

Report No. 13956-LE

Lebanon Private Sector Assessment

November 20, 1995

Private Sector Development & Infrastructure Division
Country Department II
Middle East and North Africa Region

Finance & Private Sector Development Division
Technical Department
Middle East, North Africa, Europe and Central Asia Region

الجمهورية اللبنانية
مكتب وزير الدولة لشؤون التنمية الإدارية
مركز مشاريع ودراسات القطاع العام



Document of the World Bank

2601

CURRENCY EQUIVALENT

US\$ 1 00 = LL 1,680 (December 1994)

ABBREVIATIONS

| | |
|--------|---|
| AHCLA | Anti-Monopoly and High Cost of Living Act |
| BCC | Banking Control Commission |
| BCCI | Beirut Chamber of Commerce and Industry |
| BdL | Banque du Liban |
| BOO | Build-Own-Operate |
| BOT | Build-Operate-Transfer |
| CAP | Certificat d'Aptitude Professionnelle |
| CAS | Central Administration of Statistics |
| CDR | Council for Development and Reconstruction |
| EdL | Electricite du Liban |
| EPZ | Export Processing Zone |
| FDI | Foreign Direct Investment |
| FX | Foreign Exchange |
| GATT | General Agreement on Trade and Tariffs |
| GDP | Gross Domestic Product |
| GDPS | General Directorate of Postal Services |
| GST | General Sales Tax |
| HBC | High Banking Council |
| II | Industry Institute |
| IPR | Intellectual Property Rights |
| ISO | International Standards Organization |
| IT | Information Technology |
| LIBNOR | Lebanese Standards Institution |
| LIC | Lebanese Information Council |
| LL | Lebanese Pound |
| MEA | Middle East Airlines |
| MET | Ministry of Economy and Trade |
| MIP | Ministry of Industry and Petroleum |
| MMRA | Ministry of Municipal and Rural Affairs |
| MPT | Ministry of Posts and Telecommunications |
| NDTN | National Data Transmission Network |
| NERP | National Emergency Reconstruction Program |
| NIGC | National Investment Guarantee Corporation |
| NSSF | National Social Security Fund |
| NWRA | National Water Resources Authority |
| OECD | Organization for Economic Cooperation and Development |
| PSTN | Public Sector Telecommunications Network |
| RWWC | Regional Water and Wastewater Companies |
| SME | Small and Medium Enterprise |
| SOFIL | Societe Financiere Libanaise |
| SWM | Solid Waste Management |
| TB | Treasury Bills |
| TIC | Trade Information Center |
| TMA | Trans Mediterranean Airlines |
| UNDP | United Nations Development Program |
| USD | US Dollar |
| VAT | Value Added Tax |
| WTO | World Trade Organization |

PREFACE

This Private Sector Assessment (PSA) was prepared to address the concerns of both the Government and the private sector regarding the direction of the economy and the role of Government. The focus is on micro level issues that impact the ability of the private sector to complete on a global basis. In order to more systematically identify the private sector priorities, an enterprise survey was conducted in June 1994. The results of the survey formed the basis for the choice of issues that were analyzed by the PSA mission in October-November 1994. The survey results were discussed in a workshop held in Beirut in October 1994 sponsored by both the former Minister of Economy and Trade and the Chairman of the Beirut Chamber of Commerce and Industry. A seminar on the PSA results was held in Beirut in September 1995 under the initiative of the current Minister of Economy and Trade. A second volume, consisting of background materials and more detailed analysis, is available upon request.

This Report is based on more detailed discussions of topics contained in the background materials and a survey report. The members of the mission were: Albert F. Martinez (task manager), Nemat Shafik, Manuel Hinds, Judith Brandsma, Omer Karasapan, and Isil Yaprak. Contributions were made by: Jamal Saghir, Hadi Abushakra, Robert E. Anderson, Joseph Saba, and Stijn Claessens. The mission would like to extend its appreciation for the support provided by: His Excellency Hagop Demerdjian, former Minister of Economy and Trade; His Excellency Yassin Jaber, Minister of Economy and Trade; Mr. Naji Hasan, Assistant to the former Minister of Economy and Trade; Ms. Lina Taher, Economic Advisor to the Minister of Economy and Trade; Ms. Nada Mufarej of the Center of Development and Reconstruction; and Ms. Randa Hamzeh.

THE PRIVATE SECTOR IN LEBANON: PAST, PRESENT AND FUTURE

TABLE OF CONTENTS

| | |
|---|----|
| SUMMARY | 1 |
| BACKGROUND | 1 |
| WHAT DOES THE PRIVATE SECTOR LOOK LIKE TODAY? | 2 |
| Data Availability | 2 |
| Characteristics of Private Firms | 4 |
| Constraints: A High Cost Business Environment | 7 |
| The Private Sector in Search of a Strategy | 10 |
| RESTORING THE PAST OR BUILDING A NEW FUTURE? | 10 |
| The Changing Circumstances | 10 |
| Globalization | 11 |
| POLICIES FOR LEBANON'S FUTURE | 14 |
| NATIONAL AGENDA FOR COMPETITIVENESS | 17 |
| Framework | 17 |
| Achieving Macroeconomic Stability and Establishing Competitive Conditions | 19 |
| Updating the Legal Framework | 19 |
| Creating a Regulatory Platform for Competitiveness | 21 |
| Improving Public Administration | 22 |
| Developing a Competitive and Responsive Financial System | 22 |
| Increasing Private Participation in Infrastructure Services | 23 |
| Upgrading the Skills Base Through Effective Training | 24 |
| Developing the Information Infrastructure | 25 |
| Supporting Business Development | 26 |

THE PRIVATE SECTOR IN LEBANON: PAST, PRESENT AND FUTURE

Summary

1. *Lebanon's private sector survived the civil war, but has only begun to adjust to the changes in the region and in the world economy that imply a different development strategy for the future. This report describes the characteristics of the private sector today, analyzes the implications of globalization, summarizes the policy changes that are necessary for the future competitiveness of Lebanon's private sector, and recommends an agenda for both the public and the private sector. The key messages are that Lebanon should target international competitiveness, continue to liberalize and simplify the trade regime, develop long term savings, rely heavily on the private sector to rebuild infrastructure and to provide training and information services, use self-regulatory mechanisms to the extent possible, take advantage of the international network of Lebanese expatriates, and make sure that growth is shared.*

Background

2. Lebanon has always been an economy dominated by the private sector. Unlike most of its neighbors, Lebanon never flirted with statism and the country was renowned for its laissez-faire policies, its minimalist state, and its entrepreneurial tradition. This strategy served Lebanon well -- from the 1950s until 1975, Lebanon experienced steady growth, especially of trade and services, although the distribution of power and wealth was a persistent source of tension.¹ With the oil boom of the 1970s, Lebanon played a new role of intermediating goods and services -- especially financial services and tourism -- between the newly wealthy economies of the Gulf and the rest of the world.

3. The civil war between 1975-1990 changed everything. Much of the country's physical and human capital was destroyed. Estimates of physical damage from the war were about \$25 billion, with one-third of phone lines not working, one-third of power capacity out of commission, 80% of water supply polluted, and water treatment not functioning. Impossible to quantify are the human losses: 90,000 to 170,000 dead (3-5% of the population), 300,000 injured (of which 62,000 were permanently handicapped), 800,000 displaced (25% of the population), and 550,000-880,000 migrants.² Significant economic activity moved outside the country and the economy increasingly relied on transfers from Lebanese working abroad to survive. The situation deteriorated particularly rapidly after 1982, with the Israeli invasion, the

¹ See A. Bisat and M. Hammour (1993), "Economic Prospects for a Post-War Lebanon" in Fischer, Rodrik and Tuma, The Economics of Middle East Peace, Cambridge, MA: MIT Press

² Nasr, S., (1994), Investor's Guide, p. 9 and Labaki, "Atouts et Preparatifs Libanais dans le Cadre des Economies et Rapports de Force Regionaux," Cahiers de L'Orient, March 1994, p.5.

division of Beirut into east and west, the war in the Gulf between Iran and Iraq, and the Iraqi invasion of Kuwait.

4. The economic implications were growing poverty, macroeconomic instability, and a breakdown of government services. Real per capita incomes fell from about \$2400 in 1975 to \$820 in 1990 and the collapse of wages resulted in growing poverty. Income distribution continued to be a problem as the once strong Lebanese middle class was decimated. The IMF estimated that the richest 20% of the population received 55% of private income between 1989-93, while the poorest 20% received only 4%.³ Government operations collapsed and there was a breakdown of law and order, inflation reached triple digits, the exchange rate depreciated 100-fold in four years, and "dollarization" of the economy became almost complete. With the deterioration of state institutions, the private sector emerged as a substitute for the government - militia collected taxes and handled "security", private electricity generators became widespread, telecommunications and postal services were provided by private firms, and social services were provided by families or non-governmental organizations.

5. With the signing of the Taif agreement in December 1989, hostilities ceased and the period of stabilization and reconstruction began. Stabilization of the Lebanese pound and of inflation was made possible by a considerable inflow of capital. Attracting capital has had large fiscal costs -- interest payments on domestic debt absorbed about 40% of total revenues in 1993. Fiscal pressures are also coming from the Government's ambitious National Emergency Recovery Program that envisages investments of \$2.3 billion over a four year period, primarily for infrastructure. Nevertheless, progress on stabilization and the massive reconstruction effort have fueled continued capital inflows, which have spurred economic recovery. Real GDP grew by 7% in 1993, reflecting intensive construction activity and real estate development, and is targeted to grow at about 8% per annum between 1995-98.

