Linking Economic Growth and Social Development in Lebanon

SYNTHESIS NOTE
Introduction

The conference entitled “Linking Economic Growth and Social Development in Lebanon” was held between January 11-13, 2000. It addressed a wide range of topics relevant to the state of the economy and social conditions in Lebanon. During the ten sessions, local and international experts made about fifty presentations on a variety of topics such as budgetary analysis, the national debt, social development, labor markets, and globalization.

This document is a synthesis of the papers presented at the conference, and the comments of the discussants. Section I addresses the current socio-economic situation in Lebanon. Section II outlines both general and specific recommendations presented by the participants. Section III presents concluding remarks.

I. A Diagnosis of the Current Situation:

The macro-economic situation: neither growth nor austerity

The introductory discussion about the macro-economic situation in Lebanon focused on four main issues: The current recession and its causes; the large size of the public sector; the post-war macro-economic reality; and the dearth of reliable economic data.

According to some experts, the government’s expansionary policy during the early 1990’s is partially to blame for the recent economic crisis. This policy led to an increase in the domestic debt and a widening of the balance-of-payments deficit. The subsequent deflation and rise of interest rates eventually lead to yearly drop in economic growth rates, in the process leading to stagnation in the economy.

An alternative explanation for the current economic recession is what is known as the ‘Dutch disease’ hypothesis. In theory, this states that high capital inflows lead to an increase in the price of non-tradable goods and services – for example, construction and transportation – in turn increasing the real exchange rate. The appreciation in the real exchange rate, reflected by the increase in the price of non-tradables, shifts investment toward non-tradable sectors and away from the tradable (productive) sectors. Ultimately, this negatively affects economic growth rates and reduces a country’s export potential.

The increasing dominance on economic activity of a wasteful public sector – estimated in Lebanon at 50% of GDP – has aggravated economic inefficiencies. The Central Bank continuously covers the losses of the national carrier, Middle East Airlines, and the government subsidizes tobacco, sugar beat, and wheat. The surplus of public-sector employees who were hired because of political intervention during the war, has led to an alternative form of indirect and fiscally-unjustified state inflation.

---

1 In the case of Lebanon, capital inflows intensified during the wartime period and continued in the 1990’s
2 Real Exchange rate = Price of non tradable/ Price of tradable
3 This figure is reached by Marwan Iskander when the public sector is considered to include Middle East Airlines (MEA), Electricité du Liban, Intra Investment Company and the Central Bank
In the post-war era, some of the participants remarked, there was neither significant growth nor fiscal austerity. In fact, their calculations revealed that the average growth rate amounted to a mere 1.5% between 1993 and 1998, compared to the official rate of 6-7%. The effective exchange rate steadily appreciated as of the early 1990’s and real inflation rates more than doubled after 1993.4

Lastly, credible economic analysis requires sufficient and reliable data. Economic data for Lebanon – trade figures, monetary series, price indices, and some budgetary information – is collected by the Central Bank, the Central Administration of Statistics (CAS), and the Ministry of Finance. However, the figures are inconsistent and in some instances not reproducible. The inconsistency in the data is due to a lack of clarity and errors in defining certain economic variables. For instance, the balance of payments is often confused with balance of accounts, and the GDP deflator with the price index.

**Fiscal constraints and the public sector**

The Lebanese economy is faced with severe fiscal constraints at a time when the economy needs fiscal stimulus and the public sector needs more skilled personnel. The 1999 budget showed that 52% of current expenditures went toward servicing the debt, and 32% towards paying out salaries and pensions. This left the government with about 16% of current expenditures5 to allocate for other non-capital government expenditures. The deficit for the same year was estimated at about 43%, and the growth rate was close to zero.

Lebanon also faces external imbalances, social disparities across regions, high levels of poverty, and a high unemployment rate. There is much wasteful spending, and in some instances outright theft. However, in most cases there is simply a lack of planning.

Prior to the Hoss government’s recent five-year fiscal adjustment plan, which outlines for fiscal austerity measures, the Hariri government prepared a document – which was approved by the president and parliament – projecting a phased reduction of 50,000 employees in the public sector over a five-year period. The objective was to reduce the number of unproductive civil servants. Yet neither the past nor present government has acted upon this document. One of the reasons why the state has been reluctant to do so is the absence of a retraining-rehabilitation program that will allow discharged employees to acquire new skills, thus rendering them productive and useful in alternative sectors.

The public sector remains in great need of skilled professionals, even though there is a surplus of civil servants. Nor are outside experts – hired to conduct specific studies – a panacea for ministries and other public bodies, since the duration of their contract is limited. The optimal solution would be to integrate experts into the civil service, even if that means paying higher overall salaries.

**The national debt and privatization**

4 Source: Charbel Nahas

5 Or 25% of total (current + capital) expenditures
In the 1999 budget, the largest item on the expenditure list is debt servicing. Most of the debt is domestic, though the foreign component has been increasing in the last few years - from 16% at the end of 1994 to 28% at the end of 1999. One of the strategies used by the Hariri government was to take advantage of the interest rate differential – borrowing at cheaper rates externally – so as to swap part of the domestic debt for external loans. The major difference between an external and internal debt is that the first entails a resource transfer from a country to the outside world, while a domestic debt involves an internal reallocation of resources between holders of debt instruments and taxpayers. In the case of Lebanon, it is Lebanese investors living abroad who own part of the foreign debt, effectively rendering it indirectly domestic.

The interest rate differential justifies, to a certain extent, the debt-substitution policy and the restructuring of the national debt. However, indicators\(^6\) that measure currency vulnerability and the possibility of debt default reveal that if Lebanon continues to increase its foreign debt, the Lebanese economy could face both outcomes. A debt-substitution policy is risky, and its impact may outweigh the gains resulting from the interest rate differential. One expert argued that in the extreme case when most of a debt is external, the potential savings from a lower interest rate could be outweighed by a currency depreciation, a reduction in consumption, and an economic recession.

