'.<sup>34</sup> For now there are no legal obligations for the EPA contracts to be made public, although former Minister of Energy and Water Jibran Bassil publicly made a promise to this effect (Executive 2013). Sources within the MEW 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.<sup>35</sup> This, however, is no good reason for Lebanese authorities to not at least release the fiscal details in the EPAs or to redact the latter to the same effect (Publish What You Pay 2012). If this does not happen, financial disclosure requirements of international oil companies falling under US and European jurisdictions will only be partially helpful in extrapolating what the fiscal agreements within the EPAs may have been.<sup>36</sup> For now, international oil companies are not obliged to disclose the contracts they sign, neither would the Lebanese government be under current legislation, 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 Lebanese media and in conversations with the author, disagreements in this respect have been explained in reference to the preference of former Minister of Energy and Water Jibran Bassil to auction only a few blocks (blocks 1, 4, 5, 6, and 9) 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 paper but essentially appear to come down to 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.<sup>37</sup> This has reinforced the impression or 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 sector. Several theories have

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Author's interview with international diplomat specialized in petroleum finance, 9 June 2014.

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LPA, 'The Exploration and Production Agreement', n.d. Other biddable items include the Royalty rate for other Petroleum than Crude Oil. Decree 10289 (art. 72).

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Author's interviews, 30 May and 6 June 2014. Even so, it would then make little sense for the companies to sign confidentiality statements as opposed to the authorities.

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One obstacle in this context may be that in Lebanon, petroleum companies falling under US or European jurisdiction will partner in their consortium with non-operating companies that may come from jurisdictions that do not require disclosure on their revenues and/or ownership.

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Author's interview with MEW official, 6 June 2014.

in this context been suggested. They range from politicians placing sectarian denominations on the blocks and their respective revenues; them giving priority to blocks that are closest to the territories under their control in order to benefit from onshore petroleum activities; them striving for access to the companies that will take part in the consortiums and/or the upstream operations they will be subcontracting; to geopolitical struggles involving Russia whose companies are now not among the pre-qualified operating companies.<sup>38</sup> None of these theories can be easily substantiated, others sound unlikely, and some may be dismissed as rather fanciful. Yet, unfounded speculations are at least partly a result of the fact that transparency in the process thus far could, and perhaps should, have been taken to higher levels, combined with a deeply rooted mistrust of Lebanese politicians. In any case, the delay caused by continued political bickering over the missing decrees may in itself have a harmful effect on the competitiveness of the bidding process if and when it eventually takes place. A number of prequalified operating companies are rumored to be losing both patience and confidence, prompting them to withdraw.<sup>39</sup> Sources within the MEW remain optimistic and argue that in terms of the number of international oil companies, Lebanon received more interest than neighboring Israel and Syria.<sup>40</sup> They add that prequalified companies will not be in a hurry to withdraw given the long-term perspectives of petroleum activities and because they spent money on seismic data and registration. If future withdrawals and reduced competition would cause the bids to be unfair to Lebanon, they say that a decision may be made not to go ahead and wait for better offers.

#### d 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 ensuring that Lebanese private sector companies receive a much-needed boost. Accordingly, scores of Lebanese companies are already preparing themselves for the petroleum industry.<sup>41</sup> 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.<sup>42</sup> Among Lebanese petroleum

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Author's interviews with Lebanese businessmen, civil society activists, journalists, and foreign diplomats in Beirut, May-June 2014.

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Author's interview with Western petroleum company official, 23 May 2014.

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Author's interview, 12 June 2014.

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Author's interviews with Lebanese businessmen and at the Beirut Chamber of Commerce, June 2014.

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Albid.; Nasser Hoteit: 'l'enjeu du gaz est économique et industriel pour le Liban,' Le Commerce du Levant, June 2014.



officials there seems to be an expectation that the operators will be largely self-regulating in this respect as they are assumed to pursue efficiency targets that are at odds with favoritism and corruption, and because as a consortium its members will keep each other in check.<sup>43</sup> In congruence with this, sources within Western major oil companies that prequalified confirm their strong intention to refrain from unfair practices and bribery, calling them 'bad business practice' primarily in reference to the potentially escalating nature of bribery or sweetheart deals if given into.<sup>44</sup> 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. On top of the generally phrased legislation banning corruption in all petroleum activities (Decree 10289, article 162), 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 allow themselves to be scrutinized by an external auditor (Decree 10289, article 157). As such, these requirements certainly meet international best practices and Lebanese authorities should be lauded for adopting them.

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 practices. 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 (Leenders 2004, 29-37; Traboulsi 2014, 39-41). Sources within the MEW understandably argue that they 'are not into the business of market regulation.'<sup>45</sup> 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.<sup>46</sup> The less than optimal degree of the LPA's political insulation generally adds to the risk that even when it chooses to be pro-active in this field, as the intention appears to be, it may ultimately not be fully successful in effectively countering corruption in upstream subcontracting. Under existing legislation, public oversight or scrutiny in this respect, by media

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Author's interviews with MEW officials, 6 and 12 June 2014.

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Author's interviews, May 2014.

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Author's interview, 6 June 2014.

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Decree 10289 (article 72) does oblige operators to disclose their subcontracts to the LPA, but only upon a decree drafted by the Minister of Energy and Water Resources and adopted by the Council of Ministers. Although this can be positively viewed as acknowledging the need for disclosure of subcontracts, it at the same time points up to the possible pitfalls associated with the LPA lacking full independence and the need for public disclosure.

and/or civil society, does not appear to be in the cards as neither operators nor 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, wartime control over several clandestine ports by sectarian militias and illegal seaside properties held by major Lebanese politicians since, there is a risk that such onshore locations may be viewed as political-confessional fiefdoms (Leenders 2004, 188-189; Leenders 1988, 271-287; Al-Akhbar 2012). That, in turn, could place serious political and confessional constraints on fair and 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, 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).<sup>47</sup> In short, market concentration, favoritism, corruption, and measures that fall short of drastically regulating, policing, and disclosing 'cost oil' provisions would constitute a risk of Lebanon's petroleum revenues being skimmed even before they reach the state's treasury.