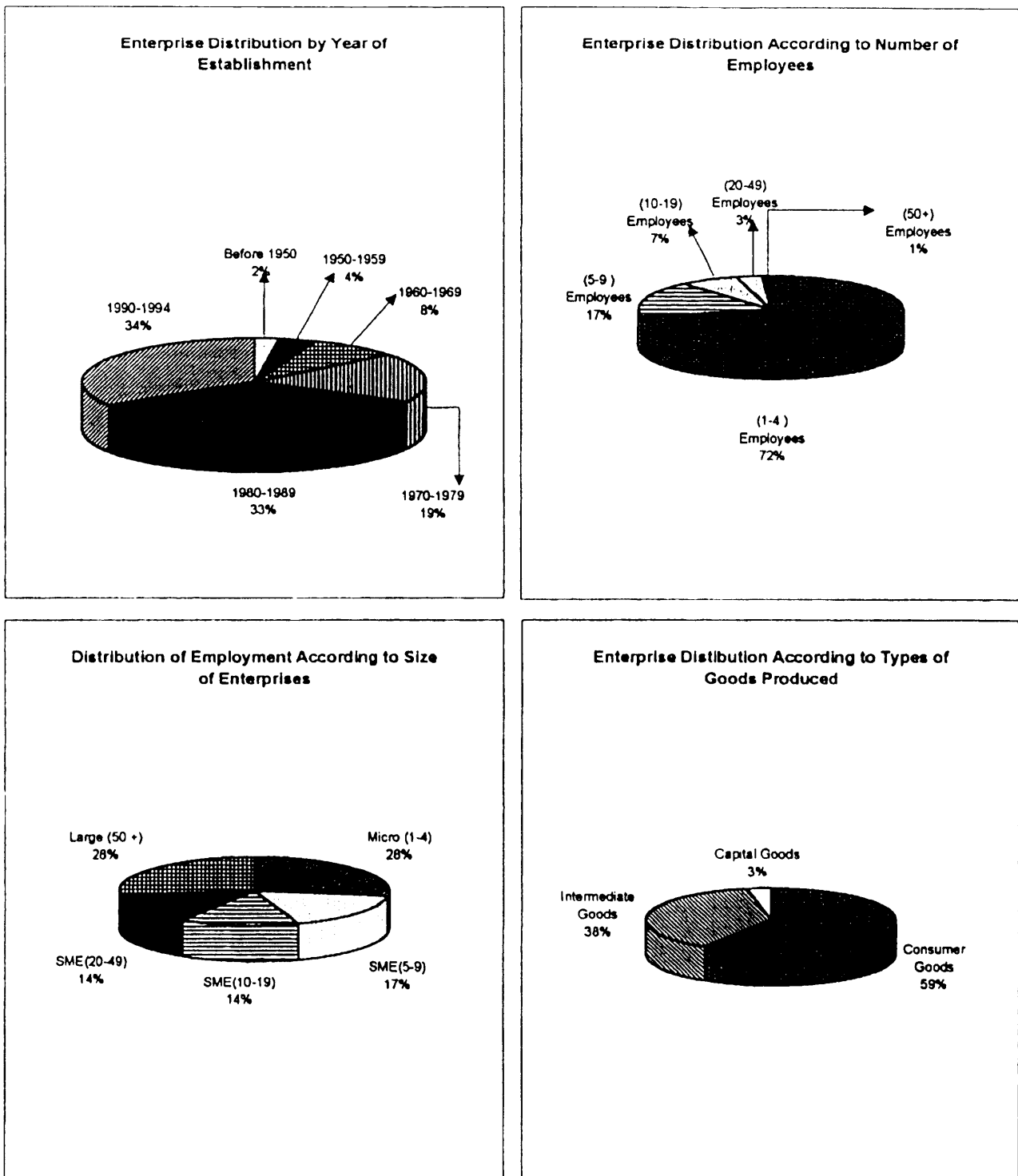
What does the Private Sector Look Like Today?

Data Availability

6. Information on the real economy and particularly on the private sector is scarce in Lebanon. Official national accounts estimates have not been produced since the closure of the statistical office in the 1970s. Some data on prices or on selected markets are collected by private organizations, but none are comprehensive or statistically reliable. Estimates are that the private sector accounts for about 80% of GDP, 85% of domestic investment, and 92% of consumption. The first and preliminary phase of an industrial census -- financed by KFW and prepared under the auspices of the Ministry of Industry and Petroleum -- came out in December

³ IMF, Lebanon: Economic Recovery, Stabilization, and Macroeconomic Policies, August 1994, p. 6.

Figure 1: Results of Industrial Census, 1994, Ministry of Industry and Petroleum



1994 (Figure 1). The census covered 23,517 enterprises in Lebanon, and of the 95% which responded: one percent have 50 or more workers; 10% between 10 to 49 workers; 17% between five to nine workers; and 72% have less than 5 workers. The census shows an industrial structure dominated by small scale businesses, with very little by way of medium and large scale manufacturing. Indications are that the structures are similar in the other sectors.

7. To ensure that recommendations are based on an accurate picture of the private sector's concerns, a survey of private sector firms was conducted in Lebanon as background to this report. The survey was based on a random stratified sample of 100 firms with more than five employees and less than 200 employees. The decision to exclude micro-enterprises and very large firms reflected the fact that they differed fundamentally from SMEs and that larger firms tend to be well represented in business associations, whose views were conveyed during the PSA mission. The objective of the survey was to identify the characteristics, problems, and needs of small and medium enterprises in Lebanon based on the results of an intensive questionnaire. The detailed results of the survey are contained in a separate report,⁴ but this section briefly summarizes the key findings.

Characteristics of Private Firms

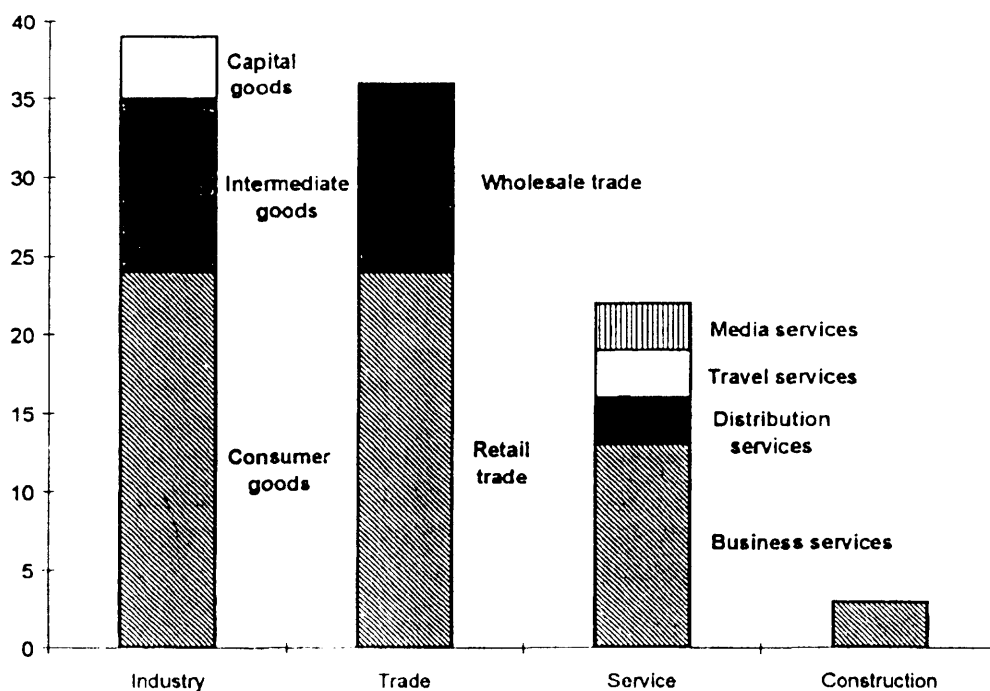
8. **Sectoral and Size Characteristics.** The sectoral breakdown of SMEs in Lebanon is depicted in figure 2. Each sector tends to be dominated by one subsector -- manufacturing by consumer goods, trade by retail, and services by business services. The average firm has monthly sales of \$177,527 and employs 38 employees who earn an average monthly wage of \$563 (Table 1). Construction firms tend to be the largest -- with a large number of employees

| | Number of Firms | Average Full-time Employees | Average Wage (monthly) July '94 US\$ | Average Sales (monthly) July '94 US\$ |
|---------------|-----------------|-----------------------------|--------------------------------------|---------------------------------------|
| Manufacturing | 39 | 53 | 613 | 119,423 |
| Services | 22 | 18 | 480 | 99,659 |
| Trade | 36 | 30 | 538 | 328,675 |
| Construction | 4 | 68 | 600 | 327,500 |
| All sectors | 101 | 38 | 563 | 177,527 |

and high monthly sales -- while services tend to be the smallest. Manufacturing tends to employ a large number of workers, but monthly sales are below average. Trade firms employ less than the average number of employees but tend to have the highest monthly sales.

⁴ World Bank, Small and Medium Enterprises in Lebanon: A Survey. January 1995.

Figure 2: Subsectoral Breakdown of Sample Firms

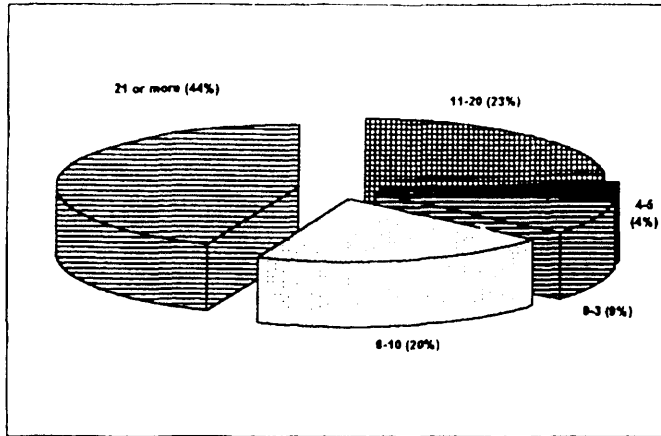


9. **Individualistic Survivors.** The experience of operating in the midst of a civil war has given the Lebanese private sector a particular character. Most firms are survivors -- two-thirds of the firms interviewed were over ten years old (Figure 3) and the median age of entrepreneurs is 45 years -- implying that most of their business experience was gained in a war economy. There were relatively few post-war business start-ups⁵ (Figure 4) and very few entrepreneurs were post-war newcomers. These firms learned to survive in an environment of high uncertainty and risk, substantial opportunities for arbitrage as a result of the disruptions to the normal flow of goods and services during the war, and an almost complete absence of public services. Entrepreneurs coped with such an environment by operating with short planning horizons (70% did not plan beyond one year), remaining small and flexible, keeping high cash reserves, and operating almost exclusively in dollars.

10. The war years also exacerbated the tendency for individualism among entrepreneurs. Seventy percent of firms were started by their current owner, especially in services where 96% were started by the entrepreneur/owner. The remainder of firms were

⁵ The industrial census of December 1994 had a different finding, with 34% of respondents establishing their operations after the war. Thus, the SME survey finding of few post-war start-ups should be treated with caution, especially since it may reflect sampling biases or that many firms existed, but were dormant, during the war years and only recently expanded their activity.

Figure 3: Age of Firms



family businesses. Joint stock companies or even partnerships were rare among SMEs in Lebanon who preferred individual or family operations for the sake of speedy decision making and secrecy. Entrepreneurs were also not "joiners." There was considerable skepticism about the utility of formal business associations and most relied instead on informal contacts to do business and to solve problems. This attitude was also reflected in the

way the private sector lobbies the government -- direct, informal contacts with government officials were far more important than coordinated technical studies combined with lobbying through associations. Although such mechanisms seem to be effective for insiders, they serve as barriers to entry for newcomers, especially small ones.