In light of such fiscal constraints, the privatization of state assets is a possible solution. However, to many experts of the World Bank and the International Monetary Fund (IMF), the primary objective of privatization is to improve efficiency and productivity, not to insure the reduction of the debt and the deficit. The macro-economic benefits of privatization should also include an increase in capital inflows, the broadening of domestic capital markets, and the acquisition of new technology.

Experience shows that if privatization is not accompanied by state efforts to establish a proper regulatory framework, the privatization process tends to create private monopolies from public monopolies. Absent an appropriate regulatory system, economies, in the long-run face market inefficiencies due to the newly created monopolies, even if they might initially benefit from an positive fiscal shock.

The macro-economic conditions under which the sale of public assets occurs are also vital. The investor interested in buying state assets will be more risk-averse if there is no framework to regulate privatized sectors, and if there are adverse macro-economic conditions. Purchasers of privatized bodies who foresee a high risk and less stability in a post-privatized environment will devalue the marketed sector or firm and lower the price they are willing to offer. In other words, the failure of the state to ensure a proper and stable macro-economic environment may well reduce the initial fiscal gain from the privatization process.

\(^{Income inequality and the erosion of the purchasing power}\)

\(^6\) Such as the debt service ratio (external debt payment to exports, payments include the interest as well as principal). The ratio of interest payments to exports is another indicator, both of which measure the likelihood of facing difficulties in repayment. The rate of external debt to international reserves measures the degree of absorption of foreign exchange reserves by the external debt. The higher the ratio, the more likely there will be debt rescheduling.
There are essentially four reasons for the erosion of the purchasing power of Lebanon’s middle class. Overall the average purchasing power of households in 1999 is 20.9% of what it was in 1974 and the mean income dropped from 1.5 million Lebanese Pound (L£) in 1997 to L£1.2 m in 1999. Currently, 80% of families receive 50% of the national income, the next 10% of households receive 15%, and the richest 10% receive 35% of income.  

Firstly, the depreciation of the Lebanese pound in the 1980’s reduced purchasing power and led to a hyperinflation.

Secondly, the large inflow of foreign workers – 34% of the Lebanese labor force in the 1995-1996 period  

Thirdly, the unfairness of the tax code meant that the majority of the tax burden fell on low- and middle-class households. The direct tax system is not progressive, while indirect taxes and fees generally hit fixed-income earners the most.

Finally, the forced displacement of a substantial portion of the population and the material destruction due to the war, contributed to eroding the purchasing power of middle class families and aggravating social inequalities in Lebanon.

<table>
<thead>
<tr>
<th></th>
<th>Purchasing power change between 1992 and 1999</th>
<th>% of families</th>
</tr>
</thead>
<tbody>
<tr>
<td>High income</td>
<td>4.8%</td>
<td>19.5</td>
</tr>
<tr>
<td>Middle income</td>
<td>-8.4%</td>
<td>60.1</td>
</tr>
<tr>
<td>Low income</td>
<td>-4.6%</td>
<td>20.4</td>
</tr>
</tbody>
</table>

Source: Calculations of Ibrahim Maroun based upon studies made by the CAS Reach-Mass and Yves Schemeil (St. Joseph University)

**Balanced development**

Before the war, economic growth in Lebanon was significant. However, the regional and social distribution of wealth was uneven. For instance, per capita annual income was $803 in Beirut by the end of 1950’s and $151 in the South. This tendency for unbalanced development continued throughout the war years and into the post-war period.

---

7 The Gini coefficient, which measures income inequality with an income concentration index, shows that 1992 had the lowest inequality rate of 35 % compared to 52.2% for 1988, 43.5% for 1997, and 43.3% for 1999. Some experts had reservations about the figures given that Lebanon still lacks national accounts, the sample used is not the same across the studies, and the assumptions and the sample behind each of these four unrelated studies are not known.

8 Study by the U.S.E.K. University, Kaslik

9 Source: Wafa` Sharf el-dine
Public spending during the 1940s and 1950s was channeled mostly towards infrastructure and was mainly spent in Beirut and in the northern suburbs of the capital. In the 1960s, there was a reduction in the gap between regions with regard to the provision of social services. However, the gap between sectors widened – more particularly that between the services sector (which expanded) on the one hand, and the industrial and agriculture sectors on the other. The disparity in sectoral growth led to the eventual centralization of economic activity in certain areas, most notably Beirut.

In these years, the state allocated money for basic infrastructure, such as roads and hospitals to all the regions, but this effort was not complemented by involvement of the private sector. Public works spending by the government did not induce private-sector investment as no economic incentives existed for private firms to relocate to less developed regions and contribute to their development. The state did not prepare a comprehensive blueprint linking economic sectors, because Lebanon’s laissez-faire economic philosophy precluded central planning.

In 1978, at the height of the war, the state established the Council of Development and Reconstruction (CDR). Paradoxically, the breakdown of order made state involvement in reconstruction all the more pressing. The CDR introduced an eight-year reconstruction plan in 1978 that was not fully executed because of the escalation of the war. A nine-year plan in 1983 was also presented by the CDR, and for similar reasons, it was partially executed with only 35% of the planned monies actually spent.

Lebanon’s fifteen years of conflict aggravated the unevenness in regional development. The war, in relative terms, ameliorated the situation in some regions – including Mount Lebanon, the South, and the Bekaa – and impaired development in others such as North Lebanon (see table below). During the war, some enterprises and businesses moved to the Bekaa and the South, while the North as a whole suffered from the migration of economic activity to Mount Lebanon or the city of Tripoli.