There are measures that Lebanon could take to mitigate the risks of

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A report prepared by India's Comptroller and Auditor General investigating excessive recoverable cost declarations by petroleum companies read: "The private contractors have inadequate incentives to reduce capital expenditure—and substantial incentive to increase capital expenditure or 'front end' capital expenditure". Livemint and The Wall Street Journal, 'Reliance, DGH, Oil Ministry in the Firing Line,' 9 September 2011.



corruption and cronyism in petroleum-related subcontracting. Most importantly, all tendering and major subcontracting should be made transparent to both the authorities and the public on a routine basis. Kazakhstan's Contract Agency (KCA), established in 2002 to promote local involvement in petroleum sector activities, could be a source of emulation in this respect. Among other services, it established an automated register that makes procurement processes fully and continuously transparent to all parties involved and to the public at large (Tordo 2013, 126). Accordingly, it tracks information on the entire procurement process from the initial tender, through contract specifications, and up to the award. A similar approach could be adopted in Lebanon, for example by placing such a publicly accessible register on upstream subcontracting within the LPA. Companies that want to place their bids in response to the consortiums' calls will do so via the automated register after full disclosure is given on these companies' ownership, main shareholders, and their subsidiaries. However, reforms should go further, including by adopting a robust anti-trust law, putting in place a fully competent and independent regulator, and establishing a unit therein specialized in petroleum-related activities.

#### e Daily Petroleum Operations and Dispute Settlement

State regulation and governance of significant petroleum activities narrowly defined already constitute a huge challenge but so will 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. Given their current capacity and susceptibility to corruption such secondary institutions in Lebanon are unlikely to cope. Particularly vulnerable to corruption is the Lebanese Customs Authority, which although having gone through some institutional reforms since the 1990s is still struck by high levels of corruption and inefficiency (IMF 2005). Western IOC officials expressed concern that the import of highly specialized equipment and machinery unknown to Lebanese customs officials (or absent from their inventory lists) would likely cause costly delays in clearances, thereby creating opportunities or, from an importer's perspective, a need for bribery to expedite entry.<sup>48</sup> Hypothetically, politicians with control over customs officials, whether by way of their appointments or otherwise, could use their leverage to press operators in making subcontracting decisions in their favor, as often happens in Iraq.<sup>49</sup>

Numerous other state agencies and institutions with currently weak anti-corruption controls will inevitably see their activities and workload augmented when or if routine petroleum-related operations commence. In this context, the risk of 'bureaucratic overstretch' is real (Ross

<sup>48</sup> Author's interviews, May-June 2014.

<sup>49</sup> Author's interview with IOC official, 23 May 2014.

2012, 209). Licenses and permits of all kinds are a domain wherein Lebanese state agencies frequently are extremely cumbersome to deal with unless bribes are offered to obtain them or to expedite formalities. Similarly, enforcement of environmental regulations is often highly selective when involving private interests of politicians and influential businessmen with sufficient ‘protection’ (*mahsubiya*), as illustrated by largely unsuccessful attempts to put a halt to illegal quarrying (Leenders 2004, 42-52). Several ministries and state agencies are currently involved in Lebanon’s preparations for its emerging petroleum sector and are cooperating with the LPA to put in place appropriate measures and reforms. In this context it should be noted that administrative reforms involving such and other public sector institutions since the early 1990s have been slow and that tangible results have been disappointingly limited (El Ghaziri 2007). Arguably, this has been largely due to the crippling effects of Lebanon’s political settlement and the failure of reformers to take this into account (Leenders 2004, 235-238). Whether Lebanon’s political class will grasp the need for comprehensive administrative reforms in the context of petroleum governance requirements as a way to reinvigorate and bolster administrative reform remains to be seen.

Lebanon’s judiciary calls for specific attention in this context. Operators will to a large extent be able to resort to international arbitration clauses in its dealings with the state<sup>50</sup> and with major (sub-)contracts with providers and service companies. In this context it should be noted that Lebanon has a reasonably good reputation in terms of executing international arbitrators’ decisions, although at times following long delays (Al-Akhbar 2007).<sup>51</sup> Yet, such international arbitration will to some extent still be dependent on Lebanon’s court system for its execution. Smaller contracts involving Lebanese sub-contracting companies will likely rely on local arbitration whereby in addition to courts’ involvement in execution, and in the case of a disagreement about the appointment of an arbitrator, a court of first instance will typically assign one (IBA 2012).<sup>52</sup> Furthermore, criminal infringements, including violations of environmental laws and corruption, fall under the sole jurisdiction of Lebanese courts. It is in this context that the judiciary’s deficiencies in terms of integrity and independence—as suggested by numerous international indices and opinion surveys (see appendix 3)—will gain pertinence. If Lebanon is to become a significant producer of oil and gas, its courts’ current corruption and inefficiency levels may become amplified by increased workloads, by at times large and complex financial claims, and because of the blurred public and private interests potentially troubling Lebanon’s petroleum industry.

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These provisions will be stipulated in the EPAs.

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For instance, Paris-based arbitration in a dispute between the Lebanese state and CCC-Hochtief over payments for construction work at Beirut International Airport in 1997 lasted over a decade before resulting in an ‘amicable agreement’.

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The International Bar Association concluded that arbitration in Lebanon ‘is not yet at a stage where one could assert that arbitration has become a real alternative to court proceedings’.

## f 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.<sup>53</sup> 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 experience with *Electricité du Liban* (Takeddine 2013; ILPI 2013, 18; Sarkis 2014).<sup>54</sup> They also point out that NOCs worldwide, and especially in the Middle East, have often been prone to corruption (Barms 349-350). 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 and arguments to counter the worldwide trend toward establishing NOCs and 'resource nationalism' (Ross 2012 39-41, 59-62, 240-241). 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. In addition, as argued below, an NOC may play an important role on the revenue side of the value chain and help to enhance public accountability vis-à-vis the petroleum sector at large.

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'We wanted to prevent the establishment of another redundant public institution, such as the Lebanese railway authority, which continues to have one thousand staffers while there isn't one train running. And they are still recruiting!' Author's interview with MEW official, 20 June 2014.

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Author's interviews, May-June 2014.