Figure 4: Number of Start-ups, Selected Years

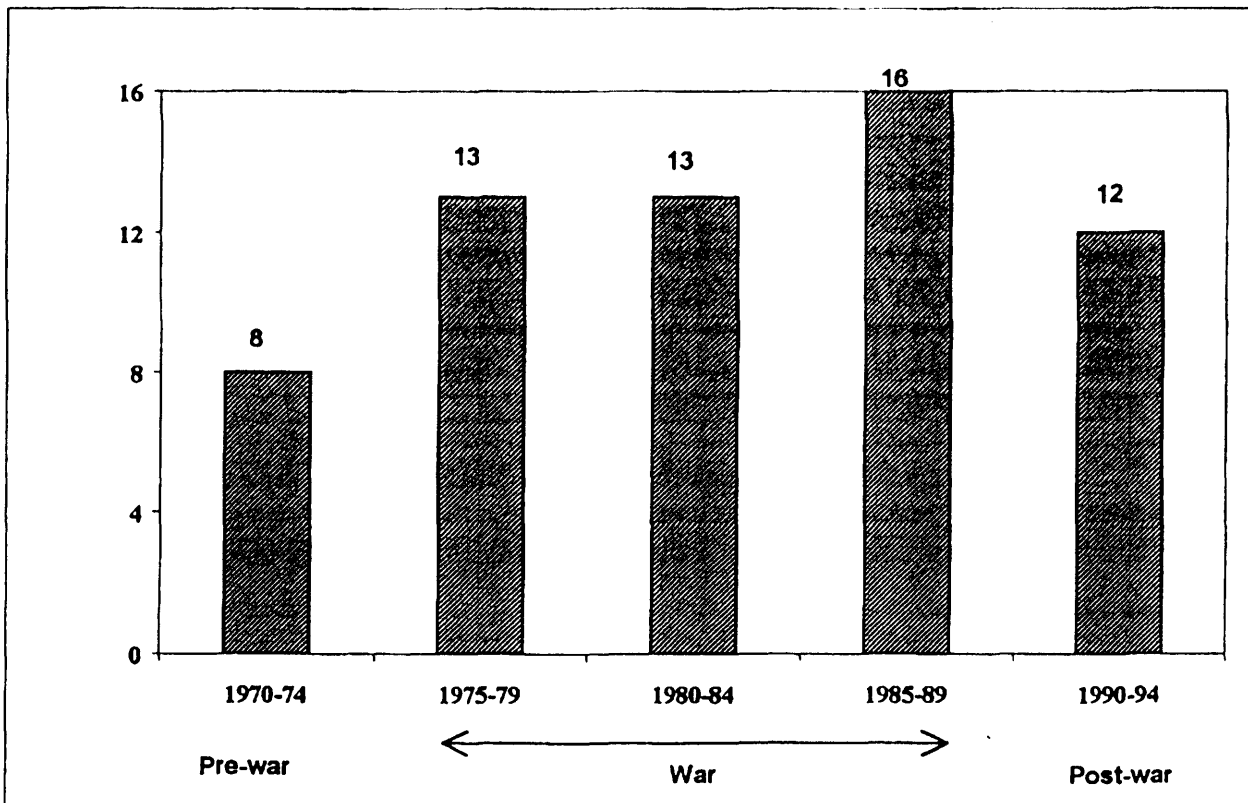
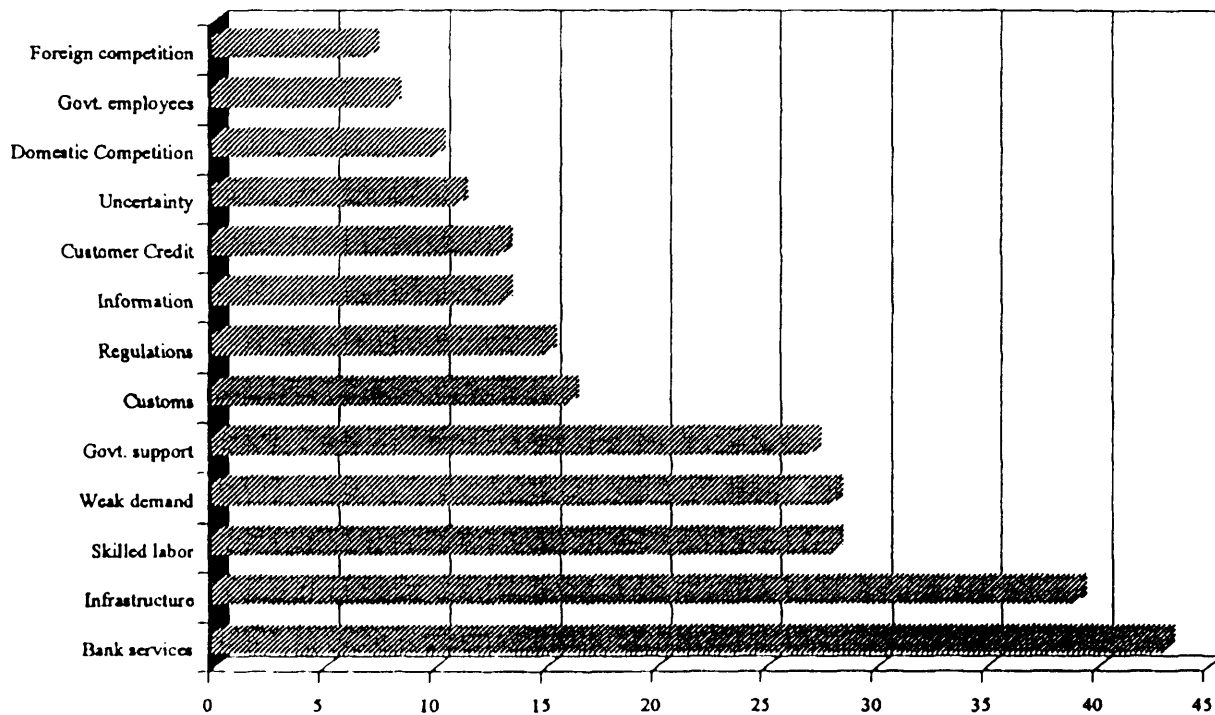


Figure 5: Constraints to the Business Environment



Constraints: A High Cost Business Environment

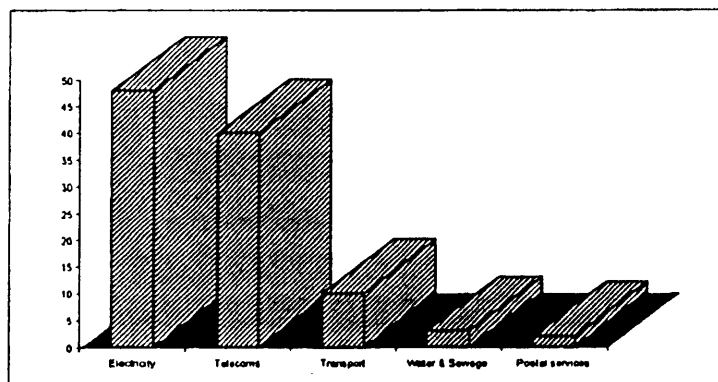
11. The theme that dominates the private sector's complaints is the high costs associated with the business environment in Lebanon (Figure 5). These costs can be divided into three categories:

- costs associated with the absence of basic public services;
- costs associated with legal and regulatory bottlenecks; and
- costs associated with deficiencies in supporting institutions in the areas of finance, human resources, and information services.

12. The significance of these costs again reflects the legacy of the war years. The breakdown of public services reflects the destruction of both physical and human infrastructure during the civil war. The costs of regulation, which are very low in Lebanon relative to other countries, reflects the tradition of laissez-faire policies and the breakdown of public administration during the war.

13. **Costs of Inadequate Infrastructure Services.** The private sector grew accustomed to substituting for government provision of infrastructure during the war. The lack of power and telecommunications were by far the most important problems, although the relative importance of each varied by sector (figure 6). Manufacturing firms were most adversely affected by power shortages while the service sector was most constrained by telecommunications. There were also important regional differences in the severity of different infrastructure problems. The private sector coped with these problems by purchasing private generators and telephone lines (such as cellular lines via New York or Cyprus) -- both of which added substantially to business costs.

Figure 6: Main Infrastructure Problems



14. **Regulatory and Legal Costs.** Although the regulatory environment in Lebanon is very liberal, there were three areas that were particularly problematic: contract enforcement, establishment of standards and quality controls, and outdated rules and regulations. The deterioration of the court system and shortfalls in judges and legal personnel have affected the quality of court decisions and the time it takes to get legal judgements.⁶ Widely accepted standards for goods and services do not exist and legitimate producers are often undercut by lower quality, pirated goods, and poorly trained "professionals." Moreover, the war meant legislative stasis and as a consequence much of Lebanon's legal framework is outdated. The country is only just beginning to catch up in building a modern legal framework that will be so crucial to future development.

⁶ An IDF grant with the Ministry of Justice is addressing some of these issues.

15. **Costs of Inefficient Financial Intermediation.** Complaints about bank lending were the most common among private firms. Entrepreneurs complained, fairly typically, that interest rates and collateral requirements were too high and that banks were unwilling to lend longer term. As a result, SMEs in Lebanon rely almost

Figure 7: Source of Working Capital

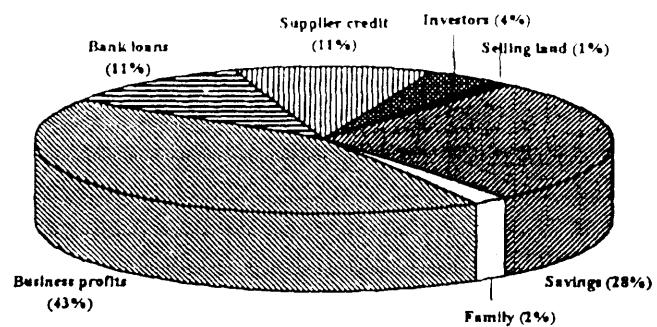
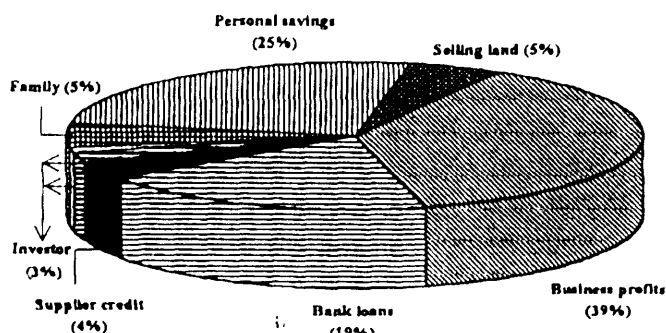


Figure 8: Sources of Investment Capital



exclusively on own resources to finance both working capital and investment (Figures 7 and 8). The combination of business profits, family money, personal savings, and land sales serve to finance about three-quarters of firms' needs. This heavy reliance on own resources is not unusual for SMEs, given the high risk of failure and the administrative overheads associated with bank lending. Nevertheless, over half (55%) of firms had received loans from banks, with bigger and

older firms more likely to be successful with their loan applications. There is scope for greater efficiency and responsiveness in the financial system in addressing private sector concerns.

16. **Costs of Shortage of Skilled Workers.** Although Lebanon's population is well-educated on average, 60% of entrepreneurs interviewed complained that their workers were not as skilled as they needed them to be. The labor market is highly dualistic with excess demand for high skill workers (who have opportunities abroad) and a large pool of underemployed low skill workers who compete for low wages with migrants from Syria. Most in demand by the private sector were professionals in the areas of marketing, accounting, finance, computers, and various technical skills. The shortage of skilled workers was blamed on emigration and the deterioration of school quality during the war years. Eighty percent of entrepreneurs wanted some kind of training for their workers and most were very willing to pay for these services.