<table>
<thead>
<tr>
<th></th>
<th>Avg. income per month USD($)</th>
<th>Unemployment (percent)</th>
<th>Schooling 10-15 yrs. (percent)</th>
<th>Illiteracy (percent)</th>
<th>Housing connected to water network (percent)</th>
<th>Infant mortality (per 000)</th>
</tr>
</thead>
<tbody>
<tr>
<td>Beirut</td>
<td>1,379</td>
<td>7.5</td>
<td>96.1</td>
<td>8.7</td>
<td>95.1</td>
<td>19.6</td>
</tr>
<tr>
<td>Beirut Suburbs</td>
<td>1,149</td>
<td>8.6</td>
<td>94.9</td>
<td>8.7</td>
<td>77.3</td>
<td>27.6</td>
</tr>
<tr>
<td>Remaining Mt. Lebanon</td>
<td>1,297</td>
<td>7.0</td>
<td>98.4</td>
<td>6.6</td>
<td>89.2</td>
<td>27.6</td>
</tr>
<tr>
<td>Bekaa</td>
<td>842</td>
<td>10.7</td>
<td>93.3</td>
<td>13.5</td>
<td>70.8</td>
<td>39.8</td>
</tr>
<tr>
<td>South</td>
<td>756</td>
<td>9.1</td>
<td>93.3</td>
<td>14.4</td>
<td>79.0</td>
<td>27.2</td>
</tr>
<tr>
<td>Nabatieh</td>
<td>726</td>
<td>9.6</td>
<td>96.8</td>
<td>14.8</td>
<td>90.4</td>
<td>-</td>
</tr>
<tr>
<td>North</td>
<td>823</td>
<td>10.6</td>
<td>90.0</td>
<td>16.7</td>
<td>67.6</td>
<td>48.1</td>
</tr>
</tbody>
</table>

Source: Central Administration of Statistics (CAS) 1998/ Mona Harb el-Kak

At the end of the war, the World Bank sponsored what was known as the National Emergency Reconstruction Plan (NERP). In 1994, an $11bn plan (Parallel Plan for Reconstruction and Development - PPRD) was introduced to include the $2.2bn allocated for the NERP and with the purpose of rehabilitating 19 basic sectors. The NERP mostly
sought to rehabilitate existing infrastructure and urban services. It did call for a balanced dissemination of infrastructure, but failed to help regions which did not possess the infrastructure in the first place. It was fully executed for some sectors – for example power, postal services, Beirut airport, and roads – and only partially for others – for example the potable water network and solid waste treatment.

To this day, there is a regional imbalance in economic development in Lebanon. Most economic plans have continued to focus economic activity in Beirut, while failing to push for the spreading of economic activity to all other parts of the country.

Labor market

There are four major imbalances in Lebanon’s labor market. These are the unequal composition of the labor force, the surplus of foreign workers, low real wages and high unemployment levels, and an alarming emigration rate.

Between 1970 and 1997, Lebanon’s labor force increased by 138%. The increase did not bring about a sufficient improvement in the gender balance and most created jobs were in the lower-skilled bracket and in the services sector, rather than in the industrial and agricultural sectors.

<table>
<thead>
<tr>
<th>The composition of the labor force (of the resident population)</th>
<th>1970</th>
<th>1997</th>
</tr>
</thead>
<tbody>
<tr>
<td>Labor force</td>
<td>572 thousands</td>
<td>1.36 million</td>
</tr>
<tr>
<td>Women</td>
<td>17.5%</td>
<td>21.6%</td>
</tr>
<tr>
<td>Services sector</td>
<td>55.8%</td>
<td>65.1%</td>
</tr>
<tr>
<td>Agriculture sector</td>
<td>19.0%</td>
<td>12.0%</td>
</tr>
<tr>
<td>Industry + power</td>
<td>17.8%</td>
<td>14.7%</td>
</tr>
</tbody>
</table>

Source: Central Administration of Statistics/ Albert Dagher paper

The labor force is estimated in 1997 to be 1.36 million, some 34% of the residing population, which is estimated at close to four million people. The number of migrant workers – mainly Syrians, Egyptians, and South and Southeast Asians – peaked in 1993-95 at about 1.4 million, exceeding the Lebanese labor force. This excess was mainly driven by the booming construction sector. The inflow of workers mainly affected low-skilled and blue-collar Lebanese workers. High-skilled workers, in contrast, were in high demand but short supply. Recently, more and more medium-skilled employees have taken on low-skilled jobs, for a number of economic reasons. This reflects the fundamental disequilibrium in the Lebanese labor market.

With regard to wages, disparities increased and real wages decreased over the last two decades. For instance, real wages in 1992 were 30% of their nominal value in 1974. Participants noted that the average monthly wage was $1,100 before the war, compared to $218 in 1997. At the same time, two out of three Lebanese laborers then earned less

---

10 All labor market figures are drawn from the paper of Albert Dagher

11 1974 prices
than L£500,000.\textsuperscript{12} The problems do not end here. The real rate of unemployment is estimated at between 20-40\%,\textsuperscript{13} a large gap due to the lack of credible data. Unemployment in Lebanon is mostly disguised and partial, and is under-evaluated given the high emigration rate.

The alarming emigration rate is another major factor adding to the problems of the Lebanese labor market. It is mostly young skilled male Lebanese who emigrate. Since 1992, some 690,000 Lebanese are thought to have emigrated. Indeed, some participants regarded this as a historical phenomenon. Some wondered whether Lebanon was able to absorb all the doctors, engineers, and nurses graduating every year. Many assumed not, and argued that migration seemed the natural outcome for this group. Not everyone agreed, however, that this was a positive phenomenon, since Lebanon has invested in these skilled professionals who end up working abroad, with little or no known beneficial impact on Lebanon.

\textbf{Social public spending}

Even though Lebanon has gone through a war, basic social indicators since the mid 1970s have improved. Internationally, post-war Lebanon has among the highest levels of spending on education and health, at 20\% of GDP. In spite of this, the results are not satisfactory with a double-digit illiteracy rate, no health coverage for over 50\% of the population, expensive health services, and other problems.

