Analyzing Lebanon's energy sector

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LEBANON: RISK ASSESSMENT REPORT

LEADERSHIP & DEMOCRACY LAB

Thinking Ahead

Potential investment risks and mitigation strategies

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1 – Introduction

Lebanon, located in the Levant between Israel and Syria, has always possessed elements of political, economic, and social precariousness. The country's neighbours, as well as regional powers like Saudi Arabia and Iran, have considerable influence on the state, utilizing it for their ends and as a proxy for their affairs. Consequently, a number of wars have ensued, destroying infrastructure, homes, and public buildings. However, since 2006, there has been relative calm which has led to an increase in foreign investment, infrastructure rebuilding, and the birth of a strong civil society – among other positive consequences.

Despite the country's faults, its market and investment structures provide a number of strong features. For instance, in relation to other Middle Eastern countries, Lebanon's debt is centralized, its bond market is stable, and elements such as currency transfer and convertibility are lower risk. Demonstrative of the central bank's stability is its capacity to obtain annual growth despite the regional instability.

This report will focus on Lebanon's energy sector and electricity production. This economic area can be described as problematic. From state energy being sold to its citizens at a loss, to lacking twenty-four hour a day electricity, this sector appears to have much to gain from domestic and foreign investment.

Our team's research analysts have identified the relevant risks pertaining to a wide variety of potential investment situations (outlined in the executive summary). For each risk that is identified, the researchers have provided assessments of the level of that particular risk, as well as a number of mitigation tactics. The research analysts assess the implications of domestic and foreign issues/events, both historical and current, in order to provide a well-rounded guide for prospective investors.

1.1 – Executive Summary

Government Structure

Lebanon's confessionalism-based government structure has historically played a role in driving domestic instability. However, more recent developments, including the rise of "big boss" politicians and a lackluster proportional representation system, have been the real cause of tension between religious sects and political ideologues. The nation's regime structure, however, is surprisingly not a significant barrier to foreign investment.

The largest risks identified within the government include market distortion risk/corruption and the potential for harmful man-made events. Both should be addressed through anticipatory measures and investigation.

Private Energy Competition

Due to Lebanon's inability to provide adequate electricity services to citizens, a growing number of small-scale electricity providers have taken it upon themselves to deliver services at a premium during blackouts throughout the nation. Since these providers are more profitable through sustained energy instability, they pose a significant threat to energy security in Lebanon, going as far as opening fire on the nation's only 24 hour power plant.

The key risks posed within the energy sector pertain to infrastructure, including environmental/permit risk (as seen through delays in construction) and man-made events (as seen through potential attacks on energy-related infrastructure). Both risks require careful navigation by investors, while the potential for attacks can be addressed through procuring security personnel and anti-terrorism systems.

Terrorism

Despite the number of terrorist attacks within Lebanon and its neighbouring countries, the direct risk to businesses and foreign investors is quite low. Foreign companies operating within the borders must take security measures depending on the size and transparency of their infrastructure and work sites.

Foreign Investment Landscape

While the Investment Development Authority of Lebanon (IDAL) heavily incentivizes foreign businesses to operate within its borders, the most significant challenge for foreign investors is navigating a complex business environment. Poor intellectual property protection, combined with a business landscape marred with informality and local unwritten rules, drive a significant breach of contract risk. However, generous taxation laws, a strong central bank, and high liquidity for foreign currencies bolster Lebanon's position as an investment destination in the Middle East.

Renewable Energy

Investors may be wary of Lebanon's electricity transmission systems. Until an energy company in Lebanon is fully privatized, the government takes responsibility for their transmission systems, effectively removing these systems from the hands of the company that owns and operates it. Dialogue pertaining to the development of renewable energy projects has remained stagnant, yet can be an attractive avenue for foreign investment in the future.

1.2 – Risk Overview

2 – Politics in Lebanon: Government Structure as a Political Risk Factor

I. Jamie Arabi – *Leader of the Lebanon Risk Assessment Team*

Lebanon's regime type is called confessionalism. Confessionalism is a form of power-sharing whereby positions of political power are distributed based on confession, or religious sect.[1] This unique democratic system's origins can be traced to the nineteenth century when France and Great Britain established links with Maronite Christian and Druze communities, respectively.[2] Those relationships were solidified throughout the early twentieth century, namely during France's 1923-1943 mandate of Lebanon. Under the mandate, the relationship between Muslims and Christians in political life became one of bipolarity – which consequently led to the loose formation of Lebanon's confessional political system in order to settle political tensions.[3] The termination of the French mandate in Lebanon in 1943 led to the full autonomy of the state as well as the legal entrenchment of confessionalism vis-à-vis the Lebanese National Pact.[4]

The Lebanese National Pact holds that based on the demographics of the Lebanese population, a Maronite Christian is to hold the presidency, a Sunni Muslim is to hold the premiership, and a Shi'ite Muslim is to hold the Speaker of the Chamber of Deputies Chair.[5] Furthermore, the Lebanese Constitution maintains that the Chamber of Deputies (the Lebanese parliament) must consist of equal representation between Christians and Muslims (as per Article 24 and amended by the constitutional law of 21 September 1990).[6] Although this regime type continues to act as a barrier to Lebanese unification, it has allowed the country to maintain its relative domestic peace.

Though equal representation was implemented in 1990, many negative structural factors plague Lebanon's political, economic, and social systems. This has played a tremendous role in Lebanon's small-scale, perpetual conflict. Outside of the political sphere, most religious communities live harmoniously. However, the inherent divisiveness of confessionalism continues to hinder the unification of the 18 recognized sects during times of domestic and regional unrest.