17. **Costs of Lack of Information.** There is reportedly almost no information of use to private businesses available from official sources in Lebanon. Instead, entrepreneurs have to make decisions based on educated guesses, hearsay, and, sometimes, based on studies compiled by private consulting companies. Almost all entrepreneurs expressed a desire for aggregate economic and financial statistics, basic information about markets, and more information about government projects and plans. However, with the exception of census-type data and information about government activities, most entrepreneurs thought the private sector would be best placed to supply such information, albeit sometimes working cooperatively with

the Government or with universities. However, in the absence of protection for intellectual property, there will remain little incentive for those with information to share it with others.

18. The high cost business environment in which private firms operate in Lebanon has not been insurmountable, as evidenced by the firms interviewed in the survey. But like any such survey, the findings reflect the biases of incumbents -- entrepreneurs that have managed to find strategies for overcoming the constraints they faced. What is impossible to assess is the degree to which the high costs of doing business in Lebanon have deterred new entrants, especially smaller firms that are ill-equipped to work through informal contacts, and also perhaps foreign capital, especially of non-Lebanese origin.

The Private Sector in Search of a Strategy

19. Perhaps the most vocal complaint heard from the private sector -- including SMEs, large enterprises, and business associations -- was the lack of a Government vision for Lebanon's future. In response, the Government has reiterated that its job was to provide the infrastructure and rules of the game, enabling the private sector to find the most profitable activities. Clearly entrepreneurs' search for guidance reflects the fact that Lebanon's private sector is at a crossroads. Firms that survived the war years by taking advantage of short term arbitrage opportunities are learning to operate in a more stable environment where investing for the longer term requires more information, more skills, more credit, and a more sophisticated regulatory regime. The private sector's current focus on investments in real estate and treasury bills is a natural by-product of the high returns to such activities and the legacy of risk adversity inherited from the war years. Although there is very little that the Government should do to alter the pattern of private investment, there is a need for policies that alter risk perceptions (especially for foreign capital) and create the macro-economic stability needed for investments of a longer-term nature. The section that follows provides the outlines of a possible strategy for the future, based on international experience, and the subsequent sections define the specific measures necessary for such a strategy to be successful.

Restoring the Past or Building a New Future?

The Changing Circumstances

20. Lebanon's initial conditions have changed little over time, but the implications of the country's endowment have changed with growing globalization of the world economy. Lebanon is a small, open economy with limited natural resources, a relatively educated labor force, a strong entrepreneurial tradition, and a large international network of expatriates that are an important source of skills and capital (estimated at about \$40 billion). In the past, Lebanon's liberal economic climate provided important intermediary services to neighboring countries, most of whom were either fairly closed economies or lacked international skills and contacts. Thus Lebanon emerged as an important cross-roads for transit traffic of people, goods, services, and capital, which was deposited mainly by Gulf Arabs in Lebanese banks for placement in international financial markets.

21. Today the international context is dramatically different. The once capital surplus economies of the Gulf are facing serious fiscal problems. Alternative financial centers, such as Bahrain, have emerged in the region as have trading centers like Dubai. While the civil war raged in Lebanon, neighboring countries in the Middle East established direct contacts with international trading partners and financial centers, no longer needing Lebanese intermediaries. Similarly, physical crossroads are no longer necessary and alternative tourist destinations have emerged. A regional strategy, while familiar and partially viable, is not sustainable in the long run as most Middle Eastern countries are increasingly integrated into the world economy. The peace process in the Middle East will also bring about greater political stability and renewed investor interest in the region, but the lesson from other countries is that peace without a favorable policy regime will not be a panacea.⁷ And the complex relationship between Lebanon and Syria adds another factor to the equation. So what is the role of Lebanon in such a new environment?

Globalization

22. The past decade has seen two major revolutions in the world economy -- the technological revolution and globalization of production. The technological revolution -- with greater speed of information processing, transportation, and communication -- has made nimbleness the source of a country's comparative advantage. The globalization of production has meant the integration of factor markets as internationally mobile capital seeks the lowest cost and most productive location for producing and assembling components of goods and services in a truly global production process. The achievements of the Uruguay Round and the implications of the World Trade Organization will only increase the importance of these revolutions and create new opportunities, particularly in trade in services.

23. Lebanon is in many ways ideally suited to operate in such a changed international environment. Lebanon's smallness is an advantage in securing market access. Proximity to Europe will be crucial in the years to come as European industries restructure and look to out-source many parts of their production processes that require a lower wage but educated work-force. For example, the cost of shipping a container from Beirut to Marseille is only about \$300, while the same container would cost about double that from Paris to Marseille. Moreover, Lebanon's network of expatriates with connections and capital all over the world will be a vital resource, similar to the Chinese network in Asia (see Box 1). Lebanon's entrepreneurs have always been dynamic and nimble, and the war years may have developed these skills even further. Factor markets have always been relatively well-integrated in the Middle East, with the importance of labor and capital flows far exceeding trade in goods. And unlike many of its neighbors, Lebanon is starting with a clean slate, unencumbered by many inefficient public enterprises and in the midst of rebuilding state-of-the-art infrastructure and communications systems. There are potentially large profits for Lebanon's private sector from leading the process of globalization in the Arab world.

⁷ S.Fischer, D. Rodrik, E. Tuma (1993), The Economics of Middle East Peace, Cambridge, MA: MIT Press. World Bank (1994), Peace and the Jordanian Economy, World Bank, Washington, D.C.

Box 1: Learning from Hong Kong

Lebanon can take many lessons from the smallest and one of the earliest of the East Asian "tigers." Hong Kong, like Lebanon, had few natural resources, was a small open economy with an entrepot tradition, had little access to foreign assistance, and had a large international network which enabled it to play a "gateway" function vis a vis much larger neighboring economies. In the early stages, the economic foundations for Hong Kong's strategy were an excellent port, an experienced international trade sector, extensive shipping and trading links, the transfer of skills and capital from Shanghai, and labor-intensive industrialization based on low cost labor. Over time, the economy shifted toward higher skill activities with the emergence of financial and business services, fashion apparel, diversified consumer manufacturing, and tourism. This change in economic structure was reflected in the shifting composition of GDP away from agriculture and manufacturing in favor of services (Box Table 1). Hong Kong's success was driven by small businesses -- the average number of workers employed in manufacturing establishments has actually declined from 55 workers in 1950 to 15 in 1990.

| Sector | Hong Kong | | Lebanon | |
|--------------------|-----------|------|---------|------|
| | 1979 | 1992 | 1970 | 1991 |
| Agriculture | 2 | 0 | 9 | 7 |
| Manufacturing | 29 | 22 | 14 | 14 |
| Services | 62 | 78 | 77 | 79 |
| of which: | | | | |
| Trade | 20 | 24 | 31 | 28 |
| Financial Services | 15 | 18 | 3 | 10 |
| Construction | 4 | 5 | 5 | 9 |

Source: World Bank and Hong Kong, Census and Statistic Department, Estimates of Gross Domestic Product

What were the policies that guided Hong Kong's development? Box 1A describes how Hong Kong's economy and strategy evolved in response to changing conditions. Like Lebanon, policies in Hong Kong are characterized by openness, and a small, non-interventionist government. Taxes are low and the government runs frequent fiscal surpluses, thereby avoiding crowding out the private sector and encouraging high rates of investment. The government does invest in roads, rails, a subway, the airport and water supply. But much of Hong Kong's infrastructure -- port terminals, public transport, gas, electricity, and telecommunications -- is provided by the private sector, mostly under franchises with pricing under legislative control. In 1979, the government made some efforts to promote economic diversification, through technical training, industrial support services, and financing research and development, but this strategy became outdated as diversification was increasingly achieved via integration with the Chinese economy. A major mechanism for social transfers is health and education, which are provided by the state. Financial regulations are liberal, but a major upgrading was required in 1986 after a local banking crisis and to insure that Hong Kong was able to compete internationally in financial services. Public administration is oriented to supporting private sector development -- an independent Commission Against Corruption was established in 1974 reporting directly to the Governor of Hong Kong to eliminate corruption among public officials and to reduce the costs of doing business.

Box 1A: Learning from Hong Kong

Box Table 2: Evolution of the Hong Kong Economy

| | 1947-1952 | 1952-1970 | 1970-1982 | 1981-1990s |
|----------------------|--|--|---|--|
| Changing environment | Post war recovery. | Cut off China trade. Growth of U.S. and European markets. | Competition from NICs and other low-cost countries. Trade protectionism. | Reemergence of entrepot trade. Increasing international competition Growing economic links with South China. |
| Economic structure | Entrepot trade and services. | Textiles. Clothing. Consumer electronics. Plastics. | Clothing/textiles. Diversified consume. manufacturing. Financial and business services. | Entrepot trade services. Financial and business services. Fashion apparel and textiles. Diversified consumer manufacturing. Tourism. |
| Economic Foundations | Excellent port Experienced international trade sector Extensive shipping and trade links | Transfer of capital and skills from Shanghai. Low-cost labor. | Low-cost labor. Responsive physical infrastructure (e.g., housing, transportation). | Quality workforce. Accessible technology. Open and stable legal and regulatory system. Forward-looking physical infrastructure. |
| Economic strategy | Exploit shipping and trading advantages | Labor-intensive industrialization. | Export-oriented industrial diversification. | Move to higher-value-added manufacturing. Strengthen entrepot services. |

Source: IRI International (1989), *Building Prosperity: A Five-Part Economic Strategy for Hong Kong's Future*, 8.

24. What are the alternatives to a global strategy? There are some voices in Lebanon, mainly among industrialists, calling for greater protectionism and the adoption of an inward-oriented strategy. The pitfalls of such an approach are well-known from international experience and should be resisted. In addition to the inefficiencies associated with inward-orientation, such a strategy fails to exploit Lebanon's comparative advantages -- its proximity to Europe, its skilled labor force, and its international network of expatriates. Failing to use these comparative advantages will result in a rate of growth that is far lower than that which is possible.

25. An alternative that has wider support in Lebanon is a regional strategy that focuses on domestic and Arab markets. The success of this strategy would depend on whether Arab countries were willing to give preferential access to Lebanon. This is unlikely because Lebanon would have little to offer regional partners other than relatively higher priced, lower quality goods and access to a very small market. Moreover the wealthiest regional markets in the Gulf are already open to international competition and the remainder are increasingly moving in that direction under the auspices of the World Trade Organization.

26. Lebanon will continue to have regional comparative advantages such as language, familiarity with neighboring markets, and culture, but ultimately success in regional markets will depend on success in global markets. From the beginning, Lebanon's private sector should aim for international competitiveness since a global strategy will encompass any regional option. This requires the continuous upgrading of the factors of production from basic to advanced levels, and dynamic changes in enterprise strategies, structures, and processes to create and sustain competitive advantage measured against international standards. The sections below describe the policies to achieve international competitiveness, the role of Government, and finally an agenda for action.

Policies for Lebanon's Future

27. A global strategy has wide-ranging implications for public policy and private sector strategy. The following are the key lessons, all of which are documented in greater detail in separate working papers for this report.