Substantial disparities continue to persist between regions and across the social sectors, particularly in terms of education and health. The cost of providing social services is very high. This has been exacerbated by the fact that the state has not developed a comprehensive social policy. State agencies providing social services often have overlapping roles, and most of these institutions are lacking when it comes to the efficient management of public spending.

\textit{(a) Education}

A major deficiency in the education sector is its weak link to the labor market. Some participants argued that higher education institutions have failed to produce the needed economists, administrators, and technicians needed by the market. Young students are not exposed early on to those careers that may best meet their capacities and interests.

\textsuperscript{12} slightly above $300 in 1999 prices

\textsuperscript{13} Source: Najib Issa
Traditional Lebanese society and the existing education system offer little of the flexibility needed to strengthen the linkage between educational institutions and the labor market. And in those cases where the system provides a qualified candidate for a vacant job, it is often less qualified candidates with the right connections who get the job.

Public spending on education is relatively high. However its impact is unsatisfactory. Overall, Lebanon allocates 9.3% of GDP to education, compared to an average of 5.2% for OECD countries. Households are responsible for most of the education budget, as the state spends less than half of national spending on education, and covers only one-third of enrolled students.

In 1998, about L£1.9m was spent on average on each student in a public school. This rate is somewhat comparable to the cost of education in a private school – where L£2.2m is spent on average per student per year. However the quality differential of the education provided between private and public establishments remains wide. The state also subsidizes so-called ‘free schools’, and provides education allowances to families of public servants.

Regarding the quality of education, Lebanon’s appropriate ministries cannot ensure a certain standard of quality at the national level when they fail to do so in public schools. Private schools, left to their own devices, have failed to create a network amongst them to establish quality criteria. The government has tried to take a pro-active role. A new curriculum was introduced to revive and improve the level of the primary and secondary education system. School instructors have been trained according to the new curriculum, but the training is still introductory in nature. It is too early to judge the effectiveness of the new curriculum, though some experts have been critical.

Participants pointed to the fact that private universities are offered an operating license based upon a one-time criteria review. In other words, higher education institutions are left unchecked once established. For example, only the Lebanese University requires its faculty to be holders of doctoral degrees. Less than 50% of faculty members in private universities hold such a degree. Research is also neglected in most universities, and when the motivation is mainly promotion.

Lebanon has yet to provide basic education for all: 44% of children between the ages of three and five, 4% of those between the ages of six and eleven, and 12.7% of those between the ages of twelve and fifteen do not receive a basic education. The majority of those children reside in North Lebanon. Illiteracy is estimated at 13.6% for the total population, and the figure is increasing for women. About 9% of the active population are believed to be illiterate, 12% just read and write, and 25.5% have completed basic education. As for farmers and blue-collar workers, 32% of this group are illiterate.

(b) Health

There are two main types of health care systems. In liberal economic systems, it is the market that determines the price of goods or services, such as health care or the price of drugs, according to a limited level of state regulation. The American system is a good example of the latter, but is considered to be the most expensive system, as it absorbs

---

14 Average rate for the 1990’s
15 Source: Paper of Adnan al Amine from a study made by the ministry of social affairs in 1996
14% of GDP. Health Maintenance Organizations (HMOs) and Preferred Providers Organizations (PPO) have been somewhat successful in reducing prices without sacrificing the quality of care.

Centralized health care systems, on the other hand, place caps on spending and provide universal coverage. A good example is the United Kingdom’s health system. Centralized systems are sometimes criticized because they provide lower-quality health service.

The Lebanese health system is mainly liberal, and does not ensure universal coverage. In contrast, however, certain companies have the exclusive right to import drugs, driving prices up and contradicting the principles of a free market. As a result, spending on drugs consumed in 1997 between 30-40% of the national health budget. The health system is also costly, as physicians are accustomed to over-utilizing sophisticated and expensive technology.

A number of structural imbalances exist in the health sector. There are about 15,000 hospital beds, when Lebanon requires just 9,000. There are 12,000 registered doctors earning an average wage of 500 dollars per month, working with only 3,000 nurses. The Lebanese health system is also witnessing a rapid proliferation of tertiary units providing a range of high technology investigations and treatments. For instance in 1997, there were 12 open heart surgery units, 12 in-vitro fertilization centers, and 39 centers for renal dialysis – all for a population of 4 million people. There is a concentration of doctors and hospitals in Beirut and Mount Lebanon, and the overwhelming majority of beds are provided by private hospitals.

The budget of the health sector absorbs 10% of GDP, however in 1997, 58% of households are not covered by any health plan. Spending on health in Lebanon comes from three main sources: the state, quasi-public institutions, and the private sector. The Ministry of Health covers whoever is not covered by a private insurance company or the National Social Security Fund (NSSF). The ministry ends up allocating, and has been for several year now, about 80% of its budget to contracted private hospitals where civil servants, their families, and whomever is covered by the state prefer to go. There are also other governmental bodies that spend on health services for their employees such as the Ministries of Defense, Interior, and Social Affairs, as well as the Employees’ Mutual Fund and the Council for the South. Quasi-public spending is mostly channeled through the NSSF, financially and administratively an autonomous body, but under the direct supervision of the Council of Ministers and the Ministry of Labor. In the private sector, over 65 insurance companies operate covering close to 175,000 people.