For instance, the Lebanese Civil War (1975-1990), which was fought along religious lines, brought paralysis to businesses and halted operations at the Beirut Port. Furthermore, external confidence was heavily damaged as foreign investment in Beirut, a Middle Eastern financial hub, was stifled.[7] Foreign businesses withdrew their locations in the capitol city. Expansion projects which were intended to take place in Lebanon were reconsidered and eventually carried out in other Middle Eastern capitols such as Cairo, Amman, and Tehran.[8] Although a conflict of this magnitude is unlikely to occur within the near future, it illustrates the peak of the country's general volatility.

Today, all aspects of life in Lebanon, from political to social, are feeling the harsh structural implications of confessionalism and its by-product: hegemonic political blocs. Its divisiveness has weakened the ability for parliament and key political figures to come to consensuses on core issues such as new election laws.[9] Consequently, this has had the effect of producing the longest political deadlock in Lebanon's history.[10] This is hurting the Lebanese economy, and subsequently, external confidence, significantly. Parliament, being completely stagnant, is not able to pass laws concerning future development loans, and debt issuance.[11] Resulting, in part, is Lebanon's expected economic growth of 0 per cent for 2015.[12] Confessional politics in this situation, as opposed to the Civil War, plays a small role in the current political predicament. Instead, two factors have proven to play a large role in the deadlock: "big boss" politicians illegally extending their terms, and the proportional representation (PR) electoral system.[13]

Within Lebanon, the illegal extension of politicians' terms has been favourable to private businesses, as it has eased the start-up process for wealthy businessmen, the Lebanese elite, and of course, the politicians themselves.

Unfortunately, however, this is an indicator of a state that lacks functional institutions and a free and fair market.[14] Furthermore, foreign investors might have a tougher time than local politicians in exploiting the benefits of corruption. Thus, there exists a market-distortion risk.

Political success within Lebanon's PR system, much like other states' PR systems, relies on the creation of coalitions to establish a majority. Since the 2005 Cedar Revolution, Lebanon's major parties formed two coalitions, which has led to years of political stalemate.[15] The March 8th Alliance is composed of parties that support Syrian interference in Lebanese affairs such as Hezbollah.[16] The March 14th Alliance, on the other hand, is composed of parties that oppose Syrian interference such as the Future Movement, a Sunni Muslim party.[17] For the past few years, parliament has been used as a battleground in order to settle the issue of the country's role in the Syrian Civil War, among other major policy issues.[18] As opposed to foreign investment, domestic investment has been, and will continue to be, affected by this issue. A representative example of this problem is the rubbish crisis, where recently, parliament could not agree on a solution for dealing with Beirut's private waste collection contract when it ended. This led to mountains of rubbish on Beirut's streets. Decisions on important policy matters, such as the budget, are also hindered by the requirement of unanimity by the entire 24-member Lebanese cabinet.[19] This is especially problematic during the current situation where political divisiveness is the norm. As a result, the current government is not able to support large infrastructure investments or investments in the energy sector.[20]

The aforementioned issues illustrate how confessional politics can lead to, or factor into, domestic instability. The regime structure itself is not particularly a barrier to foreign investment, as it is recognized as a functioning democracy with no legislative/legal obstacles to trade with most states. Nonetheless, the regime type clearly has the ability to be used as a tool to polarize turmoil and its institutions as battlegrounds to settle political scores. This causal chain can sometimes, as it did severely during the Civil War, lead to declines in foreign direct investment and domestic investment projects. This man-made risk should be taken into consideration and funds should be allocated to safety precautions and transportation to home country embassies.

As for corruption, there are steps that should be taken in order to avoid the risk of indictment by the investor's home country. First, investors should undergo a due diligence investigation with the aid of active partners within the host state.[21] Active partners should be heavily reviewed prior to requesting their assistance.[22] This is an important step because prosecutors in countries like the United States take into account whether preventative measures were placed in order to avoid illegal practices. Thus, should the prospect of indictment arise, the investor will be in a much better position than if such preventative measures had not been taken. Furthermore, businesses should enforce monitors for best practices and take the findings into consideration, in order to prevent them from undergoing illegal practices unknowingly or otherwise.[23]

2.1 – Government Structure Risks & Mitigation

Market Distortion Risk/Corruption risk: High
Caused by the lack of legislative efficiency, which leads many officials to conduct business without jurisdictive approval; officials have taken advantage of this, making profit, but legally implicating the other parties by default.

Key Strategy: Investigation
Investigating company employees and partners in order to promote best/legal practices.

- Due diligence investigation with aid of active partners within host country
- Harsh review of active partners prior to requesting assistance
- Enforcing best practices as per monitoring agency and documenting its measures

Man-made Events: Medium to High
Man-made events like war and terrorism are typically unforeseen, due to political tensions and hostile neighbours.

Key Strategies: Anticipatory Security Measures
Using existing measures on the ground, allot funds towards safety precautions, and transportation services to embassy, if necessary.