28. **Continue to Liberalize and Simplify the Trade Regime.** Lebanon remains a highly open economy and the Government has thus far successfully resisted protectionist pressures to raise tariffs. Average tariffs are 10% and relatively few items are subject to trade restrictions. Nevertheless, there are a number of trade policy issues still on the agenda -- harmonization, simplification, and continued liberalization. The Ministry of Finance is in the midst of an effort to harmonize the tariff code to be consistent with international norms. A proposal to simplify the extremely complex tariff structure was rejected by the Council of Ministers at the end of 1993 under pressure from industrialists because it included a proposal to abolish the "customs dollar," although the overall level of protection would be maintained.⁸ This is unfortunate since if Lebanon hopes to play a role as an entrepot and coordinator of internationally-based production, a uniform, low level tariff regime is an essential precondition.

⁸ See IMF, Lebanon: Economic Recovery, Stabilization and Macroeconomic Policies, August 1994.

An interim, but second best, solution is to establish large free zones which will have important demonstration effects for the rest of the economy. While the Government is pursuing plans for a free zone in the port of Beirut, an expanded effort, which could be financed by the private sector, is recommended.

29. **Develop Long Term Savings.** Although capital inflows have been an important source of financing for the Lebanese economy, domestic savings will have to play an increasingly important role in the future if the credit crunch facing the private sector is to be resolved. An important reason for banks' reluctance to lend longer term to the private sector is the absence of longer term savings in the economy. Some banks are beginning to issue longer term certificates of deposit -- Byblos Bank, for example, has issued two year certificates of deposit. However, an important opportunity to develop long term savings -- through mandatory private pension funds -- has not yet been explored. The passage of legislation to enable the emergence of competing private pension funds would play a major role in the development of Lebanon's capital markets.⁹

30. **Develop Efficient Financial Markets.** After years of operating in an uncertain environment and relying on short term commercial loans with high collateralization, some banks in Lebanon are beginning to venture into longer term lending -- such as 3-5 year commercial loans and up to 10 years for variable rate mortgages. Some banks are also using collateralized consumer loans as a stepping stone for lending to small businesses. In the past year, a number of investment banks, investment funds, and mutual funds have been established and are working to develop the market for equity and corporate bonds. All of these are positive signs and the Government should resist the temptation to intervene in a manner that would undercut market solutions to credit allocation. The creation of specialized banks such as the Housing Bank, the Development Bank for Industry and Tourism, and the Agricultural Bank -- all of which are institutions that will have privileges such as government guarantees -- are just the sort of interventions that would undermine the development of market-based longer term lending and small and medium enterprise credit and equity markets -- in the process dashing Lebanon's hopes of becoming a world class financial services center.

31. **Get Connected -- Rebuild Infrastructure Quickly with Private Sector Help.** The Government's emphasis on quickly rebuilding state-of-the-art infrastructure is understandable given the destruction of the war years and it will make a contribution to reducing direct operating costs for the private sector. But there could be much greater reliance on private sector financing of such infrastructure given the Government's fiscal constraints, limited capacity, and poor track record in providing such services. Moreover, Lebanon's private sector already has experience providing itself with power, telecommunications, mail delivery and other services during the war years. Experience in other countries has shown that involving the private sector would not necessarily result in delays in the rebuilding efforts. But to rely more on the private sector for reconstruction would mean a major shift in the Government's role. Regulatory

⁹ For a detailed discussion, see World Bank, Lebanon: Financial Policy for Stabilization, Reconstruction, and Development, Washington, 1994 and World Bank, Averting the Old Age Crisis, Washington, 1994.

capacity would need to be developed, transparent contracting procedures and operating rules established, and clear rules concerning conflict of interest enforced.

32. **Hardware Matters, but Software Matters More.** The "hardware" of development (roads, power, communications networks, etc.) are vital for the private sector, but the "software" (skilled workers, functioning institutions, information, and effective legislation) are arguably more important and more difficult and time consuming to attain. To realize the strategy for Lebanon's future described above, both the public and the private sector will have to invest more in such "software" -- through education reform, training program development, institutional and regulatory reform, and efforts to facilitate information flows and to clarify the rules of the game. Much of these investments have long term pay-offs, and require of both the private and public sectors a commitment to and consensus about the need for sustained investment.

33. **Use the Network.** Lebanon's network of about 600,000 expatriates are an important asset in an increasingly integrated global marketplace. Thus far, the focus has been on attracting the estimated \$40 billion in capital held abroad by Lebanese nationals through international offerings of Lebanese paper (Treasury bills, Solidere shares, and Eurobond issues). Attracting the resources -- human as well as financial -- entails focusing on certain areas of reform. Compared to those with established businesses in Lebanon, expatriates interviewed placed a greater emphasis on the re-establishment of the rule of law and a more transparent regulatory regime (see Box 2). Progress in the peace process in the region was also mentioned prominently. Many portfolio investors have complained about the lack of investment opportunities -- as indicated earlier, Lebanese entrepreneurs tend to be individualistic and family firms are unlikely to go public. Although the Beirut Stock Exchange is scheduled to operate in a few months, the expectation is that no more than a handful of enterprises will be listed. The major investment opportunities -- for attracting both financial and human resources from the expatriate community -- are the relatively large infrastructure projects of the Government. Increasing private sector participation in new projects and privatization of certain activities would be a major mechanism for utilizing the extensive network of expatriates.

34. **Develop Conditions for International Competitive Advantage.** Wages for skilled labor in Lebanon are relatively high -- average wages in the private sector in the survey were \$563 per month, although low skill workers are abundant and cheap. Lebanon would have difficulty competing with Asian economies in many low wage, low value added, mass production activities. Instead, Lebanon must build on its endowment of a skilled and dynamic population by developing market niches in the international system.¹⁰ There is, for example, scope for Lebanon doing "front office operations" such as marketing, finance, design, packaging and quality control for other manufacturing bases. Government policies should establish the

¹⁰ For an interesting discussion of what those market niches might be, see Labaki (1994), pp. 7-13. Labaki includes Lebanon's potential comparative advantage in: (1) sea transport link to the Arab hinterland (esp. Syria, Jordan, Iraq); (2) specialized tourism such as skiing (Lebanon has the only skiing in the Middle East) or regional package tours; (3) high tech services and manufacturing; (4) high value added agriculture and food processing; (5) more sophisticated banking services that draw on the experience of expatriate Lebanese; and (6) health and educational services (although this will be limited relative to the past given the growth in regional alternatives).

conditions and institutional mechanisms that stimulate and enable private sector dynamism towards sustainable long term competitive advantage rather than short term cost advantages.

35. **Rely Heavily on the Private Sector.** The Government of Lebanon has limited capacity and has a huge reconstruction agenda. In addition to the private sector's potential role in sharing the burden of reconstructing Lebanon's infrastructure, the private sector could play a much greater role in collecting, processing, and disseminating information and in self-regulation for both professions and manufacturing. Private sector organizations such as associations could influence the conditions for upgrading factors of production through active involvement in the efforts of the Government and private institutions to improve education and training, as well as establishing linkages with institutes and universities to shape the agenda for technology diffusion and business process research.

36. **Debate the vision and lobby for it.** The Government of Lebanon has wisely resisted the temptation to tell the private sector where to invest. But there is a need for greater dialogue between the Government, private sector, and other groups on strategic visions of the country's future. The Government has established an Economic and Social Council consisting of 90 members with broad representation (including the private sector) that will have an advisory role. There are also the business associations and the numerous informal channels for lobbying. Despite this, many in the private sector feel that the Government is not "listening" enough to them and more vehicles for such listening and debating economic policy need to be found. Building such a national consensus on Lebanon's economic future could provide some of the common ground across social groups that was lost during the war.

37. **Share the Growth.** Implementing the reforms described in this report should be accompanied by policies ensuring social cohesion and poverty alleviation. Income distribution in Lebanon remains highly unequal and, because of widespread tax evasion and political problems with targeting, the Government has been unable to achieve social transfers through the budget. In East Asia, where equitable distributions of income helped provide social cohesion, governments often used in kind, rather than cash, transfers (such as education and health care) to achieve equity objectives, to create opportunities, and promote productivity gains. In Lebanon, none of this will be possible if the private sector does not pay taxes, which are extremely low by international standards. In addition to universal education, policies that support small and medium businesses and provide targeted low-income housing can facilitate shared growth.

National Agenda for Competitiveness

Framework

38. The policies underlying a global strategy would have to be transformed into a set of actions by both the Government and the private sector. These actions address four major objectives:

- creating an incentive framework that drives the private sector to pursue international competitiveness -- this includes policies for achieving macroeconomic stability and establishing competitive conditions in the economy;
- establishing a supportive institutional setting that enables the private sector to respond to market opportunities -- the most critical of these institutions are the legal system, the regulatory framework, basic education, and public administration;
- eliminating constraints that discourage investment and raise costs -- the major constraints were identified to be inefficient infrastructure services, an underdeveloped financial system, and lack of information services;
- developing mechanisms that would support the upgrading of firm level capabilities and factors of production -- these mechanisms support the development of skills, improvements in technology, and creation of clusters or networks of firms.

39. An overarching issue is the role of the Government. Because of lack of resources and capabilities, the Government -- to maximize effectiveness -- would have to focus on essential functions that it is in the best position to perform. It is in this context that the action agenda recommends privatization of many Government assets and projects (e.g. refineries, airlines, industrial parks, EPZ, tobacco monopoly), the private provision of certain public services, and self-regulatory mechanisms in many private sector activities. In addition, private sector organizations such as business associations, universities, and research institutes are envisioned to have an active role in supporting private sector development.

40. There are several specific objectives that are addressed by the action agenda. The diversification of export markets is supported by the development of international standards for both products and services, the establishment of export processing zones, and the improvements in the efficiency of information generation and dissemination. Attracting foreign investments is enhanced by reform of legal institutions, development of the financial system, and privatization -- which provides greater opportunities to foreign investors. Upgrading technology is made possible by skills development, an efficient information infrastructure, and linkages between learning institutions and the private sector. The growth of the service economy would be accelerated by flexible labor markets, an upgraded and dynamic skills base, and a less restrictive regulatory environment. Supporting small enterprises through networks and industrial park development would not only enable them to secure some of the advantages of scale economies but also accelerate their growth into larger operations, thereby creating a larger "middle class" in the enterprise sector. Finally, privatization and private provision would enhance institutional effectiveness of public administration.

41. The following sections summarize actions in nine areas which are discussed in greater detail in separate working papers for this report.

Achieving Macroeconomic Stability and Establishing Competitive Conditions

42. The ability of the Government to maintain macroeconomic stability depends on its ability to close the fiscal deficit.¹¹ Without improvements in raising revenues, the Government should not take the macroeconomic risks of reducing tariffs. Addressing the fiscal problem requires actions on several fronts. Accelerating the planned introduction of a General Sales Tax (GST) would be major step. Improving tax administration and consolidating the tax base by eliminating exemptions would be another.¹² A more fundamental change would be the reorientation of public sector investment towards factor creation. This would require a shift in the Government portfolio of assets through the privatization of assets and activities that would liberate a large stock of resources to enable the Government to invest in the upgrading of human capital and institutions, as well as reduce the burden of public sector investment in future budgets.