<table>
<thead>
<tr>
<th>Agents</th>
<th>Share of national spending on health</th>
</tr>
</thead>
<tbody>
<tr>
<td>Data source</td>
<td>Consultating and Research Institute</td>
</tr>
<tr>
<td>Households</td>
<td>53.8%</td>
</tr>
<tr>
<td>Private insurance</td>
<td>16.1%</td>
</tr>
</tbody>
</table>

\[16 \text{ The ratio per person (2.8/1000) falls within the OECD range of 1 to 3.8 per 1000}\]
### Ministry of Health

<table>
<thead>
<tr>
<th>Ministry of Health</th>
<th>11.2%</th>
<th>13.7%</th>
</tr>
</thead>
<tbody>
<tr>
<td>National Social Security</td>
<td>9.0%</td>
<td>10.9%</td>
</tr>
<tr>
<td>Fund (NSSF)</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Ministry of Defense</td>
<td>3.7%</td>
<td>4.5%</td>
</tr>
<tr>
<td>Ministry of the Interior</td>
<td>3.1%</td>
<td>3.8%</td>
</tr>
</tbody>
</table>

(c) Social protection and social safety nets

A number of institutions in both the public and private sectors provide formal social protection for their employees. The most often-used medium is the NSSF, which by 1999 covers close to 1.2 million Lebanese - one-third of the population. The social system is not comprehensive, however, and benefits are often limited. For example, few self-employed professionals are covered. Moreover, services are suspended once an employee retires or is dismissed from his job.

Among the problems faced by Lebanon’s social security system is complex bureaucratic procedures, lack of coverage for eligible employees, high compensation for military personnel and dependents, etc. The end result is that social protection is not provided to the disadvantaged segment of the population, such as retirees and the unemployed, who need assistance the most.

A number of state institutions and ministries provide an indirect social safety net, though this is uneven in terms of geographical distribution. All in all there exists no far-reaching social safety net in Lebanon, assisting specific target groups such as the elderly or the transitional poor. There are a number of institutions which provide some social protection schemes, but little information is available on the existing needs and coherence of these schemes. Thus the problem does not lie in the instruments of social policy, but in the absence of an overall safety net policy.

### Globalization and trade policy

The impact of globalization on developing countries includes wider markets, access to technology, stiff competition, and market volatility. However, because different countries have different economic and social backgrounds, these impacts will vary.

Where is Lebanon situated in this increasingly globalized world? When we examine the ratio of manufacturing exports to total exports, Lebanon is about average in terms of competitiveness. On the other hand, the composition of Lebanese exports of mostly non-durable low-valued goods shows a less-than-competitive economy. Lebanon is more open than average developing countries if the trade-to-GDP ratio is considered.

The high trade restrictions on imports originating from Middle East countries tend to weaken the argument of openness. The restrictions are still high relative to other developing countries with a weighted average of 24% compared to 7% for Israel, and 9% for Central Europe. Arab countries too impose high tariffs against Lebanese exports. This means that Lebanon’s trade with its Arab partners tends to be less open than with other...
countries. Tariff rates in simple averages imposed by Arab countries ranged in 1995 from 42.2% in Egypt to 11% in Syria whereas the simple tariff rate imposed on Lebanese exports destined to Europe, the United States or Japan was about 4.5%.\(^\text{17}\) The high trade and non-trade barriers between Arab countries make all the more substantial the potential impact of a pan-Arab free-trade zone on regional exchanges. Trade agreements between Lebanon and a number of Arab nations have been bilateral and limited in scope, with customs duties lowered on a select number of items.\(^\text{18}\) An Arab free-trade zone is expected to be in full operation by the year 2008. The liberalization of trade among the Arab states will increase the volume of regional trade, but most of all it will limit the costs\(^\text{19}\) of and complement the emerging Euro-Mediterranean free-trade zone.

Lebanon can expect both positive and negative repercussions if it joins the World Trade Organization. Lebanon is not a major exporter with known comparative advantages, so its bargaining power in the WTO negotiations is very modest. In addition Lebanon may gain little from the dispute resolution mechanism of the WTO: As it is a minor exporter, Lebanon will find it difficult to challenge competitors for unfair trade practices. On the other hand, it stands to gain from the WTO’s most-favored-nation clause, which means that it will enjoy the benefits offered to any other WTO member. Furthermore, Lebanon, being a developing nation, is authorized to gradually adjust its system and agree to commitments the country is ready for. This should ease the transition and minimize the associated costs of globalization.

II. What Could Be Done?

What economic model for Lebanon?

What model do we want for Lebanon in the next ten years? To what extent should we allow the laissez-faire economic model to continue, and what is the appropriate role for the state in terms of social policies, creating jobs, and fostering the proper environment

\(^\text{17}\) Source: Paper of Mona Haddad
\(^\text{18}\) the tariff rates between Arab countries remain volatile. A country could raise the base rate rendering the trade agreement neutral or the net impact of the liberalization insignificant
\(^\text{19}\) For instance trade diversion.
for the private sector? It is also important to determine how regional and international developments affect discussions of any model or strategic choice for Lebanon, and how to develop a policy-making mechanism that is forward-looking and not merely reactive.

Even if a common vision is agreed upon, it is even more important to prioritize economic objectives and develop a mechanism to effectively implement such a vision. As the Nobel laureate Douglas North noted, institutions and regulations play a vital role in economic growth. In the case of privatization, for instance, success requires a proper legal and institutional framework. This could entail the creation of a higher committee for privatization led by the prime minister, a law to regulate privatized sectors, or the introduction of strategic partners into the entities that are going to be privatized.

**Fiscal and monetary policy**

In light of the existing economic recession and the role of the public sector in remedying the situation, participants debated the Hoss government’s five-year fiscal adjustment plan. The plan’s main objectives include reducing the budget deficit to 4.5% of GDP, reducing the debt-to-GDP ratio to 96%, decreasing interest rates, and stabilizing the annual growth rate at 5.0%. A number of fiscal reforms were proposed to achieve these objectives and to ensure fiscal sustainability. The proposed reforms included modernizing the tax system, rationalizing public expenditures, increasing the tax revenue base, reducing the debt, and privatizing some public assets. Experts called on the government to fully implement the value-added tax (VAT) as well as a new general progressive household income tax. On the expenditure side, the institutional framework for debt management ought to be revised. Similarly, a ceiling must be imposed on expenditures, especially current spending, and public investment programs have to be rationalized and prioritized.