- These strategies are unique and depend on the proximity to urban areas, conflict hot-spots, and residential zones

3 – Left in the Dark: Small-Scale Private Competition and the Potential for Returns

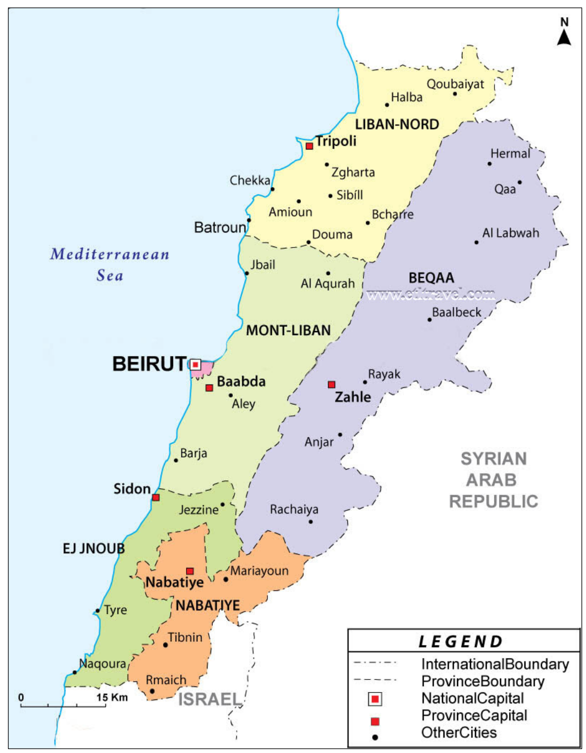
I. Jamie Arabi – *Leader of the Lebanon Risk Assessment Team*

Over 40 years ago, Lebanon exported energy to its northern neighbor, Syria. Since Lebanon's civil war ended in 1990, however, the country has struggled to keep its lights on for hours in the day. Small rolling blackouts typically last only a few hours, while larger ones can persist for over 18 hours.[24] During the summers, when the heat calls for increased air conditioner usage, these numbers increase.

A typical state response to such a problem might be to hire/contract private-sector electricity companies. Unfortunately for the Lebanese populous, establishing small private generator companies is against the law. Thus, individuals have taken the initiative to purchase diesel-fuelled generators and illegally sell electricity by the neighborhood.[25] Currently, about 500, 000 private power generators are in use.[26] Since demand for electricity has become increasingly high, illegal entrepreneurs, such as the ones mentioned above, are able to profit greatly. Rather than attempting to enforce the law, the government now regulates the prices of diesel-generated electricity.[27] Despite the efforts of the aforementioned small-time electricity providers, opportunities for large, legitimate private-sector partnerships are in the midst.[28] However, this might come at a cost. The case of Zahle, Lebanon's fourth largest city, is telling of this cost, and is perhaps indicative of the risks for prospective investors.

Electricite de Zahle (EDZ) is a private energy utility center that distributes electricity over low and medium voltage networks.[29] EDZ is currently able to distribute energy due to strong local support, a concession contract dating from the 1920s, and most importantly, the 3-year contract with Britain's Aggreko, which maintains the local power plant.[30] In combination with the state's electricity distributor, Electritie de Liban (EDL), the city's citizens are able to enjoy 24 hour a day electricity and pay for only one bill, rather than two, resulting in a the average household saving approximately 35-45 per cent.[31] However, not everyone is pleased about this.

In February 2015, gunmen opened fire on an electricity transformer in Zahle, leading to periodic blackouts in some districts.[32] Unfortunately, this was not an isolated event. Two more attacks on electricity infrastructure took place weeks later. EDZ's chief executive officer (CEO), Assaad Nakad, stated that he and his family were threatened over the phone.



Zahle, Lebanon: located in the central Beqaa Valley region of the country. Image: ETL Travel

Who are the culprits of these attacks and threats? Those individuals that sell electricity from their diesel-generators.

Gilbert, a generator operator, who did not state his last name on the record for obvious reason, claims to be threatened by properly distributed, consistent electricity.[33] The operator stated that one of the neighborhoods he provides energy to experienced a "glitch": 24 hours of state-distributed energy. This was solved by a simple bribe to artificially produce power cuts.

Investors interested in the private, local energy sector have little to worry about when it comes to bribes. At EDZ in Zahle, most of the day-to-day operations are conducted by locals, who pay taxes in order to sustain the power plant. Thus, the willingness for a power-plant worker to accept bribes is decreased, as they have stakes in their community. This is opposed to workers at EDL, who might not be directly affected by electricity shortages.

A typical diesel generator. Image: Reuters

A number of private security agencies exist in Lebanon. Thousands of corporations and public institutions, from mosques to banks, employ companies such as *Patrick Security and Services Agency (PSAA)*, and *Zodd Security* – both of which are native to Lebanon.[34] PSSA, which is certified by the Lebanese government and French police authorities, provides armed personnel with skills from parachuting to open-water diving. Hiring such staff is recommended in case of small-scale attacks. The perpetrators in the aforementioned attacks focused on disrupting the plant's infrastructure, rather than directly harming individuals. Thus, having armed men surrounding the perimeter of the facility, along with security fences, should act as a strong deterrent.

Companies like Zodd Security sell products, rather than services. The company specializes in equipment such as surveillance cameras, spike and razor concertina, and security fences. It is recommended that, along with the above three products, investors purchase car bomb jammers and vapor explosive detectors (EVDs). The general risk towards power plants like Zahle's do not currently warrant a very high degree of defense security, however, these products should be purchased as a means of damage prevention.

Despite the previously discussed risks, there is much room for companies like Aggreko to improve on the quality of Lebanon's electricity production and distribution. Accordingly, the large population of individuals who lack consistent electricity demonstrates that the potential for large investment returns are great.

3.1 – Private Energy Competition Risks & Mitigation

Environmental and other permit risk: Medium to High
The delay of construction permits is an issue in Lebanon due to the country's political deadlock. Subsequently, permit-issuing by government agencies has become a very slow process and can sometimes stop completely.

Key Strategy: *Avoid Bribery and Active Partners*
Avoiding bribery by instituting measures on-ground for company and investor protection concerning legal matters is strongly suggested.