Updating the Legal Framework

43. The legal framework for commerce is critical to the promotion of foreign direct investment and the reduction of costs of doing business (see Box 2). Immediate actions would have to be undertaken to improve the capacity of the judiciary. These include: training programs to improve familiarity of judges with domestic and international business law and practices; revisions in procedural rules to expedite the judicial process; and increased resources to support the upgrading of the court libraries and database. As an alternative to the courts, arbitration should be encouraged -- businessmen's associations could be major instruments in promoting arbitration as an alternative dispute resolution method. Lebanon should join the New York Convention on Recognition and Execution of Foreign Arbitral Awards (CREFAA) and the International Convention on the Settlement of Commercial Disputes (ICSID).

44. To strengthen further the laws on property rights, three actions would be beneficial. One, cadastration should be made mandatory subject to transparent guidelines. Two, legislation lifting rent control should be enacted as soon as possible. Three, protection of intellectual property should be improved by incorporating international practices and norms.

45. There are some changes in the commercial code relating to the workings of legal business forms that would improve the environment for competitive markets. The requirement that the majority of members of the Board of Directors of a corporation be Lebanese should be eliminated. Rules governing the rights of minority stockholders should be introduced. Minimum requirements for number of stockholders and capital to establish a corporation should be abolished so as not to discriminate against SMEs.

¹¹ See World Bank, Lebanon: Financial Policy for Stabilization, Reconstruction, and Development, July 1994, and Lebanon: Public Expenditure Review (May 1995).

¹² An ongoing project to improve tax administration in the Ministry of Finance should result in higher collection rates.

Box 2: The View From Abroad

Lebanese Expatriates

It is often argued that expatriate capital and human resources make Lebanon a case apart from other nations in development and reconstruction. Underlying the argument is the assumption that those who fled will return with their progeny, money, skills, and international connections; or at least they will invest heavily in their country's reconstruction. But the Lebanese expatriate community is an eclectic group, diverse in its communal allegiances, geographic diaspora, social and economic outlook. For the most part, successfully established in different countries (or at least having secured their children's future outside Lebanon), this community now looks for incentives, opportunities and certain minimum conditions as a precedent to long term, economic investment. The Lebanese expatriate community is a sympathetic, but nevertheless, commercially hard-nosed group. Since their return is considered a crucial element of Lebanon's successful recovery, the views of this community as to the incentives, opportunities and conditions for return are critical for setting a strategy for private sector development.

Risk Perceptions Which Constrain Long Term Investment and Return

The Peace Process. A number of risk perceptions are almost always mentioned as constraints whose mitigation is necessary as a condition precedent for return and long term investment. Not surprisingly, the most often noted risk concerns the continuation and outcome of the peace process and the prospects for the continued sovereignty of Lebanon. Private capital is not at ease with the presence of foreign troops. Ideally, investors seek a situation of stability and predictability in an environment involving neither hostility nor servility to foreign countries. While it can be argued that addressing this risk is beyond the scope of private economic activities, increased private sector activity, particularly involving long term foreign-origin investment, would contribute significantly to achieving the desired conditions of security and stability. The issue then turns to mitigating other constraints, and identifying opportunities for the attraction of expatriate and foreign private sector investment.

Rule of Law. Potential investors see a substantial risk in what they perceive as the continued absence of the rule of law. Lebanon has a heritage of a strong legal system. The laws are well known and the texts are generally adequate; but enforcement is considered haphazard, though improving. Perhaps more damaging, there is a perception in the expatriate community that corruption has become institutionalized in networks of protection, beyond the law, for self-dealing, bribes, and the bartering of favors and influence. These potential investors argue that so long as this breakdown of the rule of law continues, the rules of factional and familial fealty will dictate economic entry and determine success. Consequently, many in the expatriate community state they will take investment risk only to the extent they can know and control events and actors, without reliance on legal recourse or national institutions. This risk perception thus limits investment horizons to short term, small endeavors. It impedes much needed privatization plans (since some fear privatization could become a parceling of national assets on the basis of favors and factions) and also accounts for the fact that so much investment for the time being is focused on residential or commercial real estate or quick trading transactions.

The Need for Large Projects for Private Sector Participation. The absence of large private sector projects (other than real estate development) is considered a significant constraint in several respects. Large projects are needed to attract significant investment banking and large multinational firms who would locate in Lebanon. These firms would bring in expatriate Lebanese and also create a level of confidence in the market place. In the absence of such projects and firms, many expatriates do not see long term opportunities. Simply put, many well educated Lebanese ask what would they do over the long term and, perhaps more importantly, what would their children do to earn a good living? Although the situation is steadily improving, there is lack of sophisticated globally and regionally connected economic activity which would employ the highly skilled expatriates. In addition, many Lebanese seeking investment opportunities do not find that many projects -- many of the private sector businesses are either too small or closed to outside investment. Inviting private sector participation in many of the large projects being contemplated by the Government would create more opportunities for private investment and skills.

46. Finally, to improve conditions in credit markets, the different pieces of legislation governing mortgages and other security interests should be consolidated and revised to incorporate: use of extra-judicial procedure as an alternative debt recovery procedure; use of special rules and panels of judges to accelerate disposition of judicial foreclosure proceedings; and regulation of liens on receivables.

Creating a Regulatory Platform for Competitiveness

47. While the regulatory system has not -- in practice -- been a major source of distortions in the economy, it could play a positive role in enabling firms to compete in the global marketplace. The regulatory system should therefore be developed with the recognition that it has a profound impact on the following major factors that influence competitiveness: (a) the nation's available technologies and skills; (b) demand conditions that stimulate growth; and (c) competitive conditions that drive the pursuit of innovation.

48. Most of the complaints on existing regulations revolve around import procedures and tax administration. Much can be done to streamline the trade regime, including the elimination of most licensing requirements for both imports and exports, the simplification of the tariff structure by reducing the number of rates and incorporating all of the different fees and taxes into the tariff structure, and the establishment of Export Processing Zones and Free Trade Areas to expedite import processing for certain types of exporters and manufacturers.

49. To meet the growing demand for quality products and services in domestic and export markets, Lebanon needs an effective system for setting and monitoring standards. Presently, quality standards have a small place in Lebanon's policy architecture. This has been a major constraint to the ability of Lebanon to diversify its exports to non-Arab countries. To correct the existing situation, LIBNOR and the Industry Institute could be strengthened to set the framework for standards and certification. However, only a few standards should be mandatory in the domestic market -- specifically those relating to health, safety, and environmental protection. Other standards should be voluntary, and the adoption of international standards should be carried out by private sector organizations. There should also be international accreditation of local private laboratories or agencies, although foreign product and service certification agencies could also be used. Initiatives for the promotion of quality awareness and assistance to companies in developing quality control systems could be undertaken by private organizations.

50. The establishment of appropriate standards for health and safety, consumer protection, and environmental protection -- along with the strengthening of enforcement capability -- would not only reduce the uncertainty caused by the existing regulatory vacuum in these areas, but also contribute towards the upgrading of products, processes, and services. Legislation and enabling regulations in these areas would need review and revision towards international norms. Information disclosure rules would have to be put in place, along with the wider utilization of quality certifications and the emergence of credible and reputable testing laboratories.

51. Finally, the regulatory system should discourage anti-competitive practices. The current legislation regulating competitive behavior -- the Anti-Monopoly and High Cost of Living Act (AHCLA) -- was passed in 1967 and would have to be updated to take into account the market developments of the past three decades. The capacity of the Ministry of Economy and Trade -- the office that is charged with the enforcement of the AHCLA -- would also need to be upgraded.

Improving Public Administration

52. As a result of the war, the current structure and capability of public administration has deteriorated to the point where nothing short of massive restructuring is necessary. Privatization of commercially oriented enterprises can be a major instrument for improving efficiency in many economies. In Lebanon, the environment -- characterized by shortages of financial and human resources in the public sector -- provides a favorable basis for realizing the benefits of privatization. Several assets and projects -- the tobacco enterprise, the airline, the oil refineries, the tank farm, the establishment of industrial parks, EPZs and FTAs -- could be privatized without much complication. Other privatizations -- such as infrastructure services -- may require the establishment of explicit, transparent, and credible regulatory arrangements. What is needed is a comprehensive review of the assets, services, and functions that could be privatized, and a systematic -- rather than ad hoc -- approach to privatization. Some services which would have to remain the responsibility of the public sector could be contracted to the private sector. This would have the effect of not only improving efficiency in service provision, but also allow the Government to focus on its core functions.

53. There are many short term measures that could be undertaken to improve the efficiency of public administration. Contracting services to the private sector would achieve efficiency gains, as long as the contracting process is merit and market based. Creating "islands of efficiency" by focusing on the institutional development of a few critical offices would provide a quick response to private sector clamor for improved services, while longer term solutions are being designed. Several procedures could be streamlined, including the elimination of several licensing requirements.

54. Fundamental restructuring of the civil service is necessary -- one cannot indefinitely run a public administration that is characterized by an inefficient core surrounded by islands of efficiency. Longer term measures would have to tackle the upgrading and rationalization of staff, reorganizing the structures of public administration, and streamlining administrative procedures. This requires a clear view of the role of Government and an appropriate choice of management systems and technology.

Developing a Competitive and Responsive Financial System¹³

55. Attaining high rates of growth requires a flexible financial system, capable of mobilizing large amounts of resources and allocating them to the private sector at low costs and in a wide variety of terms and conditions. Currently, the financial system is allocating most of its resources -- at the margin -- to the public sector, and the resources that are being provided to the private sector are concentrated on a small number of borrowers at extremely short maturities. Improving the responsiveness of the financial system would have to address three main issues.

56. First, the institutional setting inherited from the war is inadequate for ensuring effective debt collection. The legal structure for debt collection and the mechanisms to enforce them are inadequate -- the court procedures are too long and complex, and enforcement is uncertain and at times dangerous. The information network is deficient -- financial statements are unreliable and current information is limited to a small number of customers. While banking regulations have been put in place based on Basle principles, supervision capacity remains weak. These aspects of the institutional setting would have to be strengthened.

57. Second, the banking system lacks the skills to lend money prudently in a modern market as well as to provide financial services required by a globalized economy. Deficient credit risk analysis leads to concentration of lending to a few, known customers, as well as to the Government. Expansion of lending to the private sector in general -- and to SMEs in particular -- requires the upgrading of credit evaluation skills. Three actions could be undertaken. One, training efforts could be intensified -- the Association of Bankers could play a major role in this initiative. Two, accounting and auditing systems should be strengthened, which should be reinforced by regulations or legislation on disclosure of financial information. Three, competition could be enhanced by reducing Government borrowing and developing capital markets.