Some participants disagreed on whether reducing public spending and increasing revenues would resolve Lebanon’s macro-economic imbroglio. That is because the ability of the state to raise more revenues is limited, given current socio-economic conditions. A better synchronization of monetary, fiscal, and economic policy is then required. Only once a better fiscal situation is in place will interest rates drop, provoking higher levels of investment and, consequently, an improved fiscal account.

Reducing the public debt is of paramount importance, given that debt servicing is consuming a majority of public expenditures. In order to escape the vicious cycle of high interest rates, increasing debt, and lower investments, the debt-management framework has to be consistent with a new interest-reducing monetary policy. Few experts at the meeting questioned current orthodox monetary policy, which stresses curbing inflation and stabilizing exchange rates. Monetary policy needs to be viewed as an economic instrument which uses interest rates to stimulate private-sector investment. In the early 1990s monetary policy was centered on reducing inflation rates and pegging the nominal exchange rate. This was important at the time, but is no longer sufficient to jump-start the economy, and is not salutary in any debt-reducing strategy.

The debt substitution strategy could save the government a considerable amount of money. However, it should not be abused, since a large foreign debt share will increase Lebanon’s economic vulnerability and political dependency on foreign creditors. Indeed,
and as a result of this perceived liability, the Lebanese government has decided to place a 30-35% ceiling on foreign debt, as a portion of the total public debt.

The government also needs to maximize the use of bilateral and multilateral loans, a sizable amount of which has never been used, despite being earmarked by foreign countries for use in Lebanon. Meanwhile, on the local debt market, there is a need to improve and modernize the market infrastructure, foster the development of a secondary market, and introduce new debt instruments.

**Labor market and employment policies**

Lebanon must adopt an employment policy that is consistent with its global development strategy. The issue of employment has been dealt with so far in a residual way, as a by-product of economic policy. The Ministry of Labor, for instance, is not part of the economic ministerial council, which defines the country’s economic policies.

Lack of orientation and support for the young and has contributed to the existing disequilibrium in the labor market, where there is a surplus of workers in some sectors and shortages in others. Young people need assistance and advice in making their career choices. There are three parties that can provide such a support: the family, the school, and the state. The state can help by reviving the Employment Bureau, especially its research department. With a new database on the labor market, job seekers and job providers can be better linked. A more efficient system based on reliable data will help future employees find the job that best suits their training. It will also permit employers to save resources by quickly choosing the appropriate candidate.

Moving beyond the structural disequilibrium in the labor market, there is less upward mobility in the Lebanese labor force in terms of skill improvement. Professional training and rehabilitation programs need to be encouraged in both the public and private sectors. The government should provide and enforce work licenses and permits to all, based upon a skill test that is offered on a regular basis. Life-long learning is a strategic choice Lebanon needs to consider as part of the continuous effort aimed at raising productivity and real wages, and reducing unnecessary production costs. Life-long learning is more than a rehabilitation program and less than a formal college degree. It is a system of continuous training and improvement through which employees and productive agents in the economy can continue to acquire new skills and be compensated accordingly.

Outdated labor laws are an overriding problem in the labor market. The newly formed parliamentary committee for updating legislation should be assisted in revising labor laws. This should help improve work and safety conditions, rectify gender imbalances, and provide incentives for employers to create new jobs. Rejuvenated laws ought to determine fair conditions and norms for strike action, guarantee employees’ rights, and restrict arbitrary dismissals. Contracts need to be flexible and the minimum wage regularly calculated according to a formula that best reflects the current state of the economy.

Last but not least, immigration policies and laws should be revised, since the size of the foreign labor force has direct implication on unemployment rates, most notably in the lower-skilled bracket. A number of measures have been proposed, including taxing foreign labor and forcing foreign laborers to purchase personal insurance. Some have
called for a selective immigration policy based upon market needs, and a minimum wage enforceable on all.

**Social vision**

To what extent does Lebanon have a social vision? The 1999 budget seems to reflect a deficiency in the government’s social spending. However, if one closely examines the Lebanese budget, he will find that the government does indirectly spend on socially-relevant sectors. An example of this is the government’s providing education allowances or money allocations for social training centers. While this comes under the heading of current spending in the budget, it is in fact a form of hidden investment, with concomitant future returns for society and the economy as a whole.

Optimal international practice reveals that countries viewed as socially active, such as Finland and Sweden, often have low levels of public social investment. In these countries, the state does not compete with the private sector, but acts as a catalyst for growth. It is often an agent that guarantees the existence of a proper macro environment, and a smart spender with a futuristic, preventative vision.

The primary role of the government is, thus, to create a new paradigm for economic and social development. This includes providing basic social services and infrastructure, ensuring competitive behavior and the adoption of international standards, strengthening regulation and monitoring of economic activity, and acting as a catalyst for economic development.

(a) **Education**

Some of the participants argued that the role of government in education is defined by one of three possible strategies: The state can carry on with its current policy of allowing the education system to be subject to the forces of supply and demand with limited governmental interventions and presence; it can withdraw gradually from the education
sector; or it can revive the public school consolidation program, reinforce the Lebanese University and revive public education.

Because education consumes a large portion of GDP, spending on education must be made more efficient and effective. This means addressing a number of issues, including the excess of instructors and school mapping. As for immediate measures, the state has to merge the three education line ministries\(^{20}\) and carry on with the unification of the Lebanese University. Spending on primary education yields higher returns than spending on higher education. Therefore the state ought to focus on providing basic educational services, which are of particular benefit to disadvantaged groups in Lebanese society.