## IV Revenue Management Options, Expenditure and Risks of Corruption

Of course, the more one moves up Lebanon's prospective value chain involving petroleum, the more speculative the analysis will be. This certainly applies to revenue management, spending aims and targets, and procurement and expenditure mechanisms. The complex choices that will have to be made in this respect will and should not only be steered by concerns or efforts to reduce corruption risks, but the latter certainly deserves to receive close consideration. Understandably, since Lebanon's petroleum potential still needs to be confirmed, few concrete steps have been taken in this direction. Accordingly, a public debate on the issue is in order in preparation for the day that petroleum revenues may arrive.

### a The 'Sovereign Fund' and Its Management

Law 132 (article 3) mentions that net proceeds arising out of 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, meaning it will 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 that has developed over millions of years 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, and attempts to separate the petroleum proceeds from the ordinary state budget to better control their usage ('ring fencing') (World Bank 2014, 19-29). For the topic of the current paper, 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. Accordingly, since the early 1990s many oil producers have established such special funds. All these considerations have also informed the Lebanese intention to establish a petroleum fund, including a resolution to counter corruption, waste, and the plunder of what may be significant volumes of precious resources.<sup>55</sup>

The problem is that worldwide experience suggests 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.

As a recent report by Revenue Watch Institute put it: 'The rhetorical appeal of natural resource funds as symbols of development and progress has sometimes outstripped their practical value as solutions to specific macroeconomic or budgetary problems. This lack of clarity represents a real danger, as poorly conceived funds can become channels for corruption' (Revenue Watch Institute 2014; Bulte and Damania 2008, 246-254).

In this context, of course, it is of essential importance 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, 209). 'Fund raiding', as happened under Mu'ammār al-Qadhafi's rule in Libya, is the most striking example of this as billions of dollars were consumed, spent on white elephant projects and other dubious investments, or simply vanished in numerous private bank accounts of the Qadhafi family and their allies (Global Witness 2012). Another example of this is the expenditure of petroleum proceeds held in such funds on arms in times of extreme political crisis, as happened in Chad where its fund for future generations, even when supervised by the World Bank, was cancelled in 2005 following several coup attempts against President Idriss Déby (Pegg 2009, 311-320). Yet, even when 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, 53-57), the probability of fund raiding appears to be less acute except, perhaps, in times of full-scale war (Al-Ayyash 1997, 170-173).<sup>56</sup> 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, 116).

In the context of Lebanon's crippling political settlement it is extremely doubtful that, from scratch, a new agency can miraculously emerge that will sustain the solid institutional qualities to withstand political interference and offer guarantees of full transparency and accountability, even when such features remain a necessary precondition

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Even so, during Lebanon's civil war (1975-1990), Lebanon's central bank was never fully raided by militias, earning its governor a reputation of 'the banker in a bunker'.

for effective corruption controls. However, in this context some Lebanese and foreign observers have already suggested that the Lebanese Central Bank could be a suitable candidate to manage the fund, which would certainly not be unusual as central banks elsewhere are often the designated manager of sovereign wealth funds given their asset management expertise. Indeed, the Lebanese Central Bank has by and large preserved its integrity and independence, in sharp contrast with most public institutions (Leenders 2004, 225-230). In this context, the Norwegian International Law and Policy Institute observed in a report on Lebanon's emerging petroleum sector that '[t]he combination of strong qualitative performance combined with a shared understanding among Lebanese of the importance of [the central bank's] independence ... was part of the explanations informants gave' (International Policy Institute). The report continues that for its integrity and independence the central bank should be viewed as 'a model' for petroleum governance. Yet, the main reason why the central bank did not succumb to political pressure and muhasasa is far from selfless respect for institutional independence; arguably, it was the direct result of the fact that the central bank's independence was and still is the pillar of the lucrative market for treasury paper. Lebanon's private banks rely heavily on this market and political elites are among its key owners (Leenders 2004, 230). One lesson that can be drawn from this, crudely as it may sound, is that Lebanon's political class needs to sustain a private interest in preserving or respecting the sovereign fund's independence and integrity. This hardly offers grounds to see the central bank as a 'model', as the circumstances under which its institutional qualities arose are somewhat anomalous and, indeed, not immune to controversy. Perhaps one way to go about this is by placing the fund within the central bank, and closely integrating the general management of the central bank with that of the fund (e.g. by granting its governor overlapping roles and responsibilities). This way one will intently connect the country's market for treasury paper and associated interests of private banks, with the management of petroleum revenues, and thereby help create vested interests among the political class in good governance. In short, the way in which the sovereign fund will be managed and by whom, and how this will relate to the interests of the political elites, will be essential for any rules on withdrawals and technical safeguards for independence, transparency, and accountability to stand a chance of being respected.

**b Sovereign Fund Allocations and Expenditures**

Having an effective fund manager in place, whether this is the central bank or otherwise, will not guarantee that all resources that it releases according to set rules on allocation and earmarking 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. Paying off Lebanon's hefty public debt and/or re-financing (parts of) it, is one such a proposal (Le Commerce du Levant 2012).<sup>57</sup> From a purely economic and financial point of view there are certainly grounds to argue for this. Moreover, it is argued that this would radically resolve any problem or remove any risk of the country's expected petroleum wealth being squandered. At first sight, and from an anti-corruption perspective, the suggestion sounds appealing. Yet, for a number of reasons it ultimately fails to be persuasive. First, it is highly doubtful that there will be political or indeed popular support for the idea, as spending (most of or all) the proceeds from petroleum will be viewed as financing past corruption and waste while it would have the opportunity costs of ignoring urgent problems such as widespread poverty and sharp regional socio-economic imbalances. Second, without guarantees of fiscal prudence, paying off the public debt may simply improve the state's creditworthiness, which could be an incentive to start the borrowing and spending cycle all over again in a context of still failing or lacking political and administrative reforms. In this sense, paying off the debt now could be tantamount to financing the corruption of tomorrow. Third, by hypothetically removing any opportunities for corruption on the revenue-side via drastic debt repayments, the scramble for access to and muhasasa in the production-side of the petroleum sector is likely to be intensified, negatively affecting production performance. Fourth, paying off the entire debt, if indeed the size of petroleum revenues would allow for this, would eradicate the treasury paper market and put the private banks out of business. By implication, this would remove one of the very few remaining pillars of cohesion and collaboration among the political class.

