THE IMPACT OF THE ASSOCIATION AGREEMENT WITH THE EUROPEAN UNION ON LEBANON

Executive summary

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This executive summary presents the major results from the assessment study of the impact of the Association Agreement between the European Union and the Lebanese Republic on the Lebanese economy. The outline of the document is as follows. In Part 1, the macro-economic background to the AA is presented, along with a discussion of the expected global impact as has generally been presented in the literature. Because the impact of the Agreement is likely to be significantly different for the various sectors of the Lebanese economy, a detailed overview of the impact is provided in Part 2, in the form of sectoral analyses. Part 3 presents the results of a more general approach to modelling the impact of the Association Agreement, based on a Computable General Equilibrium Model. Part 4 is the conclusion.

1 The Association Agreement and the macro-economic environment

1.1 Introduction

The post-war economy in Lebanon since 1992 has been characterised by a monetary and exchange rate stabilisation policy, high interest rates, budget deficits, and an improvement in the capital inflows including foreign direct investment. Almost half of total budgetary revenues comes from taxes on international trade and about 50% of imports originate in the European Union (EU).

Since the end of the war, Lebanon has built up an ambitious program of economic reconstruction and stabilisation. The reconstruction increased the net public debt from 38% of GDP at the end of 1993 to about 97% in 1997 and by early 2000 the ratio was 140%. On the other hand, fiscal revenues represent 17% of the GDP and the tax to total revenue ratio remains below international standards. As a result, the Lebanese government is now trying to deal with major problems that have arisen with this policy: slowdown of economic growth, large public debt, budget deficit, a large current account imbalance as well as high interest rates paid on the Lebanese Pound. The government therefore has a double objective: correct the fiscal imbalances and stimulate economic activity. The 1999 budget was particularly austere and also introduces a global fiscal reform.

The Lebanese private sector faces both institutional obstacles as well as structural constraints that limit economic growth. It suffers from poor economies of scale, very high local interest rates due to the strong linkage between the Lebanese Pound and the US dollar which has reduced the competitiveness of Lebanese products, as well as a lack of investment in industry and in R&D. More generally, the fact that the actual economic policy of the Lebanese government is driven by monetary considerations is considered a major drawback for private managers.

One feature that has emerged most clearly during this study is the duality of the Lebanese economy. On one hand, a wealthy working population, mainly localised in Beirut and the coastline, benefits from a modern infrastructure which is rapidly recovering, the pre-eminence of Lebanese emigrates and the strength of the service sector – especially banking, which is already largely liberalised.

On the other hand, a majority of the population outside Beirut is shifting away from the "European standard of living" and suffers from the weaknesses and lack of competitiveness of the agricultural and industrial sectors. Moreover, this population is still directly affected by the instability in the South and the lack of productive investment due to the absence of a general peace settlement in the region.

It is not the priority of the Lebanese government to reduce these inequalities in the short run, as its policy is much more focused on the maintenance of the exchange rate between the Lebanese Pound and the US dollar and the reduction of the public deficit that on the strengthening of non competitive sectors. This choice to drive the economy on purely monetary considerations has led to an almost unique economic situation which does not compare with any other country, especially in the Mediterranean area.

1.2 The Agreement Association between Lebanon and the EU

1.2.1 *The nature of the Agreement*

The regional trade agreement - which is still the subject of discussion between Lebanon and the EU - is expected to significantly affect the Lebanese economy at both the fiscal and welfare levels.

The Euro-Med Agreement (EMA) concerns mainly the total dismantling of trade tariffs between the EU and the countries involved and for Lebanon includes an important provision for the liberalisation of the right of establishment and trade in services. The agreement does not prevent parties from applying their laws and regulations regarding entry, work, and other labour-related conditions. The agreement does not impose the liberalisation of the right of establishment on both parties.