58. Third, the supply of domestic long term savings is grossly inadequate for financing a sustained and rapid rate of economic growth. Actions in three areas would improve domestic savings mobilization. The stock exchange should be developed by creating the regulatory framework and related institutions -- the establishment of a supervisory institution along the lines of the US Securities and Exchange Commission should be considered. The supply of long term funds could be increased through the reform and privatization of the pension system, and the development of mutual funds and the life insurance industry. Finally, market solutions to the problem of long term credit should not be undercut by subsidized and Government sponsored specialized financial institutions. The specialized financial institutions should be privatized, eliminated, or converted into a single apex institution lending to other financial institutions, rather than directly to retail clients.

¹³ For a more detailed analysis, see World Bank, Lebanon: Financial Policy for Stabilization, Reconstruction, and Development, July 1994.

Increasing Private Participation in Infrastructure Services

59. During the 17 years of war, due to the lack of basic services which were not provided by the Government, the people responded by turning increasingly to private sector solutions such as self-contained private telecommunications systems or diesel generators. Building on these initiatives, the Government decided to increase the role for the private sector in infrastructure financing, management, and operation. The Government is still reluctant to privatize and transfer majority ownership of utility services to the private sector. Thus, its approach has been to introduce private participation through three main avenues: BOT concessions (mobile telephone), contracting out (garbage collection), and twinning/technical assistance (electricity and telecommunications).

60. Privatization is in the Government agenda in the medium term. Privatizing the provision of infrastructure services has several advantages. It allows the already taxed government capacity to focus on critical functions that the private sector cannot perform. It expands investment opportunities for private sector resources. Finally, privatization alleviates the fiscal problem.

61. However, privatization of infrastructure services requires in many cases the adoption of a new legal framework and the formulation of regulatory structures. While there are no legal constraints to private sector participation, the lack of a concession or privatization law limits private sector involvement to the BOT scheme and its variants. A new regulatory framework is needed to encourage competition, regulate monopolies, rationalize pricing, and protect consumers. The effectiveness of regulations is dependent on the ability and independence of the regulatory commission. In the case of Lebanon, size considerations argue for a single Utility Regulatory Commission to cover all utility sectors.

62. The size of infrastructure investments and the importance of the regulatory regime to the viability of infrastructure projects create the need for a mechanism that allows private sector financiers to unbundle risks and secure insurance against non-commercial risks. The existing National Investment Guarantee Corporation (NIGC) could be strengthened and revitalized as an institution to cover political and policy risks.

63. To coordinate Government actions and ensure that priority projects that are found to be suitable for private sector participation are prepared for public tender, a new unit -- the Secretariat for Infrastructure Development and Investment in Lebanon (SIDIL) -- could be created in the Council for Development and Reconstruction (CDR). Priority actions of SIDIL could include: issuance of guidelines for BOO/BOT projects, distribution of guidelines to the investment community, and establishment of procedures for acting upon project proposals.

Upgrading the Skills Base Through Effective Training

64. Developing the country's skills base is critical to the process of achieving competitiveness, not only because skills are capable of continuous growth but also because they are critical to the process of innovation and technological upgrading. However, the current training system is obsolete in design, physically run down, and full of implementation errors.

As a result, the private sector does not have the requisite trained labor to compete -- the survey results indicate significant gaps in requirements and supply of various types of skills.

65. A major and fundamental issue is the position of occupational preparation vis a vis the academic curricula. The current system offers vocational and technical preparation in conjunction with academic secondary curricula, which results in students not having the requisite preparation to compete for higher education, lacking the intellectual stature and technical knowledge to become technicians who supervise the work of others, and not learning a trade that would allow them to become skilled workers. Lebanon would have to consider a model that separates academic education from vocational and technical training.

66. The wide range of requirements in the economy should allow the emergence of a diversity of training systems. Traditional crafts would continue to utilize apprenticeship programs. More sophisticated industries could organize apprenticeships along the lines of the German Dual system, combining training in enterprises with training in conveniently located vocational schools. Post secondary solutions could also be devised, but their effectiveness would depend on ability of schools to adapt to market conditions. Business associations could also organize training programs, as is currently being envisioned by the Chamber of Commerce and Industry in conjunction with French counterparts.

67. The most pervasive feature of the Lebanese vocational and technical schools is their distance from the labor market. Curricula are obsolete or irrelevant. The most immediate and urgent need is to create links with industries that are the major employers of graduates of training institutions. Through employers' associations, firms should be able to better convey their requirements. In addition, entrepreneurs should be more active participants in school boards and communicate more often with school staff. There are a variety of avenues through which firms can voice their complaints about the responsiveness of training institutions, and more important, work out solutions to improve the quality of training.

68. There are several actions that could be undertaken immediately, while the fundamental changes in the approach to training are being reviewed. Employers' associations could offer training programs -- either directly or by collaborating closely with training institutions. Enterprises could improve their in-house programs with the help of training institutions. Large Government contracts could include training as one of the components. Finally, the Government could improve its system of certification and standards.

Developing the Information Infrastructure

69. The process of globalization has made information an important competitive tool, resulting in increasing information intensity in almost all sectors. As economies advance, the information sector itself -- media, communications, consulting services, and information technology -- grows at a faster pace. To move towards an information based economy, the Government and the private sector would have to devise policies, legislation, regulations, and institutions to develop and foster a conducive environment for growth.

الجمهورية اللبنانية

مكتب وزير الدولة لشؤون التنمية الإدارية
مركز مشاريع ودراسات القطاع العام

70. An appropriate legal framework is a necessary element in laying the basis for an information based economy. Lebanon needs to strengthen legislation in three areas: intellectual property rights, confidentiality, and liability. Legislation on intellectual property rights should cover copyrights, patents, and trade secrets. In addition, there should be legislation covering product, service, and financial information disclosure.

71. To be effective, the information sector would have to maintain appropriate standards of reliability and timeliness, at the same time establishing ethical standards. The private sector should establish self-regulatory mechanisms, using business and professional associations as vehicles. Standard setting should also be driven by the private sector, and should be voluntary. Linkages with international groups would ensure incorporation of international standards in Lebanon.

72. An efficient telecommunications network provides the mechanism through which information is transmitted and shared. The Government plans to improve the penetration rate for telephone services, with BOTs recently awarded to two foreign firms for the establishment of mobile telephone services. Privatizing telecommunications services in the context of an appropriate regulatory framework is the best strategy for ensuring responsiveness to private sector requirements. Value added services should continue to be privatized and made subject to competition. An important issue is that of frequency management -- the Government should look into market mechanisms for allocation.

73. The public sector would have to improve its own information generating and diffusion capacities. Institutional development of the Central Administration of Statistics is a priority -- this would provide information to both the policy makers as well as the private sector, who would use the information to provide value added services. The computerization of the Commercial Registry would improve information diffusion, enhancing markets in the process. Statistics from offices such as Customs and Taxation can have significant value.

74. Private sector organizations can play an important role in information processing and dissemination. The business associations can provide information services to their members on a wide range of topics -- trade procedures, regulations, legislation, statistics, investment opportunities, etc. Universities and institutes can be major sources of information on technological developments. Consulting and information service companies should be able to commercialize information by value adding activities.

Supporting Business Development

75. One of the means of achieving competitiveness -- especially for SMEs -- is the development of clusters of intermediate products, services, and ancillary industries. The creation of an SME network allows a group of businesses to collaborate with the objective of securing some of the benefits of large firms while maintaining the flexibility of small operations. Networks have worked in several places, among them Italy, Denmark, and Sweden. The process of building the network in these countries was entirely private sector, although in some cases seed money was provided by the government. Networks could either be sectoral or locational, but the end objective was the setting up of a "hub" which coordinates common

activities (such as training, technology, information, or standards) of network firms. A broker - typically a respected retired entrepreneur -- guided the process. Lebanon could pilot such a program.

76. The establishment of industrial parks and creation of export processing zones are other mechanisms that encourage the creation of clusters and allows cost sharing, resulting in increased efficiency. Establishing industrial parks provides firms alternative sites without firms having to incur major investments in infrastructure and utilities. The growth of manufacturing firms that were established during the war in residential areas has created a demand for suitable alternative sites, not only because existing sites could be utilized more efficiently for some other purpose, but also because renewals of manufacturing licenses in the same location are becoming difficult as municipalities begin to apply zoning and environmental regulations. Export processing zones target mainly export manufacturers by providing them with an environment that is as close as possible to a free trade status. To ensure that industrial parks and export processing zones are client-oriented and run on commercial principles, the private sector should take the responsibility and bear the commercial risk for developing and managing parks.

Maintaining Macroeconomic Stability and Competitive Conditions

| Policy Area | Policy Objective | Short Term Actions | Medium Term Actions |
|-----------------------------------|--|---|--|
| Fiscal Policy | Achieve macroeconomic stability by cutting the fiscal deficit. | <ul style="list-style-type: none"> ■ Tap private sector in financing and implementing Government investment projects | <ul style="list-style-type: none"> ■ Privatization of public assets and enterprises ■ Private provision of public services and selected Government functions |
| Monetary and Exchange Rate Policy | Ensure consistency in current policies. | <ul style="list-style-type: none"> ■ Liberalize interest rates and allow flexibility in exchange rate adjustments to respond to market forces. ■ Develop indirect monetary control instruments | <ul style="list-style-type: none"> ■ Consider adopting a currency board |
| Taxation Policy | Enhance revenues without creating distortions. | <ul style="list-style-type: none"> ■ Improve tax administration. | <ul style="list-style-type: none"> ■ Design and implement a broad based sales tax ■ Eliminate some of the tax holidays |
| Trade Policy | Simplify and liberalize trade regime. | <ul style="list-style-type: none"> ■ Reduce number of tariff rates. ■ Convert nomenclature to international convention. ■ Align customs exchange rate to market rate. ■ Streamline customs administration and procedures. | <ul style="list-style-type: none"> ■ Eliminate import and export licensing requirements except for special items such as drugs and firearms |

Improving Efficiency of Public Administration

| Objective | Short Term Actions by Public Sector | Medium Term Actions by Public Sector | Actions by Private Sector |
|--|--|---|--|
| Streamline operations by shedding activities that could be performed by private sector | <ul style="list-style-type: none"> ■ Review all Government operations, determine those that could be privatized, and design a program for privatization and private provision. ■ Implement privatization of those assets, services, and enterprises that could be transferred to the private sector without complications. ■ Contract to private sector selected public services. | <ul style="list-style-type: none"> ■ Put in place legal and regulatory framework to enable privatization of assets, services, and functions with monopoly characteristics. | <ul style="list-style-type: none"> ■ Bid for Government assets, enterprises, and provision of services ■ Develop financial vehicles for larger projects. |
| Implement efficiency enhancing measures | <ul style="list-style-type: none"> ■ Focus on improving critical offices by creating "islands of efficiency". ■ Develop mechanisms for responding quickly to private sector complaints. | <ul style="list-style-type: none"> ■ Design and implement structural reform of public administration focusing on upgrading and rationalizing staffing, developing an appropriate organizational structure, and streamlining administrative procedures. | |