The allocation of significant petroleum proceeds and their expenditure, or that of sovereign fund dividends, is bound to entail a menu of items that will all deserve to be considered and financed, including paying off part of the public debt and refinancing other parts to bring it back to more healthy proportions, as well as expenditures on public procurement, social welfare, and poverty alleviation. Judging from Lebanon's past experience with reconstruction, public procurement in particular will run the risk of rampant corruption. However, as the case of Mongolia illustrates, the arrival of revenues from mineral assets

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In January 2012, former Prime Minister Najib Mikati announced that proceeds from the sovereign fund would be used to bring down Lebanon's public debt from 137 percent of GDP to 60 percent.



could be seized as an opportunity for drastic reforms in this context. In 2013, Mongolia established a new central procurement agency, which takes major spending responsibilities for large projects away from line ministries, standardizes procedures and makes them fully transparent online (Van den Brink 2012, 6). Most strikingly and promisingly, it allows a role for civil society organizations in both bid evaluation and contract monitoring.

The need for decentralization and empowering Lebanon's local governorates and municipalities—long advocated but with relatively small results—may also gain extra relevance and urgency in the context of the revenues made available by petroleum production and strategies to spend them wisely. Smaller, local constituencies are more likely to demand higher standards of governance and public service delivery. For now, at a central level, local interests and agendas often translate into pressure on MPs who respond by offering their patronage in order to be re-elected.

#### c Cash Handouts

Perhaps the most radical proposal aimed at circumventing Lebanon's dismal public sector performance and widespread corruption is to use (parts of) petroleum revenues for cash transfers to all adult Lebanese citizens. Such an arrangement is carried out, in various ways, in the oil-rich US state of Alaska, in Bolivia, East Timor, and Mongolia (Gillies 2010; Ross 2012, 237-238). In Lebanon, late Finance Minister Mohamad Chatah, who was assassinated in December 2013, was perhaps the most vocal proponent of cash handouts (Chatah 2012). The arguments in favor of cash handouts are multifold and include expected gains from circumventing corruption-ridden state institutions, countering citizens' dependency on politicians' patronage, and encouraging a relationship between the state, its petroleum revenues, and citizens (Devarajan 2010). From this perspective, all Lebanese will gain a direct stake in the performance of petroleum governance, and they are thereby assumed to press for greater accountability and corruption controls. Yet, at least in theory, the counter-arguments appear equally persuasive. First, it is far from certain that citizens will spend the handouts wisely, for example by saving them or by investing in education. Anecdotal evidence about how Lebanon's sizeable remittances are spent and consumed in this respect is not encouraging (Daily Star, 2009).<sup>58</sup> Second, if no serious measures are taken to address the monopolistic and oligopolistic features of its economy, the opportunities of both increased consumption and investment will be merely captured by a rent-seeking business class. Third, cash handouts, if done properly, would be neutral in terms of income distribution. In some countries that may not be a problem, but given Lebanon's large disparities in

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IDAL Chairman Nabil Itani claimed that only 10% of remittances are invested.

income and wealth this may be viewed as an opportunity cost that is difficult to defend (Shaxson 2007, 1123-1140).<sup>59</sup> Fourth, there are no guarantees that cash handouts will promote popular pressures for accountability and good petroleum governance; it may merely cause the public to demand higher production (Gillies 2010). Finally, and assuming that the cash handouts will be sizeable enough to undermine politicians' patronage, there are no a priori reasons to believe that public decision-makers would cooperate and this way bankroll themselves out of office (Leenders 2004, 64-71).<sup>60</sup> Overall, and despite some of its drawbacks, the idea of cash handouts certainly deserves consideration. In this context, introducing conditional cash transfers could also be considered; for example by issuing vouchers for health and education services, either indiscriminately to all citizens or targeted at vulnerable groups (De la Brière 2006). Direct transfers, whether being monetized or in kind, will not be a panacea for solving the corruption problem once and for all. Yet, should cash transfers become part of the menu of spending items associated with a hypothetical windfall of petroleum revenues, they would perhaps be best placed within the central bank's sovereign fund where they could be kept and managed separately in a 'Mohamad Chatah Account for all Lebanese Citizens'.

#### d Capitalizing a National Oil Company and Enhancing Public Accountability

While there may be compelling reasons for the eventual establishment of a Lebanese NOC in terms of high-end employment generation and revenue maximization, it may also make good sense for investment policies and encouraging public accountability vis-à-vis the petroleum sector at large. There are, of course, many alternative ways to capitalize an NOC, and all need to be carefully considered from an economic, financial, and commercial point of view. One option may be for the Lebanese state to direct part of its petroleum revenues, or the dividends of its sovereign fund, to capitalize an NOC that, in a lasting partnership with IOCs, will face scrutiny to operate effectively and efficiently. Next to direct majority state ownership, all Lebanese adult citizens could be made shareholders in the NOC, this way perhaps complementing or substituting for possible direct cash transfers, as discussed above. For reasons of political expediency, another part of the NOC's shares could be designated for open subscription. Accordingly, it may be reasonably expected that Lebanese citizens and the country's political class will gain not only a direct stake in the good governance of petroleum revenues but also in its production, thereby encouraging accountability and responsible expectations of sustainable petroleum production. It may be in this context that an NOC's necessary institutional insulation from Lebanon's crippling political settlement, and more conventional designs to ensure efficiency and transparency, may have a better

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In line with other proponents of cash handouts elsewhere, Mohamad Chatah argued in this context that with higher incomes the Lebanese would also pay higher income taxes. That is assuming that the Lebanese tax authorities are able to fully collect income tax, which, given large-scale tax evasion, is far from certain. Also, it raises questions about the very progressiveness/regressiveness of Lebanon's income tax system.

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Other obstacles that may be suspected to trouble any Lebanese cash transfer system include a) the issue of Lebanese nationality and/or residence in light of Lebanon's large diaspora and the already highly controversial issue of naturalization, and, b) the risk of massive fraud in the distribution of cash; not uncommon in Lebanon as illustrated by state subsidies on Internally Displaced Persons.

chance to take hold and last. To be sure, any such scheme involving public distribution of shares will face challenges and obstacles that will need to be carefully addressed (Palley 2003, 6). Yet, such efforts may be worthwhile given the accountability effects that are likely to result from the citizenry's acquired stakes in the production of petroleum that, first and foremost, is theirs.