The participants offered several other suggestions: There is a need to strengthen foreign languages, which would ensure that Lebanon maintains its regional comparative advantage. The education system must be made more flexible. And educational and research institutions must be encouraged to integrate and interact when it comes to their activities. The minimum age for compulsory education should be raised from twelve to at least fifteen in order to ensure that the student finishes his or her basic education (9\(^{\text{th}}\) grade or Brevet). Correcting this mismatch can better help fight illiteracy and increase enrollment in high school and ultimately college.

\((b)\) Health

The health sector is subject to both market failures and moral hazard behavior.\(^{21}\) There is, thus, a need to put in place an incentive-driven mechanism that will ensure that the market functions in the interest of the society as a whole and not to benefit certain agents in the health sector. Compulsory health insurance could be part of the solution with a system similar to that in the United States. In the American system, the family physician acts as an intermediary between the patient and the specialist. This helps reduce the abuse of some services and assist customers in determining their healthcare needs. HMO companies, on the other turn, compete through better services and lower prices.

Public spending on health in Lebanon is very high, though the share allocated for basic health services, demanded mainly by lower-income families, remains low. This misallocation of resources must be reversed. Furthermore, the largest portion of the Ministry of Health’s budget goes to contracted private hospitals, which are expensive and generally take advantage of the system. The state needs to reduce its reliance on the private sector and better use public facilities, especially a series of new, though not yet equipped hospitals.

Some participants also stressed the need to promote investment in the drugs market,\(^{22}\) since spending on medicine consumes close to 40% of the national health budget. The state’s policy of permitting exclusivity in the importation of drugs, which is a necessity product, must be revoked to allow more competition.

\(^{20}\) Ministries of high education and culture, vocational and technical training, and education

\(^{21}\) Abuse (e.g., over-consumption) of the system by one party affecting other involved parties (principal-agent theory)

\(^{22}\) the monopolization of supply and the subsequent high prices of drugs is pushing health costs too high
The role of the state in healthcare has to be revised where the government becomes a regulator, a service provider, a monitor, and a proactive agent providing the appropriate incentives for private institutions to work in the best interest of the economy.

(c) Social safety nets

Among the important challenges facing the Ministry of Social Affairs is the better targeting of disadvantaged groups such as the handicapped, orphans, and the elderly. Objective criteria must be set to determine the basic needs of each of these social groups. The ministry has also to review its role vis-à-vis students in private technical schools, re-evaluate its strategy and the effectiveness of its social development centers, and put an end to the automatic, unchecked, renewal of contracts with NGOs. Participants also emphasized the need to give the social security administration more independence. They added that compensation to public-sector employees must be re-examined and the collection of fees improved.

Plans for partial state intervention to address specific social needs are insufficient: experience has proven that partial plans are usually expensive and not very effective. A comprehensive socio-economic vision is both easier to execute and more effective, and ties in social development to economic growth. Social objectives are best met when there is growth based on a reorganized labor market, a reformed fiscal system, and flexible and equitable economic policy.

From balanced development to globalization

A national strategy for regional development necessitates a strong state willing to undertake development activities whose outcomes may not be perceptible in the short term. This means formulating a global and coherent plan d’aménagement, rather than dissociated sectoral policies. In this way, Lebanon would be able to put in place a system of balanced rather than parallel growth.

Lebanon should encourage competitiveness between regions. This is the case in Europe, where regions compete one against the other to attract foreign investment. The extent to which municipalities are able to play this role in Lebanon remains subject to discussion, but regional economic councils may be set up to stimulate investment. A successful balanced development strategy would also benefit from the establishment of new regional centers with executive authorities. The regional authorities could be at level of the caza, the mohafazat, and even the municipal level. Decentralized decision-making is essential at both the political and administrative levels as it efficiently and effectively serve the needs of the region. The creation of regional authorities promotes as well the action of intermediary political leaders, counterbalancing the central elite.

With an internally balanced economy, Lebanon will have an easier task preparing for globalization. The country remains very expensive for both consumers and producers. Unless production costs are reduced, Lebanon will remain not competitive globally. The example used by one participant was illustrative of the problem: the Beirut port is open for only a few hours per day. A simple, and inexpensive, measure to reduce costs would be to increase working hours. This would reduce costs to importers and exporters, since
merchandise would flow faster, while the increased volume of trade would expand the tax base. Commercial banks can also play a role in helping Lebanon regain a competitive edge. Their lending policies need to be revised with the dual objective of making reasonable profit, and allocating funds to promising productive sectors.

Some participants noted that Lebanon, in terms of intra-industry trade, can more effectively compete with Middle East countries than with non-Arab trading blocs such as the European Union. Lebanon is, therefore, expected to benefit from liberalization in inter-Arab, since trade barriers with the Arab countries are the highest.

Lebanon must join the WTO. However, it needs to better prepare itself for negotiations with the world trade body. This will mean, first, appointing an accomplished negotiating team. It will also imply educating and informing the Lebanese private sector on the trade agreements and their impacts. Moreover, the state must develop a trade strategy that both capitalizes on Lebanon’s human resources and promotes private investments in niche markets and productive sectors.

III. Concluding Remarks:

In conclusion, the following is a recapitulation of the basic views and orientations of the participants, as they emerged from the overall discussion.

At the outset, most participants agreed on the characteristics of the current economic and social crisis: a severe budget deficit; costly public subsidies, mostly to the energy, air transportation, and agriculture sectors; an inflated and largely unproductive public sector;
the heavy weight of the state in the national economy – more than 45% of GDP; and the general slowdown, if not the stagnation, of the economy.

Many participants argued that this was not a short-term situation. Rather it is the product of an economic model that became dominant in Lebanese society in the last several decades. This model led to the development of a rentier economy, domestically and externally – whether regarding transfers, remittances, speculation, interest, real estate deals, customs protection, and public-sector employment – and the domination of such activities and revenues over the economic cycle. This was accomplished at the expense of real economic productivity and competence. This, in turn, was reflected in the deteriorating quality of locally-marketed goods and services, and those oriented towards exportation. It also led to a devaluation of productive work and work ethics in Lebanese society in general.