- Employing active partners in order to assist foreign investors with on-ground insight
- Enforcing best practices as per monitoring agency and documenting its measures in order to avoid indictment if subject to investigation by home country or agency

Man-made risk: Low to Medium
Although the small aforementioned attacks are not prevalent, they pose a risk to infrastructure and can be averted.

Key Strategy: Anti-terrorism equipment and personnel
Purchasing anti-terrorism equipment such as security fences can keep insurgents far from the power plant while armed personnel will deter such events.

- Purchasing EVDs and car bomb jammers to detect any threats and hiring personnel to use this equipment
- Installing a high security fence with spike and razor concertina
- Hiring trained personnel to guard the plant

4 – Terrorism in Lebanon: Mitigation Techniques for Energy and other Investment Types

I. Jamie Arabi – *Leader of the Lebanon Risk Assessment Team*

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In November 2015, 43 innocents were killed in Southern Beirut, and approximately 240 were injured as a result of a double suicide bombing. To no-one's surprise, ISIS has claimed responsibility for the attack.[35] Reading about such atrocities has nevertheless become a stultifying routine in the Middle East. For Lebanon, however, attacks of such calibre have become uncommon since the Civil War ended in 1990. Syria's five-year civil war has only intermittently inflicted casualties to its eastern neighbour. Nevertheless, now that ISIS and al-Nusra have pledged to retaliate against the Army's crackdown on jihadi cells, this relative peace may be short-lived.

The distance between Southern Beirut and commercial hotspots is significant. Image: Your Middle East

This assessment will focus on two types of investors: foreign direct investment (FDI) and portfolio investments.[36] Because FDI entails a controlling ownership of an entity in a foreign country, it requires managing day-to-day management and taking into consideration direct liabilities such as employees. Conversely, portfolio investments are typically passive ventures, meaning that they need not consider management activities, among other constraints.[37] The obvious question on the minds of both categories of investors is this: *Are the general security risks in Lebanon heightened as a consequence of the recent bombings? If so, are my investments/projects at risk?* The questions asked, the risks involved, and the mitigation strategies relevant to both types will be nuanced due to the inherent differences in investment methods. Answers to these questions as well as mitigation strategies will be provided below.

<u>Foreign Direct Investment</u>

FDI investors are typically responsible for their employees, and therefore share an interest in their security, as well as the security of their offices and consumers. Furthermore, since stakes in a foreign company are, by and large, tough to withdraw from, as opposed to portfolio investments, shareholders in this category are not typically interested in withdrawing right away. Knowledge of the frequency of violent acts and where they generally occur is therefore important.

Measuring the number of terrorist attacks in Lebanon within the last couple of years is sure to raise skepticism among potential investors. Since January 2013, there has been 29 recorded terrorist attacks. A majority of the attacks throughout this time took place within Syrian border regions such as Arsal and Hermal, as well as southern Beirut suburbs.[38] Of the attacks, nine took place in Beirut: the most heavily invested city by foreign investors. Furthermore, only three attacks transpired in areas within Beirut relevant to most commercial FDI.[39] Thus, although the state's general security risk increased as a result of the recent strikes, Beirut is not representative of this trend.

The above assessment serves as a guide for general investments – especially real estate investment, which is becoming a popular venture in Beirut.[40] The energy sector, on the other hand, which has a considerable portion of its infrastructure in south Beirut, warrants concern. In 2012, the Ministry of Energy and Water spent $850 million (USD) began constructing two power plants in the area.[41] Likewise, in some northern cities, energy investment by the state has come into effect within the last four years. Although the government funds these projects, the same security risks apply to foreign investors concerned with this sector. This is because regions zoned for industrial use are nearby energy projects currently under construction. Energy projects in the north of Lebanon near the Syrian border, and those in southern Beirut are at higher risk because those locations are more prone to conflict. In such regions, this risk is compounded by a plant's close proximity to commercial and residential districts.

Small- to medium-scale terrorist attacks similar to the aforementioned one do not pose a particular threat to the power industry. The bombings usually target a certain group, religious sect, or community. Nonetheless, if such bombings take place in a residential area, where population density is high (and a power plant is nearby), the risk of the plant's exposure to damage increases. Thus, a simple mitigation tactic is to locate sites that are far from densely populated areas. Moreover, to ensure the safety of employees working within the plant, it is recommended that security fences are built and security personnel hired beyond any standard measure.

<u>Portfolio Investment</u>

Unlike FDI, portfolio investments, such as bonds and other debt investments, treasury bills, and mutual funds, do not require the active engagement necessary for the foregoing type of investment. This kind of investor should be assessing the stability and reliability of Lebanon's central bank to evaluate whether or not capital can be withdrawn if security risks heighten. It is also worth knowing whether or not attacks such as the one that occurred last week will become commonplace, contributing to a loss.

As mentioned earlier, within the last few years, terrorist attacks have been used as a tactic in small conflicts near the Syrian border. It is tough to forecast the frequency of terrorist activity in the country due to the current volatility of the Levant, in general. This precariousness itself is indicative of the geopolitical instability, which of course, should be taken into consideration by investors of both groups.

If one should choose to invest in bonds, or other portfolio investments, they can rest assured that the process of investing is backed by the country's tradition of free trade and unrestricted exchange.[42] There are no restrictions on the movement of capital, which includes, but is not limited to, the exit of firms or access to foreign exchange. Despite regional and domestic instability, the country recently managed to raise $2.2 billion (USD) of debt at 6.65 and 6.2 per cent, among other Eurobond sales of the like.[43] Its ability to raise this large sum is a testament to Lebanon's power in the capital markets.[44] Nonetheless, the rate of bond sales is generally decreasing as a consequence of the neighbouring conflict.