## V Summary and Recommendations

When it comes to analyzing the risks of corruption in Lebanon's emerging petroleum sector, and indeed corruption more generally, the devil is in the details. Moreover, a sector-specific focus on the risks of corruption needs to be firmly placed and understood in Lebanon's political, social, and economic context before one can make sensible and feasible suggestions or recommendations for ways to mitigate them. The risks of corruption in Lebanon's emerging petroleum sector should not be discounted. To begin with, and given the country's consistently disappointing performance in the past in terms of sound institution-building and countering corruption, it does not have a good head start for good petroleum governance. By tracing the sector's prospective path down the value chain, from oil extraction, revenue generation, and management, up to expenditure policy options—this paper identified various vulnerable locations or areas of concern, and it gave reasons to be wary about the risks of corruption. In doing so, the paper is hardly comprehensive or exhaustive, but has pointed to the daunting institutional and political challenges awaiting Lebanon when or if it becomes a significant petroleum producer. In the end, however, much will come down to the volume of petroleum revenues that will reach the shores of Lebanon. This, of course, depends on what petroleum reserves IOCs will eventually find. What will also matter a great deal in this context is the Lebanese government's discipline in what is now sensibly designed as a gradual and phased approach to assigning offshore blocks and opening them for production.<sup>61</sup> This would not only make sense in terms of countering the risk of 'Dutch disease' and bureaucratic overstretch, but also of mitigating the risk of widespread corruption bankrolled by large rent windfalls.

It should also be noted that Lebanon's recent legislation and establishment of new relevant institutions, such as the LPA, strongly suggest awareness of the complex issues at stake and a resolution adopted by many 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. Key in this context—and given Lebanon's awkward political settlement—is to sort out the right politics to uphold these good intentions, and improve and strengthen the institutions and policies relevant to the

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Author's interview with MEW officials,  
12 June 2014.

sector that have already been put in place.

When it comes to recommendations, there is no desire to join the chorus of 'administrative reform' and 'good governance', which in Lebanon and elsewhere have generated a generic set of platitudes stripping institutional reform from its political underpinnings and its consequences (Bukovansky 2006, 181-209). Neither does it make sense for a foreign analyst to impose their recommendations for better petroleum governance onto Lebanese policymakers and the public at large; all policy options should primarily arise from a national debate that by itself would already feed a culture of greater accountability. Nevertheless, perhaps a number of suggestions can be useful for this debate to center on possible remedies.

Across the value chain of petroleum production it will be essential that Lebanon's fractured civil society use the opportunity and momentum of building petroleum governance structures to find common ground in demanding transparency and accountability, and in jointly scrutinizing every aspect of how the sector will be managed. In this context it should be noted that there are already various modest but promising initiatives by civil society organizations which aim to raise public awareness and knowledge relevant to the petroleum sector and its governance, and monitor Lebanon's media coverage of the issue and enhance media capacity.<sup>62</sup> Lebanon seems to be on the verge of becoming a petroleum producing country. There is now momentum and an opportunity to coalesce these initiatives and expand their reach. Strikingly, and despite their differences otherwise, most Lebanese of varying sectarian and/or political backgrounds appear to be largely in agreement that strong efforts should be made to prevent the emerging petroleum sector from sinking into the all too familiar scenario of rampant corruption and cronyism.<sup>63</sup> Such efforts may perhaps be most effectively channeled into a joint and concrete initiative.

Against this background it may be worthwhile to establish a Lebanon petroleum watchdog comprising a broad coalition of Lebanese civil society organizations and activists who follow and document developments in the petroleum sector with the aim of scrutinizing petroleum-related policies and activities, increasing public awareness, and demanding full transparency and accountability.

In conjunction with this, overall petroleum governance would benefit from a pro-active role of IOCs in publicizing and explaining their intentions and efforts, especially in the context of anti-corruption controls, to the Lebanese public as soon as they commence their operations. If or when Lebanon adopts the EITI and enters into business with IOCs, other petroleum companies will take part of a multi-stakeholder group that could provide a platform for public outreach. Given Lebanon's past of widespread corruption and opaque business

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In addition to the Oil & Gas Sector project by the Lebanese Center for Policy Studies, Lebanese civil society initiatives relevant to petroleum governance have already been launched by organizations including Publish What you Pay, Revenue Watch Institute, the Samir Kassir Foundation, Common Space Initiative and International Alert; all variously encouraging debate on available governance options, awareness raising, and enhancing media capacity. Author's interviews with civil society activists, May-June 2014.

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A strong consensus in this respect was suggested by debates organized by International Alert in Beirut that included youth representatives of various Lebanese political parties and movements in early 2014. Author's interview with International Alert representative, 11 June 2014.

practices, IOCs will need to do more. For instance, IOCs should establish a strong relationship with the Lebanon Petroleum Watchdog, and be highly responsive to queries on the integrity of the petroleum sector generally that will undoubtedly arise in Lebanese society as soon as production starts.

With regard to the overall governance structure put in place to regulate and manage Lebanon's petroleum sector, the following suggestions can be made:

- Grant the Lebanese Petroleum Authority (LPA) greater institutional and full budgetary independence from the Ministry of Energy and Water (MEW).
- Make the selection and appointment of all LPA staff the sole prerogative of a special committee ('the Petroleum Human Resources and Oversight Committee'), consisting of the president of the civil service board, the deputy-governor of the central bank, and the minister of state for administrative reform, and supported by a review panel of internationally renowned and qualified experts and academics in the field of petroleum governance.
- Clearly assign, define, and separate the MEW's prime task of formulating overall petroleum policies, subject to approval of the Council of Ministers, and the LPA's role as regulator and overall policy enforcer in the petroleum sector.
- Subject the MEW's prerogative to present LPA staff to the disciplinary board to binding review by 'the Petroleum Human Resources and Oversight Committee'.
- Strengthen the Court of Account's capacities to audit the LPA, and ensure that all its reports and/or findings are made publicly available. To ensure full disclosure in this respect, all work carried out by the Court of Accounts will need to be saved on a protected server accessible to 'the Petroleum Human Resources and Oversight Committee,' which can decide to disclose these or parts of these data when it deems necessary.
- Abrogate current legal stipulations that compel the LPA Board of Directors to obtain ministerial approval before making public statements.

On top of these cross-sector suggestions, a number of recommendations pertain more specifically to locations on the petroleum value chain, following the order of contexts in which they emerged in this paper.