Several participants wondered whether a break with this economic model was needed to take the country out of its structural crisis? Was such a break possible? What would its political, economic, and social costs be, or its phases and risks? Would an inevitable future adjustment provoke a shock, a social crisis, or a large and dramatic migration? Indeed, some estimates put the number of Lebanese who left the country at 800,000 over the last decade.

At a time when Lebanon, the region, and the world are changing profoundly, some questioned whether Lebanon should reproduce the past – or more precisely, images and illusions of the past. More urgent was the reversal of the country’s deteriorating quality in education and services, the declining productivity of industry, and the diminishing competence of human, administrative and scientific resources.

The participants underlined the importance of a sustained effort to lower the very high production costs in Lebanon, when compared to other countries in the region and in the developing world. This was imperative to again make Lebanon competitive. Examples mentioned were the low efficiency of the Beirut Port, the problems faced by express mail companies, the high cost of energy, traffic problems, the irrational nature of social expenditures, and other issues.

Some asked: Was it acceptable that Lebanon should remain without a national map and compass: The country lacks a population census, national accounts, and detailed and regular statistics on manpower and productivity, on tourism and occupancy rates, on construction activities, on remittances, on service exchanges. In sum, can Lebanon today, as a country without national data, without sectoral indicators, without the comparative studies required in this information age, set public policy and encourage investors and individuals alike to rationalize decisions and institutional initiatives?

Participants emphasized, in addition, the urgency of a serious and sustained engagement of the state in administrative reform, privatization efforts, fiscal reform, and the gradual suppression of subsidies. They noted that what is needed is a strong focus on policies and incentives to promote high value-added and exportable Lebanese goods and services in different sectors.

In terms of social expenditures – on education, health, or social protection – the participants underlined that the problem was not the level of spending: Lebanon – whether the state, institutions, or households – allocate more than 20% of its GDP on socially-relevant sectors, one of the highest ratios in the world. In spite of this high level of expenditure, Lebanon has not been able to insure basic needs in health and education for
all its citizens. It is not clear that protection and social assistance is reaching the right groups in society. The quality of social services is diminishing, as are administrative efficiency and the ability to deliver. Political interference is leading to distortions and waste in public spending. The state hesitates to define a proper role for the public sector – whether in terms of administration, promotion, monitoring, social solidarity or a mix of these. In sum, Lebanon needs a comprehensive social development plan, injecting an overall sense of direction to the activities of the public sector, private institutions and civil society organizations.

Uneven regional development has underscored the lack of an overall vision for the Lebanese territory as a whole. The participants noted the absence of coordination and synergy between sectoral policies, particularly regarding their impact on different regions and on a balanced regional development. They noted that the logic of most reconstruction plans since the 1970s revolved around rehabilitating and expanding what existed before the war, in the same places where they existed. Plans did not aim at correcting significant historical distortions and altering the excessive concentration of activities and resources around the capital and some areas of central Lebanon and the coast.

Participants agreed on the need for a more equitable distribution of public services to deprived regions. More important, these regions require new investment and job-creation. This means directing economic activities to these areas. This can be done through publicly-mandated fiscal, legal, and administrative measures. Also required are political-cultural incentives, as well as policies promoting deconcentration and administrative decentralization. These can encourage Lebanese, whether they live in Lebanon or abroad, to contribute to the well-being and renaissance of their regions of origin. A proper conduit for this would be revitalized municipalities, or new representative local structures at the qada or muhafazat levels.

The labor market is also problematical. There is an apparent increase in unemployment, leading to the emigration of Lebanon’s youth. Manpower productivity has deteriorated to a low level on the world scale. The linkage between the educational sector and the labor market is very weak. There is a dearth of much-needed professional and technical skills, and a need to modernize training and rehabilitation institutions. Unplanned migrant labor is making more difficult the employment of Lebanese in certain jög categories. Individuals in the so-called liberal professions, as well as enterprises, are often unlicensed. Lebanon lacks labor statistics and studies, preventing the formulation of a national strategy to deal with labor issues, and the upgrading of the labor force.

In terms of institutional reforms, the participants underlined the need for public sector reforms to ameliorate competence, productivity, flexibility and costs. However, they insisted that this was not the only national priority. Lebanon also needs, as urgently, to introduce radical reforms in the private sector, guaranteeing transparency, accountability, productivity, good management, and consumer and stockholder protection. This is a prerequisite for efficiency and competitiveness in private enterprises. This would make them attractive to institutional and individual investors.

What is needed, additionally, is imagination, so that the Lebanese cease to make the customary implicit or explicit assumptions about their “economic nature” and that of Lebanon. This will help overcome myths about the past, as well as perceptions of supposed comparative advantages and regional economic functions. On the contrary, the Lebanese should explore new and promising opportunities and activities, and firmly
adopt public policies and private initiatives to seize these opportunities and consolidate and promote more advantageous activities.

More generally, participants called for a strategic socio-economic approach to present challenges, using a historical perspective. This is preferable to the present, short-term view in the country at large, with its emphasis on the pressing crisis, and oriented towards ready-made and quick-fix solutions. There is a need for a comprehensive national vision, a vision of what Lebanon should be in twenty or thirty years, and a determination to implement this vision stage by stage. One thing definitely not needed is a list of public works projects, public orientations or public wishes, which will soon be abandoned or will remain unrealized.

Finally, the participants considered the conference a significant step towards building a consensus on a comprehensive development strategy for Lebanon. This, they agreed, must be followed up and encouraged through more studies, open dialogue, and appropriate public policies. The conference was said to have represented, in their view, the manifestation of an effective partnership between the state, civil society, the private sector, and the research community. Such as partnership can contribute to a national project to reconstruct Lebanon as a convivial, viable, and creative community for the 21st century.