It is clear that regardless of regional instability and isolated attacks in Lebanon, foreign investment manages to flow into the country. Although the aforementioned factors have not acted as barriers to investment, investors are able to count on a strong central bank and unrestrictive capital policies if security concerns escalate.

4.1 – Terrorism Risks & Mitigation

Man-Made Event Risk
Foreign Direct Investment (FDI): High
Threats of terrorism and war directly affect employees of foreign entities within Lebanon, especially in areas known for being hubs for commercial FDI (like Beirut).

Key Strategy: Anticipatory Security Measures
Using existing measures on the ground, allot funds towards safety precautions and transportation services to embassy, if necessary.

- These strategies are unique and depend on the proximity to urban areas, conflict hot-spots, and residential zones

Portfolio Investors: Low
Due to the lack of active engagement necessary, the holdings of portfolio investors are not in immediate, unforeseeable risk within Lebanon.

Key Strategy: Staying Current with Lebanese/ Middle East and North African (MENA) Affairs
Keeping a keen eye on interest rate fluctuations and Lebanon's performance in the capital markets will allow portfolio investors to take precautionary action with their holdings.

- MENA risk reports
- World Bank ratings and updates on Lebanon/MENA

Site Risk: Medium
Finding a suitable site for power plants that is far away from both residential and commercial will be a difficult task for foreign investors because most inhabitable land is already being utilized within the country.

Key Strategy: Picking Site Locations Away from Densely Populated Areas with IDAL
Working closing with IDAL, determine feasible site locations where power plants can be constructed, ensuring that security needs of associated employees are also being met.

- Scoping potential sites through the assistance of IDAL representatives
- Working in conjunction with security groups to assess man-made risks in different geographies

5 – Foreign Investment in Lebanon

Shervin Yousef-Zadeh – *Researcher on the Lebanon Risk Assessment Team*

Supervised by I. Jamie Arabi – *Leader of the Lebanon Risk Assessment Team*

Political deadlock and regional instability have significantly constrained the opportunities that foreign parties have to invest within Lebanon.

In order to understand the impact of broader instability within both the nation itself and the region as a whole, it is crucial to first understand what kind of environment exists for foreign investors in the country.

The Government of Lebanon retains control over attracting and sustaining foreign investment; thus, instability within the government translates to a loss of investor confidence through the risk of foreign capital mismanagement. The Investment Development Authority of Lebanon (IDAL)[45] was established in 1994 as a means of formalizing existing investment channels within the nation while simultaneously attracting outside investors. More importantly, IDAL serves as the direct connection between outside governments, individuals, and small to medium enterprises (SMEs) interested in investing in the nation and the President of the Council of Ministers, who exercises total authority over the actions and policies of the agency.[46] With Lebanon's current political deadlock, there has been no elected President since May 25 of last year, despite 30 attempts to elect one through parliamentary sessions.[47] With ideology-driven political deadlock[48] taking precedent over fiscal policy decision-making, legislation concerning public finances, IDAL's incentive platforms, and private sector economic development will not be passed – or even discussed – anytime soon.

Investments in Lebanon have traditionally been complemented with competitive incentives at nearly every stage of the investing process. Foreign businesses benefit from the same rights and conditions as Lebanese businesses and face a relatively low minimum capital requirement of $20,000 USD[49] in order to be formally recognized by the government. The nation has one of the largest tax holidays[50] for foreign investors in the Middle East, allowing up to 10 years of tax exemption; this, coupled with the lowest statutory corporate tax rate in the region, makes the nation stand out as an investment destination based purely on monetary policy. Unlike many nations in the Middle East that set stringent performance criteria for external entities as a means of controlling a flood of foreign capital, Lebanon has no performance requirements[51] once a business has been registered and licensed in accordance with IDAL policy. Incentives for businesses going forward are dependent upon the zone in which they operate, but include tailor-made incentive packages for larger investment projects.[52] Clearly, the problem with foreign investment does not lie with the way in which foreign investors are formally treated. The informal costs of doing business, however, prove to be a significant hindrance for foreign parties.

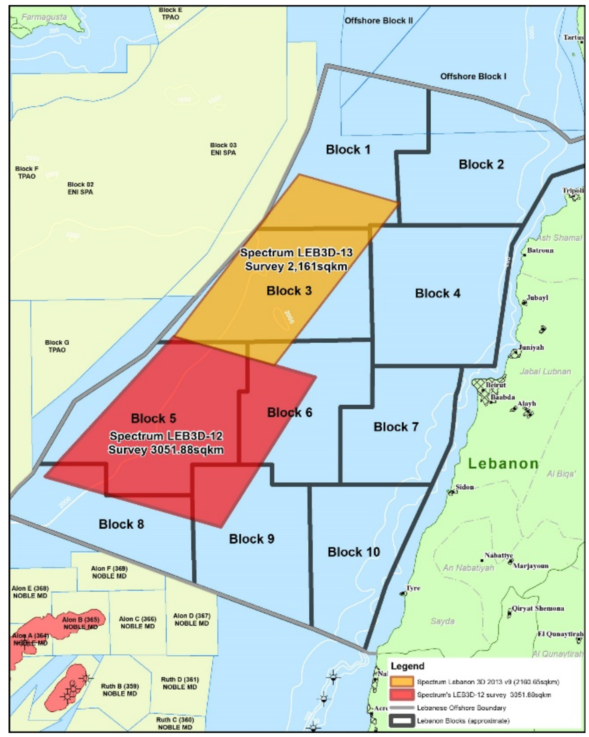
Corruption and a lack of judicial oversight make sustained business activity in Lebanon incredibly costly. The International Finance Corporation, a member of the World Bank, ranked Lebanon 123rd out of 189 countries in its 2016 "Doing Business" Report[53] measuring regulatory quality and efficiency. In other words, in order for an investor on the ground to ensure smooth business operations, it is not rare to have to pay off local officials, de-facto political groups, and competing businesses. This barrier to business can be attributed to issues that many countries in the MENA region are no stranger to: a weak judicial system with few resources to enforce laws in the business sector and poorly enforced intellectual property rights. While the government "generally aims to provide Trade-Related Intellectual Property Rights (TRIPS) intellectual property rights (IPR) protection",[54] such protection is not traditionally seen as a priority, and most likely will not be in the months ahead. Thus, the potential for breach of contract between foreign investors and on-the-ground businesses and groups should be heavily considered.