With regard to the pre-qualification process and tendering toward EPAs:

- Request all prequalified operating companies and non-operating companies, and all their participating partner companies—or all such

companies that are successful in obtaining EPAs—to fully and publicly disclose their ownership and major shareholders.

Failing this:

- Present full public disclosure of ownership as a biddable item for the EPA bidding round.
- Fully and publicly disclose the final EPA contracts or at least release information on the ownership of all winning companies, partner companies, and their subsidiaries, and disclose the agreements reached on all biddable items, including cost oil stipulations.
- Demand that all (operating and non-operating) companies, their partners, and subsidiaries, and all subcontracting companies, be registered in jurisdictions that are fully transparent.
- Place severe penalties on all companies involved in petroleum production and upstream activities that hide, conceal, or defraud provided information identifying their ownership.

With regard to plans to establish a Lebanese National Oil Company, after necessary and promising commercial opportunities have been verified, and in order to ensure that it will operate effectively and efficiently:

- Legally compel the Lebanese National Oil Company, even at the later stages of its development, to only engage in oil production activities in consortiums in which IOCs are a key operating partner.

With regard to upstream subcontracting:

- Adopt a robust anti-trust law and put in place a fully competent and independent regulator, and establish a unit therein specialized in petroleum-related activities.
- Demand full public disclosure of all large subcontracts and the tendering process that preceded them.

Failing this:

- Oblige all consortiums to turn such a disclosure into a biddable item for their tendering and subcontracting process.
- Establish an automated register that makes procurement processes fully and continuously transparent to all parties involved and to the public at large.

With regard to revenue management and efforts to enhance transparency and accountability:

- Commission the central bank to establish a unit fully integrated into its overall top management to manage the sovereign fund.
- Within the sovereign fund, allocate petroleum proceeds, or fund



dividends, but no more than one-third of total petroleum revenues, to pay off parts of Lebanon's public debt and refinance other parts.

- Establish a new Central Procurement Agency, which takes major spending responsibilities for large projects away from line ministries, standardizes procedures, makes them fully transparent, and allows for participation of civil society organizations in both bid evaluation and contract monitoring.
- Reinvigorate reforms aimed at decentralization and empowering local governance to prepare the latter for receiving earmarked expenditure from petroleum income.
- Consider and weigh the arguments in favor of and against limited and/or conditional direct cash transfers via the sovereign fund's 'Mohamad Chatah Account for All Lebanese Citizens'.
- If or when the Lebanese National Oil Company will be established, ensure that a majority of its shares will be held respectively by the state, in addition to a part of its shares being distributed to all Lebanese citizens, and the remainder reserved for open subscription.

## Appendix 1

### Corruption Risks in Stages of Petroleum Production

**Table 1** Corruption risks prior to operation

Activities		Corruption risks
Preliminary assessment of potential	Prior to the development of an oil industry and petroleum law.	<b>Usually low.</b> Though diplomatic pressure may already be placed on host governments by oil companies.
Development of regulatory framework	The set of legal instruments and institutions needed to prepare for and monitor operations, including production.	Important to secure adequate legislation and allocate regulatory functions to competent institutions, and thus avoid political interference in individual cases.
Establishment or granting of role to NOCs	National oil companies, often established or given important roles.	Secret transactions and exemptions from ordinary rules in society. Home country support in international tenders may have advance consequences in the market. Threat to undermine regulatory authority on the pretext of commercial interests. Often used as means of avoiding political accountability when favoring certain oil companies.
Granting of rights	Pipelines, ports, public services, ownership of equipment, technology, data, etc.	Bribery may influence decisions in favor of certain parties.

Table 2 Corruption risks in operational phases

Phases and Activities		Corruption risks
Pre-qualification	Mechanisms of approval decided.	<b>High risk of corruption.</b> Pre-qualification can, conversely, be very important to ensure efficient operation and high recovery rates. Could be used more actively to secure professional business conduct.
Tender, selection and award	Auction to award concessions. Negotiations and contracting. Decisions about local content. Awarding of concessions for exploration only or exploration and production combined.	Procurement related risk is usually high. Procedures are not sufficient to prevent corruption since serious risk is connected to criteria for awards, rules of exemption, or violation of the procedures.
Exploration	The search for oil deposits.	<b>Low risk of corruption.</b> Risk of leniency in accepting insufficiency in meeting work commitment.
Identification of reserves	Precise geological identification of oil reserves. Oil production cannot begin until resources are proven.	<b>Low risk of corruption</b> connected to these geological analyses, although there may be a risk of fraud in the presentation of the results. These data form the basis for negotiations on the FDP.
Field Development Plan (FDP)	Decisions about production profile and cost recovery schemes.	<b>High risk of corruption</b> , either related to the original contents (cost recovery and production profile) or to amendments of the original contents.
Production	Extraction of oil deposits.	<b>Low risk of corruption.</b> There is generally limited regulatory interference at this stage, though greater controls on production could be beneficial in some contexts. Risk of leniency in accepting FDP changes without expert scrutiny.
End phase	Winding up of production.	Low, though there may be some risks associated with decisions about precisely when to stop production and the quality of decommissioning.

Source Farouk Al-Kasim, Tina Soreide and Aled Williams, *Grand Corruption in the Regulation of Oil*, (Christian Michelsen Institute: 2008).

## Appendix 2

Indices, Surveys and Polls on Corruption in Lebanon (1992-2014)<sup>64</sup>

Source	Nature of assessment	Sources	Main results
Transparency International Corruption Perceptions Index (CPI 2003-13) <sup>65</sup>	Annual poll of polls on perceived corruption levels (0 most corrupt, 10 least corrupt).	Surveys and expert assessments by international rating agencies.	2013: 2.8 2012: 3.0 2011: 2.5 2010: 2.5 2009: 2.5 2008: 3.0 2007: 3.0 2006: 3.6 2005: 3.1 2004: 2.7 2003: 3.0 In comparison in 2013, On par with Mali, Gambia, and Russia, Lebanon's score worse than 11 countries in MENA region.
Heritage Foundation Index of Economic Freedoms (1996-2014) <sup>66</sup>	Measuring freedom of corruption in % points.	2003-2014: CPI 1996-2002: 'Expert' assessments incl. US state agencies.	2003-8: CPI 1996-2014: 10% 1996-2014: Lebanon among region's worst six performers.
Transparency International Global Corruption Barometer (2009-2013) <sup>67</sup>	Corruption relevant questions to respondents in public poll.	Gallup public opinion poll.	2013: 61% think that corruption increased a lot. 69% deems judiciary to be corrupt/extremely corrupt, followed by political parties, public servants, and parliament. 65% think government anti-corruption measures are ineffective. 2009: 14% admits to having paid a bribe in the past 12 months.