Creating A Regulatory Platform for Competitiveness

| Regulatory Area | Short Term Actions by the Public Sector | Medium Term Actions by the Public Sector | Actions by the Private Sector |
|--|---|---|---|
| International Trade | <ul style="list-style-type: none"> ■ Eliminate import and export licensing requirements, especially for manufacturing capital equipment. | | <ul style="list-style-type: none"> ■ Design, finance, develop, and manage EPZs and FTAs. |
| Improve Efficiency and Enforcement Capacity of Regulatory Offices | | <ul style="list-style-type: none"> ■ Modernize the operations of Customs, Taxation, Commercial Registrar, Consumer Protection, Health and Safety, Environment, and Zoning offices. ■ Hire minimum complement of competent personnel in above offices. | |
| Develop internationally recognized quality standards for products and services | | <ul style="list-style-type: none"> ■ Devise approach to standard setting emphasizing private sector driven voluntary standards. ■ Develop a limited number of mandatory standards in consultation with Ministry of Health, Consumer Protection Office, and Environmental Office. ■ Strengthen LIBNOR and Industrial Institute. | <ul style="list-style-type: none"> ■ Develop and implement internationally consistent standards through current or new associations. ■ Establish linkages with international accreditation organizations. ■ Develop testing and research capability. ■ Design and implement promotion and training initiatives. |

Creating A Regulatory Platform for Competitiveness

| Regulatory Area | Short Term Actions by the Public Sector | Medium Term Actions by the Public Sector | Actions by the Private Sector |
|--|---|--|--|
| Develop and implement consumer protection and health and safety policies | <ul style="list-style-type: none"> ■ Review regulations and procedures and strengthen offices of Consumer Protection and Health and Safety. ■ Establish linkages with consumer and producer associations including the formation of a Consumer Protection Council composed of both public and private sector representatives. | <ul style="list-style-type: none"> ■ Review and modernize relevant legislation, especially on information disclosure and penalties. ■ Improve information dissemination and use credible testing facilities. | <ul style="list-style-type: none"> ■ Participate in development of legislation and regulations. ■ Assist firms in compliance. |
| Develop and Implement Environmental Policies | <ul style="list-style-type: none"> ■ Seek assistance in the development of appropriate environmental policies. | <ul style="list-style-type: none"> ■ Develop legislation and regulations. ■ Strengthen office of environmental protection. | <ul style="list-style-type: none"> ■ Participate in process of developing policies, legislation, and regulations. ■ Incorporate environmental considerations in the design of industrial parks and EPZs. |

Restructuring the Training System

| Area of Reform | Short Term Actions by the Public Sector | Medium Term Actions by the Public Sector | Actions by the Private Sector |
|---|---|--|---|
| Basic Education | <ul style="list-style-type: none"> ■ Review structure of basic education. | <ul style="list-style-type: none"> ■ Restructure system of basic education. | |
| Certification | <ul style="list-style-type: none"> ■ Strengthen certification of graduates of training institutions. | | <ul style="list-style-type: none"> ■ Participate in certification of graduates of training institutes. |
| Labor Markets | <ul style="list-style-type: none"> ■ Remove distortions in labor markets to create incentives for workers to upgrade skills. | | |
| Linkage Between Training Institutions and Enterprises | <ul style="list-style-type: none"> ■ Include private sector in formulation of curricula and teaching methods of training institutions. | | <ul style="list-style-type: none"> ■ Participate more actively in policies of training institutions, public and private. ■ Business Associations should play a more active role in several ways: supply certain training courses directly, coordinate members' requirements with other training institutions, and educate firms on the value of training. |
| Role of Foreign Firms | <ul style="list-style-type: none"> ■ Include training as one of the bases for Government contracts. | | |
| Training in Enterprises | | | <ul style="list-style-type: none"> ■ Improve effectiveness of internships. ■ Develop in-house training capacities, contract out training, or send employees to reputable training institutions. ■ Pay on the basis of skills and performance. |

Developing the Information Infrastructure

| Policy Area | Short Term Actions by the Public Sector | Medium Term Actions by the Public Sector | Actions by the Private Sector |
|------------------------------|--|--|---|
| Intellectual Property Rights | <ul style="list-style-type: none"> ■ Modernize legislation on intellectual property rights taking into account international practices. | <ul style="list-style-type: none"> ■ Develop regulations and enforcement capability. | |
| Information Disclosure | <ul style="list-style-type: none"> ■ Pass legislation and develop regulations to ensure disclosure of appropriate financial, product, and service information. | | <ul style="list-style-type: none"> ■ Development of Accounting and Auditing Systems. |
| Public Information | <ul style="list-style-type: none"> ■ Define information to be generated by the public sector and develop production and dissemination capacity. | <ul style="list-style-type: none"> ■ Build supply links to private sector "value added" information services. | <ul style="list-style-type: none"> ■ develop value added information services. |
| Public Sector Institutions | <ul style="list-style-type: none"> ■ Modernize information generating and disseminating capacity of Central Administration of Statistics, Commercial Registry, Customs, and Taxation. | | |
| Standards | <ul style="list-style-type: none"> ■ Participate in standard setting initiatives of private sector through Lebanese Informatics Council. | | <ul style="list-style-type: none"> ■ Drive the development of voluntary standards. ■ Develop self-regulatory mechanisms. ■ Create Lebanese Informatics Council with public sector participation. |
| Skills | | <ul style="list-style-type: none"> ■ Academic education should provide the foundation for the constant upgrading of information related skills. | <ul style="list-style-type: none"> ■ Develop training systems. ■ Universities to review programs. ■ Development of Accounting and Auditing Professions. |
| Telecommunications | <ul style="list-style-type: none"> ■ Design appropriate frequency management systems, using market approaches to allocation. | <ul style="list-style-type: none"> ■ Develop policies for competitive environment in provision of data and telecommunications services. | |

Increasing Private Participation in Infrastructure Provision

| Policy Objective | Short Terms Actions by the Public Sector | Medium Term Actions by the Public Sector | Actions by the Private Sector |
|---|---|--|--|
| Increase Methods of Private Participation | <ul style="list-style-type: none"> ■ Adopt a Concessions Law. | <ul style="list-style-type: none"> ■ Increase private participation in Electricity and Telecommunications. | <ul style="list-style-type: none"> ■ Set up investment vehicles to attract funds. |
| Develop Regulatory Framework | <ul style="list-style-type: none"> ■ Restructure existing regulations. | <ul style="list-style-type: none"> ■ Set up one regulatory body for all utilities. | |
| Mitigate non-commercial risk | | <ul style="list-style-type: none"> ■ Strengthen and revitalize the National Investment Guarantee Corporation. | |
| Facilitate Privatization | | <ul style="list-style-type: none"> ■ Establish a dedicated Secretariat for Infrastructure and Investment in Lebanon in CDR. | |

Modernizing the Legal System

| Area | Short Term Actions by the Public Sector | Medium Term Actions by the Public Sector | Actions by the Private Sector |
|-----------------|---|---|--|
| Judiciary | <ul style="list-style-type: none"> ■ Strengthen Judiciary through appointment of competent judges and improving training especially in commercial legislation. | <ul style="list-style-type: none"> ■ Upgrading facilities such as the law library. | |
| Arbitration | | | <ul style="list-style-type: none"> ■ Develop capabilities for arbitration, including programs in Chambers and Associations. ■ Educate firms, especially SMEs, on the use of arbitration and provide assistance including design of standard forms and clauses. ■ Upgrade skills of legal profession in commercial and international laws. ■ Develop self-regulation systems. |
| Property Rights | <ul style="list-style-type: none"> ■ Improve property acquisition laws applicable to foreigners by expanding options such as long term leasehold. ■ Enact legislation for mandatory cadastration. | <ul style="list-style-type: none"> ■ Improve intellectual property rights legislation. | |
| Competition | <ul style="list-style-type: none"> ■ Enact legislation lifting rent controls. ■ Repeal Agency Law. ■ Eliminate requirement that majority of members of the company boards be Lebanese. | | |
| Information | <ul style="list-style-type: none"> ■ Pass information disclosure laws. ■ Improve operations of Commercial Registrar. | | |

Developing the Financial System

| Objective | Short Term Actions by the Public Sector | Medium Term Actions by the Public Sector | Actions by the Private Sector |
|---|---|--|---|
| Improve Information Flow | <ul style="list-style-type: none"> ■ Develop legislation and regulation on financial disclosure. | | <ul style="list-style-type: none"> ■ Develop and implement international standards for accounting and auditing. ■ Upgrade accounting and auditing skills. ■ Establish self regulatory mechanisms for information industry including accountant and auditors. ■ Set up credit rating agencies. |
| Develop regulatory framework that allows for financial innovation | <ul style="list-style-type: none"> ■ Review existing regulations on banking, insurance, and listed companies. | <ul style="list-style-type: none"> ■ Define approaches on regulating issuance of all forms of securities in money and capital markets, including the feasibility of setting up an independent agency to supervise capital markets along the lines of the SEC in the US. ■ Improve regulatory capacity. | |
| Privatization of the Financial System | <ul style="list-style-type: none"> ■ Privatize and remove special privileges for the Development Bank for Industry and Tourism, the Agricultural Bank, and the Housing Bank. ■ In the interim, use the Development Bank as an apex institution. | <ul style="list-style-type: none"> ■ Develop a private pension system to increase the supply of long term funds. ■ Review public pension system. | <ul style="list-style-type: none"> ■ Develop capacity to manage private pension funds. |
| Improvement in Institutions Relating to Debt Collections | <ul style="list-style-type: none"> ■ Improve judicial capacity and review relevant legislation. | | <ul style="list-style-type: none"> ■ Use arbitration channels where possible to address debt collections |
| Upgrading Skills | | | <ul style="list-style-type: none"> ■ Develop programs through associations to upgrade financial skills in both financial and nonfinancial institutions. |

Supporting Business Development

| Area | Short Term Actions by the Public Sector | Medium Term Actions by the Public Sector | Actions by the Private Sector |
|--|--|--|---|
| Role of Business Associations | | | <ul style="list-style-type: none"> ■ Take active role in providing support services to members including information dissemination, training, export promotion, and investment promotion. |
| Role of Independent Research Institutions and Technical Laboratories | | | <ul style="list-style-type: none"> ■ Establish linkages with businesses to better provide services on technology development and dissemination. |
| Role of Universities and Other Educational/Training Institutions | | | <ul style="list-style-type: none"> ■ Respond to requirements of the private sector through closer coordination and stronger linkages, especially in areas of management training, skills upgrading, and advanced research. |
| Industrial Estates and Export Processing Zones | <ul style="list-style-type: none"> ■ Develop clear zoning and environmental regulations ■ Review enabling legislation. | | <ul style="list-style-type: none"> ■ Private sector to develop industrial estates and EPZs. |
| Small Enterprise Networks | | | <ul style="list-style-type: none"> ■ Develop small enterprise networks to achieve economies of scale. |

Republic of Lebanon

Office of the Minister of State for Administrative Reform

Center for Public Sector Projects and Studies

(C.P.S.P.S.)

الجمهورية اللبنانية

مكتب وزير الدولة لشؤون التنمية الإدارية
مركز مشاريع ودراسات القطاع العام

END