Despite the presence of a strong central bank[55] with fiscally sound lending policies and significant national gold reserves backing currency transfer and conversion, Foreign Direct Investment (FDI) in Lebanon shrunk by 23% in 2014.[56] The nation's debt-to-GDP rate is expected to exceed 140% next year[57] while its GDP is set to see an abysmal 0% growth.[58]
An employee of a state-funded infrastructure agency in Lebanon spoke out about the possible causes of declining investor confidence in the nation:

"[Investors] look at the political divide between the [Pro-Syrian] March 8 Alliance and the [Saudi Arabian-backed] March 14 Alliance, and they think a civil war will break out in the country. Even looking at the region, [Lebanon] is surrounded by unstable regimes that could break out into war with the nation."

Despite political turmoil, a new stimulus package worth $1.5 billion USD[59] is expected to be announced for 2016. The package will provide a much-needed kick to the Lebanese economy and spur activity within both the public and private sector. Banking in Lebanon continues to grow, with deposits up 6% in 2015. This, combined with the nation's historically high mobility of capital, can make an investment in government bonds promising yet relatively risk-averse. Although Lebanon's level of debt seems alarming to the naked eye, investors should take some comfort in the fact that its national debt is centralized, with nearly 70% of it belonging to Saudi Arabia.

Moreover, Lebanon has seen gradual developments in the oil and natural gas sectors. Lebanon has disputed claims of approximately 30 trillion cubic feet of natural gas and 660 million barrels of offshore oil.[60] While offshore exploration projects are at the mercy of the hampered government, the energy sector is nonetheless a strategic place to look for upcoming investment opportunities once the red tape is eventually removed. Oil and gas production may very likely increase in the coming months, but it is crucial to recognize the impending politicization of the sector by both leading coalitions and the impact that the ensuing instability would have on early investors.



Red and orange blocks illustrate recent surveys and oil discoveries. Image:SpectrumGEO

Lebanon will continue to retain its reputation as an investment destination in the MENA region, but drastic changes in domestic political dynamics and regional power shifts will inevitably challenge the nation to further attract, sustain, and appease foreign investors.

5.1 – Foreign Investment Risks & Mitigation

Breach of Contract Risk: Medium
The risk level associated with "Breach of Contract" is primarily due to poorly enforced intellectual property laws and the high number of informal groups regulating business outside of the immediate judicial and governmental structure.

Key Strategy: Securing Guarantees from Multilateral Investment Guarantee Agency (MIGA)
The Multilateral Investment Guarantee Agency (MIGA) has historically provided guarantees for contracts between foreign investors and trusted companies within Lebanon.

- MIGA's guarantees deal with medium-to-large scale contracts
- Protection of governmental breach of contract and civil disturbance

In addition to MIGA guarantees, investors should conduct proper due diligence by researching a company's history of contracts, performance, and local reputation.

Taxation Risk: Low
Lebanon's standing as a tax haven within MENA, combined with generous tax incentives, provides a sense of security for foreign investors.

Key Strategy: Pushing for Increased Incentives through IDAL
IDAL's existing incentives structure for foreign investors/SMEs should be fully leveraged.

- Negotiate terms for extended incentive structures
- Close cooperation with IDAL at all stages of business venture

Currency transfer & Convertibility Risk: Low
Significant gold reserves and high capital mobility enable foreign investors to easily exchange currency and repatriate profits to their home-country.

Key Strategy: Re-investing "Fair Share" of Profits within Lebanon
Investors must work to meet minimal re-investment requirements as set forth by IDAL.

- Terms should be negotiable, bearing in mind maintenance of minimum capital requirement of $20,000 USD
- Avoid near total liquidation of assets within Lebanon to maintain favourable rapport with IDAL

6 – Renewable Energy

Alexandra Ensor – *Researcher on the Lebanon Risk Assessment Team*

Supervised by I. Jamie Arabi – *Leader of the Lebanon Risk Assessment Team*

The political situation in Lebanon has left an unquestionable mark on the country's ability to make changes to legislation. However, the current focus on renewable energy has transcended the political deadlock with the help of the United Nations (UN) and other organizations. Renewable energy in Lebanon is a growing focus, with incentives such as low-interest loans available to both residents and small businesses.

The energy sector in Lebanon is affected by supply issues, and by government inefficiency. Currently, there is too much demand and not enough energy to consistently provide energy to the Lebanese populace.[61] In Beirut, for example, the current 220-kilovolt-power supply network was regularly reaching capacity in August 2015. This was a result of high temperatures creating increased power demand. Additionally, since the late 1970s, power supply companies have implemented rolling blackouts throughout the country. In Beirut, as well as other cities, such blackouts have become the norm, and private energy companies have come to provide electricity during blackouts – for a high cost. So, although the rolling blackouts seem to be a limited issue, significant problems with power supply plants, like Beirut's, persist, creating significant performance risks. The plants have not been maintained, and many do not have the capacity to receive energy from any sources other than the current one. This illustrates the clear need for alternatives to the state energy system, but the ineffective and inefficient government poses a challenge.