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Taken from: Leenders, Spoils of Truce, pp. 3-5—yet updated for 2008-2014 (separately referenced where applicable).

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<http://www.transparency.org/research/cpi/overview>

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<http://www.heritage.org/index/>

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<http://www.transparency.org/research/gcb/overview>

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[https://www.globalintegrity.org/global\\_year/2009/](https://www.globalintegrity.org/global_year/2009/)

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Cited in The Daily Star, 28 June 2013.  
<http://www.dailystar.com.lb/Business/Lebanon/2013/Jun-28/221825-survey-shows-lebanese-corruption-at-all-time-high.ashx#axzz2vYfbHdRC>

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<http://info.worldbank.org/governance/wgi/index.aspx>

Source	Nature of assessment	Sources	Main results
Global Integrity Index (2006-9) <sup>68</sup>	Measuring existence and effectiveness of anti-corruption controls and rule of law (0 weakest, 100 strongest).	Own in-country experts and peer reviewed.	2009: 55 ('very weak') 2007: 54 ('very weak') 2006: 48 ('very weak') In comparison In 2009 Lebanon scored worse than Jordan and Syria.
Lebanese Transparency Association/REACH poll of private sector views on corruption in Lebanon (2013) <sup>69</sup>	Corruption relevant questions to respondents in poll of private sector.	Poll among 800 Lebanese entrepreneurs.	73% of respondents think corruption is a very serious problem. 61% admit to paying bribes to facilitate and expedite public sector procedures and formalities, and 25% admit to resorting to blackmail to obtain access to public services.
Economic Research Forum Institutional Country Risk Guide (1992-1998)	Measuring perceived corruption levels (0 lowest corruption, 10 worst).	Weighing and ranking average of 'expert' assessments by international rating agencies.	1998: 10 1995: 4 1992: 8 In comparison: Lebanon's 1998 score on par with Colombia and worse than Indonesia and all countries in region. Corruption levels rising faster than anywhere else in the world.
World Bank World-wide Governance Indicators (1998, 2003, 2007, 2012) <sup>70</sup>	Measuring perceived control of corruption (0 worst, 100 best).	Expert assessments and Gallup poll among Lebanese public.	2012: 21.0 2007: 31.4 2003: 40.8 1998: 51.0 In comparison: Lebanon's scores sharply declining, and worse than most countries in the MENA except Syria.

Source	Nature of assessment	Sources	Main results
Information International Benchmark Poll on Corruption in Lebanon (1999)	Corruption relevant questions to respondents in public poll.	Representative sample of Lebanese adult population.	86% deem corruption levels to be very high, 27.2% deem all politicians corrupt, 61% deem corruption in all public utilities to be high, 59% think most public employees accept gifts, nearly 100% think bribes are common.
Information International Poll elections (IIM September 2005)	Corruption relevant questions to respondents in public poll following 2005 elections.	Representative sample of Lebanese adult population.	75.8% deem curbing waste and corruption to be top priority of new government yet 48.2% think it will not succeed in prosecuting those guilty of corruption.
Lebanese Center for Policy Studies poll on elections (2005)	Corruption relevant questions to respondents in public poll during 2005 elections.	Representative sample of Lebanese adult population.	22% prioritize fighting corruption as main task for new government while 28% prioritize other economic policies.
Information International Poll (IIM November 2003)	Corruption relevant questions to respondents in public poll.	Sample of Lebanese adult population in Greater Beirut area.	53.8% blame mounting public debt on corruption and waste.
Information International Poll (IIM December 2002)	Corruption relevant questions to respondents in public poll.	Representative sample of Lebanese adult population.	38.1% blame economic crisis on waste and corruption.
Simon Haddad poll (1998)	Corruption relevant questions to respondents in public poll on 'political trust'.	Representative sample of Lebanese adult population.	68% think that 'quite a few' people in government are 'crooked', 70% think government is run by officials looking out for personal interests.



Source	Nature of assessment	Sources	Main results
Statistics International poll (An-Nahar, 25 October 1996)	Corruption relevant questions to respondents in public poll.	Representative sample of Lebanese adult population.	62% say they personally witnessed incidences of corruption in public sector dealings, 60% hold ministers responsible for corruption, 17% expect improvements, 77% think that corruption has worsened.
World Bank Lebanon Investment Climate Assessment (2006)	Corruption relevant questions to respondents in poll private sector.	Sample of Lebanese businessmen and private enterprises.	Businessmen complain about high costs of doing business blamed on inter alia corruption, public procurement viewed as most corruption prone.
Sami Atallah/ Lebanese Center for Policy Studies poll (1998)	Corruption relevant questions to respondents in poll of Lebanese private sector.	Sample of Lebanese businessmen and private enterprises.	60% say Lebanese government suffers from lack of credibility, 62% admit to paying bribes, corruption and 'informal competition' strongest perceived obstacles to doing business. In comparison: Lebanon scores considerably worse compared with businessmen's views in MENA at large.
World Bank Lebanon Private Sector survey (1995)	Corruption relevant questions to respondents in poll of Lebanese private sector.	Sample of Lebanese businessmen and private enterprises.	High cost business environment blamed on inter alia corruption and stifling state bureaucracy.
Economic and Social Council for West Asia FDI Lebanon poll (Mansour 2001)	Corruption relevant questions to respondents in poll of foreign investors in Lebanon.	Sample of foreign businessmen in Lebanon.	Corruption identified as main discouraging factor in doing or expanding business.

Source [Leenders, Spoils of Truce, pp. 3-5 --yet updated for 2008-2014 \(separately referenced where applicable\).](#)

## Appendix 3

### Lebanon's Judiciary in International Indices and Opinion Surveys (2009-2014)

**The Freedom House Index** (2014) includes the subcategory of 'rule of law' assessing the quality and integrity of the judiciary. Lebanon scored five out of sixteen (maximum).<sup>71</sup> In regional comparison, Lebanon achieved the same score as Algeria and out of eighteen countries in MENA (except the Palestinian territories that were not surveyed), Lebanon was outperformed by five countries (Israel, Jordan, Kuwait, Morocco, and Tunisia) gaining higher scores.

**Transparency International's Global Corruption Barometer** (2013) asked respondents to identify whether certain sectors of government were 'corrupt/extremely corrupt'.<sup>72</sup> In Lebanon 69 percent of respondents assessed the judiciary accordingly. By comparison, in the ten countries of the region surveyed, the Lebanese negative assessment of the country's judiciary was only worse in Algeria (72%) and Morocco (70%). In all other (seven) countries (Egypt, Iraq, Israel, Yemen, Libya, and Palestine) surveyed in the MENA region fewer people viewed their own judiciaries as 'corrupt/extremely corrupt'.

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<http://www.transparency.org/gcb2013/countries>

**The World Bank's Ease of Doing Business index** (2013) measures countries' performance on, inter alia, 'enforcing contracts', which includes an assessment of judicial efficiency.<sup>73</sup> Among 20 MENA countries (except Israel) surveyed, Lebanon was outperformed by eleven countries. More specifically, on the variable 'trial and judgment' the index suggests that on average court procedures take 556 days to complete while 'enforcement of judgments' takes one hundred fifty days. In comparison, among twenty MENA countries surveyed (which excludes Israel), Lebanon's score on 'trial and judgment' was worse only in Egypt (720), Djibouti (750), and Syria (590). Lebanon's score on 'enforcement of judgment' was outperformed by eight countries in the region, which put Lebanon in a slightly more positive light compared to its score on 'trial and judgment'. However, the latter hardly warrants giving Lebanon the predicate of 'beacon' for the MENA region as a whole. More generally, the World Bank's disappointing score for Lebanon on judicial efficiency sharply contradicts the anecdotal evidence given by Mr. Abirached (AR 7.2/3/4/5) and his claim of an efficiently performing Lebanese judiciary facing no fundamental problems in terms of severe delays or case backlog.

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<http://www.doingbusiness.org/rankings>

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[http://www3.weforum.org/docs/WEF\\_GlobalCompetitivenessReport\\_2013-14.pdf](http://www3.weforum.org/docs/WEF_GlobalCompetitivenessReport_2013-14.pdf)

### **The World Economic Forum's Global Competitiveness Report**

(2013-14) assesses countries' 'judicial independence'.<sup>74</sup> Lebanon scored 2.3, placing it at country rank of 135 out of 148 surveyed countries. On 'efficiency of legal framework in settling disputes' Lebanon scored 2.7, placing it at country rank of 130 out of 148 surveyed countries. In comparison with the eighteen countries surveyed in the MENA (which excludes Syria, Iraq, and Palestine), Lebanon's scores on 'judicial independence' and its score on 'efficiency of legal framework in settling disputes' were worse only in Yemen (which received a score of resp. 2.2 and 2.2.). All other surveyed countries in the region scored better.

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<http://data.worldjusticeproject.org/#/index/LBN>

### **The World Justice Project's Rule of Law Index**

(2014) measures countries 'rule of law'.<sup>75</sup> Lebanon's overall score on the rule of law was 0.51, placing it fourth out of seven surveyed MENA countries (Lebanon, UAE, Jordan, Tunisia, Morocco, Egypt, and Iran) (one: best, seven: worst). More specifically, Lebanon's civil justice system was ranked sixth out of seven surveyed MENA countries while its criminal justice system fourth out of seven. Of respondents to the survey, less Lebanese (0.46) viewed 'no corruption in the judiciary' than the region's average. For the civil justice system, less respondents than the region's average viewed 'no discrimination' (0.48), no corruption (0.45), 'no improper government influence' (0.39), and 'no unreasonable delay' (0.31).

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<http://www.freetheworld.com/2013/EFW2013-complete.pdf>

### **The Economic Freedom of the World Index**

measures, among other factors, countries' 'judicial independence' and 'impartial courts'.<sup>76</sup> On a scale of zero (worst) to ten (best), Lebanon's inadequate scores on its 'judicial independence' were 2.31 (2011) and 2.48 (2010) and its scores on 'impartial courts' were 3.17 (2011) and 2.94 (2010). In other words, Lebanon's judicial independence worsened while the impartiality of its courts improved. It does not become immediately clear from the index why this would be the case, although it may be suggested in this respect that the term 'judiciary' includes state prosecutors (and 'courts' do not) whose credibility indeed has been increasingly undermined by political interference in the context of the prolonged detention without any evidence of four suspects in the Hariri murder case. In comparison, Lebanon's scores on its judiciary's independence and impartiality are extremely low even by the Middle Eastern region's poor standards. In fact, Lebanon's scores are closer to that of Russia, which in 2011 received the slightly higher score of 2.59 on judicial independence, although Russia's score on impartial courts was, at 2.87, worse than Lebanon's.

In 2009 the Lebanese judiciary scored 61 ('very weak') for its 'accountability' in the international index on government accountability and transparency prepared by **Global Integrity**.<sup>77</sup> It gave a score of zero (extremely ineffective) for the effectiveness of Lebanon's 'regulations governing gifts and hospitality offered to members of the national-level judiciary'.

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<https://www.globalintegrity.org/global/the-global-integrity-report-2009/lebanon/>

An opinion survey jointly held by the **Lebanese Transparency Association** and polling agency REACH in 2013 found that amidst Lebanese common perceptions of high and growing levels of corruption in their country generally the judiciary came in second as being viewed as suffering from most corruption after the Lebanese customs authorities.<sup>78</sup>

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<http://www.dailystar.com.lb/Business/Lebanon/2013/Jun-28/221825-survey-shows-lebanese-corruption-at-all-time-high.ashx>

**The Lebanese Center for Policy Studies (LCPS) and Statistics International** conducted a survey in December 2010 and again in April 2011 among nearly 1,400 Lebanese for the Arab Barometer project. It found that only 24.7 percent of respondents viewed the Lebanese judiciary as trustworthy; a little more than 'government' and 'political parties', but behind the country's security forces, civil society, and the armed forces.<sup>79</sup>

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<http://www.arabbarometer.org/sites/default/files/countyreportlebanon2.pdf>

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