Moreover, the constitution requires that decisions by the Chamber of Deputies (the legislative branch) be made with a two-thirds majority.[62] This requirement leads to inherent inefficiencies, and the current standstill only perpetuates it.[63] Due to the current lack of a President, important government decisions are not being made – such as the general maintenance to the main power supply plant in Beirut discussed above. No doubt, this raises questions about the reliability of the Lebanese government. Any future changes to the government could also create cancellation risks for investors. Further, the current energy debt sits at about $27 billion, or just under half of the total public Lebanese debt. So, not only is the deadlock creating problems, but the energy situation is increasing stress on the Lebanese economy – which is projected at 0% growth in 2015.[64]

The renewable energy sector in Lebanon, while small, is growing. The UN has taken steps to increase the presence of renewable energy sources with the Small Decentralized Renewable Energy Generation plan.[65] This plan aims to increase investment in the renewable energy sector, and to increase the number of small, private energy generation plants in Lebanon. While this seems to be a good initiative, the currently listed contributions on the United Nations Development Programme (UNDP) website are just under $1.6 million – a very low figure in relation to the state's budget and population. Although steps are being taken to improve the renewable energy prospects in Lebanon, it is difficult to invest in this sector.

Solar panels on the roof of the famous Maronite Christian church in Harissa, Lebanon. Image: Indevco News Network

In order to invest, a company must first 'privatize,' whereby they gain approval from the Lebanese government in order to formally begin their work in the country.[66] Until such time, the state holds ownership of the company. For any investor, letting go of ownership, even for a short while, is a very unattractive. Further, the transmission company – the company that works to transport energy from the plant to the homes that use the energy – will own the transference of the energy.[67] In this case, the transmission company is a part of the government. While this process might be considered to be standard, there are many problems with it.

It is important to know that the Lebanese government is not dependable and the likelihood of the government making timely decisions regarding approval is low. The law that outlines these mandates was originally produced in 2002 but was not been passed until 2012, after the previous government had been replaced.[68] While investing in the country, there are some expropriation risks. A company will (eventually) be completely private after the initial investment; however, it will still rely on the government and the transmission company to transport the energy from the plant to its location of need. The company does not have the option to privately monopolize the transport of energy. Moreover, the company must be able to trust that the government will consistently maintain the transmission systems, and that it will be cooperative throughout this process.

Luckily for investors, the Lebanese energy sector is one that is in need of a great deal of help. Since access to energy is not consistent, the community risk is very low – possibly even nonexistent – due to the fact that investment would only increase the accessibility of energy to the population. Investing in the energy sector would not require community projects or mediation, because the investments would offer a more consistent, much needed service to the people.

Theoretically, Lebanon possesses a good environment for investment.[69] It has a free-market economy and a liberal financial environment. The problems arise when the government situation is taken into account. While the economic system seems to be relatively appealing, government regulations create problems and the reliability of the government is questionable. If a company were to make the decision to invest in the energy sector in Lebanon, the ability to make a profit would rest heavily on the state's ability to make decisions.

6.1 – Renewable Energy Risks & Mitigation

Expropriation Risk: Low
Once a company decides to enter the Lebanese market, the government will automatically take ownership of the company, until such time as the company is approved for privatization. After approval, the company regains control.

Key Strategy: Pushing for Accountability
- Oversee best practices, possibly with the use of an accountability committee
- Ensure proper documentation to guarantee accountability
- Request assistance of people on the ground in the host country

Performance Risk: Medium
The government owns the transmission companies, which have been known to fail in the upkeep and basic maintenance of the transmission sites.

Key Strategy: Subcontracting
- Use funds from private investors to help improve and maintain government owned transmission systems
  - If the government does not wish to comply, assist the government in creating a plan to improve the quality, efficiency, and maintenance of the transmission systems
- Sub-contract the maintenance of transmission systems

Cancellation and Change of Scope Risk: Low
If the government deadlock is reversed, a new power might decide to ignore or re-evaluate contracts in place.

Key Strategy: Legal Accountability
- Ensure proper documentation; continuously monitor the investment and relevant business relationships; and monitor the government situation closely
- Avoid any malpractice (bribery – the company will be liable to home country jurisdictional penalties)
- Be prepared to withdraw assets quickly if a change in government occurs

Environmental and other permit risk: Medium to High
The delay of construction permits is an issue in Lebanon due to the country's political deadlock. Subsequently, permit-issuing by government agencies has become a very slow process and sometimes comes to complete halts.

Key Strategy: *Avoid Bribery and Active Partners*
Avoiding bribery by instituting measures for company and investor protection concerning legal matters is strongly suggested.
- Employing active partners can assist foreign investors with insight on how to best
- Enforcing best practices as per monitoring agency and documenting its measures in order to avoid indictment if subject to investigation by home country or agency

Man-made risk: Low to Medium
Although the small, aforementioned attacks are not prevalent, they pose a risk to infrastructure and can be averted.

Key Strategy: Anti-terrorism equipment and personnel

- Purchasing anti-terrorism equipment such as security fences can keep insurgents far from the power plant while armed personnel will deter such events
- Purchasing EVDs and car bomb jammers to detect any threats and hiring personnel to use this equipment
- Installing a high security fence with spike and razor concertina
- Hiring trained personnel to guard the plant

7 – Conclusion

It has been demonstrated that the geopolitics of the Middle East and Lebanon's institutional structures affect the country's economic climate. Because of statesmen actively attempting to avoid a violent path within Lebanon, the country has enjoyed a relatively peaceful existence. Despite its warring neighbours and dangerous internal organizations, this virtual calm has allowed Lebanon to maintain its attractiveness within the global investment market.

Unfortunately, however, its edge in the global market will stagnate well into the future unless internal politics become more efficient and transparent. For instance, the presence of a president could have a very positive affect on the government. It might allow top executives to make decisions concerning high politics, provide confidence to the legislative branch, and restore legitimacy into the confessional, democratic process.

Reconciliation between the two hegemonic blocs (The March 8th and the March 14th Coalitions) is another important impediment that must be faced in order for political efficiency to progress. As mentioned throughout the report, permit risks are quite high due to the country's long-standing deadlock. Reconciliation between the blocs might allow for bureaucratic and legislative cooperation, allowing the permit risk level to decrease significantly.

It is believed by our analysts that if steps are taken towards the two aforementioned goals, the competitive advantage that Lebanon holds, quite loosely, can be restored and maintained. Specifically, this will open the door to advancement within the process of exploiting recently discovered offshore oil along the Mediterranean coast from Israel to Syria. A truly unified, central government is a necessary component in brokering a deal with neighbouring countries.

More generally, it is clear that the electricity/energy sector as a whole holds room for ample growth. The demand is extremely high for 24/7 electricity, regardless of its form. Although some private entities have taken the initiative to power their structures with solar energy, assistance from international organizations like the UNDP could jumpstart a new trend in Lebanese energy.

If political constraints are addressed, the investment landscape within Lebanon is bound to improve and provide a promising future for foreign investors.

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8.2 – Appendix A: Country Information

Basic Data

Area

Land: 10, 230 sq km

Water: 170 sq km

Population

6, 184, 701 (est. as per July 2015)

Language

Arabic is the official language

other commonly spoken languages are French, English, and Armenian

Religion

Muslim 54% (Sunni 27%, Shi'ite 27%), Christian 40.5% (Maronite Catholic 21%, Greek Orthodox 8%, Greek Catholic 5%, and other Christian 6.5%), Druze 5.6%, negligible numbers of Jews, Baha'is, Buddhists, Hindus, and Mormons

Literacy (age 15 and over can read and write)

total: 93.9%

male: 96%

female: 91.8%

Urbanization

urban population is 87.8% of total population (2015)

Unemployment (youth ages 15 – 24)

total: 22.1%

Total fertility rate

1.73 children born/woman (2015 est.)

Economy

Form of economy

free-market with strong laissez-faire commercial tradition

Currency

Lebanese pounds (LBP)

LBP per US dollar: 1, 507 (2014 est.)

LBP per US dollar: 1, 507 (2013 est.)

Exports

$3.787 billion (2014 est.)

$4.499 billion (2013 est.)

commodities: base metals, jewelry, chemicals, fruit and vegetables, tobacco, electric power machinery, paper, textile fibers, construction materials, consumer goods

partners: Saudi Arabia 10.8%, UAE 9.7%, Syria 8.7%, Iraq 7.6%, South Africa 7%, Switzerland 4% (2014)

Imports

$18.99 billion (2014 est.)

$19.67 billion (2013 est.)

commodities: cars, medicinal products, meat and live animals, clothing, consumer goods, paper, chemicals, electrical machinery and equipment

partners: China 11.8%, Italy 7.7%, US 6.8%, France 6.2%, Germany 5.4%, Russia 4.5%, Greece 4.1%

GDP: per capita (in 2014 USD)

$18, 100 (2014 est.)

$17, 700 (2013 est.)

GDP: real growth

2-2.5% (2015 est.)

2% (2014 est.)

2.5% (2013 est.)

GDP: composition by sector

agriculture: 5.5%

industry: 24.8%

services: 69.7% (2014 est.)

Population below poverty line

28.6% (2014 est.)

Public Debt

134.8% of GDP (2014 est.)

132.9% of GDP (2013 est.)

Budget Surplus

-6.1% of GDP (2014 est.) (- means deficit)

Political Structure

Official Name

Lebanese Republic

Legal System

mixed system based on civil law of the French civil code, Ottoman legal tradition, and religious laws covering personal status, marriage, divorce, and other family relations

National Legislature

unicameral National Assembly (128 seats; members directly elected in multi-seat constituencies via majority vote; members serve 4-year terms); seats appointed among Christian and Muslim denominations

Head of State

President: vacant

Prime Minister: Tamam Salam

National Government

Main Political Factions

14 March Coalition:

Democratic Left Movement or DLM (Elias Atallah)

Future Movement Bloc (Sa'ad al-Hariri)

Kata'ib Party (Sami Gemayel)

Lebanese Forces (Samir Ja’Ja)

Marada Movement (Sulayman Franjieh)

Social Democratic Hunchakian Party (Hagop Dirkanian)

8 March Coalition:

Amal Movement (Nabih Berri)

Free Patriotic Movement (Gibran Bassil)

Lebanese Democratic Party (Emir Talal Arslan)

Loyalty to the Resistance Bloc (Mohammad Ra’ad) (includes Hezbollah [Hassan Nasarallah])

Marada Movement (Sulayman Franjieh)

Syrian Ba'th Party (Abdel Mouin Gazi)

Syrian Social Nationalist Party (Ali Qanso)

Independent: Metn Bloc (Michel Murr)

Progressive Socialist Party or PSP (Walid Junblatt)

Tashnag or ARF (Hagop Dhatcherian)

Form of Government

confessionalism; power-sharing

Constitution

created in 1926; amended several times since adoption

International law organization participation

non-party state to ICC; has not submitted an ICJ jurisdiction declaration

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