One of the key points of the Association Agreement - which is the subject of important discussions by the Lebanese side - is the issue of the "rules of origin". For products to be considered as originating in Lebanon on one hand or the EU on the other, they have to be either fully obtained or to have undergone sufficient processing in the country of origin. The list of fully obtained products includes for instance, mineral water, live animals born and raised there, and products from live animals raised there. On the other hand, products that are not fully obtained are considered "sufficiently worked and processed" when a set of conditions is met. There are as well major causes that would render a sufficiently worked or processed product insufficient. The accumulation of origin is applicable in the Lebanese agreement: inputs from Algeria, Morocco, Tunisia, Jordan, Israel, Cyprus, Malta, Turkey, the Palestinian authority and Syria are all considered as originating in the Euro-Med zone.

1.2.2 *The expected impacts of the Association Agreement*

One of the main characteristics of the Association Agreements with the EU is the acknowledgement of the important role for dynamic effects flowing from investment, both domestic and foreign. The level of FDI (foreign direct investment) coming into Lebanon has been increasing at a fast rate since the end of the war. In 1997, according to the World Bank Development indicators, the ratio of FDI to GDP was 1% compared to 0.1% for the MENA region.

Measuring the exact fiscal impact on Lebanon as a result of signing the Euro-Med. Agreement with the EU is subject to large margins of error, but the revenue impact is likely to be the most important for Lebanon. From a fiscal viewpoint, the direct and immediate loss in total revenue resulting from the total dismantling of tariff on trade is about 25%.

As for the welfare impact, consumers are expected to be better as a result of lower prices, while some producers will be worse off because they will not be able to withstand the increased competition. On the export side, the welfare effects could be small since Lebanon already enjoys free access to the EU market for most industrial goods since 1978 – and most Lebanese exports to the EU are industrial goods.

It is also expected that the end the phase of post-war reconstruction will lead to an increase in investment in more productive sectors, leading to more efficiency, improved services, and the removal of bottlenecks. With such major changes, Lebanon's competitiveness is expected to increase, thus reducing the impact from external competition brought about by the Euro-Med. trade liberalisation agreement.

Liberalising trade with the EU is expected to facilitate the inflow of FDI, which in turn will help in the transfer of new technology and know-how to Lebanon. Under a regional trade agreement, the member countries are expected to increase intra regional trading but also intra regional investments. The numerous technical assistance projects listed in the *"Measure d'Accompagnement" of* the Association Agreement or the *MEDA* program are another medium for the transfer of know-how. Additional funding is promised under MEDA II for industrial modernisation and fiscal reforms as well as technical assistance in preparation for accession to the WTO.

Last, a trade agreement would also boost the credibility of Lebanon on the world market and the country would learn from this first experience how to be sufficiently competitive to compete at the world level and benefit from this new status as part of a wider euro-med free trade area to borrow on the international market and attract new investors.

2 The sectoral approach

2.1 The service sector

Lebanon is mainly a service country, especially in banking. This sector employs three quarters of the working population compared to less than 10% working in agriculture and 15% in industry. Thus the place of services in the economy is much more important than any other sector in GDP and it is a clear that Lebanon relies much more on services to compete with the outside world than in other countries. This situation is quite different from the one prevailing in other Mediterranean countries and explains the relatively low interest of the government in strengthening other sectors.

On the other hand, the importance of this sector does not imply that data collection for the impact analysis is easier than for other sectors. Indeed, the service sector is the most difficult one to evaluate quantitatively, partly because part of the information is kept secret, which means that quantitative results concerning the service sector are hard to obtain. Nevertheless it appeared to be quite relevant that from a qualitative viewpoint (knowledge transfer, training, new opportunities, etc) the services sector would significantly profit from the Association Agreement.

This part of the report presents the foreseeable effects of the impact of the Association Agreement, being negotiated between Lebanon and the European Union, on the service sector. Before presenting the impact on the majority of the subsectors defined according to the detailed classification of the WTO, the methodology is explained and the general framework for the negotiations on services is discussed.

2.1.1 Summary of the nature of the impact of the Association Agreement on services

In the following table, positive and negative effects of service liberalisation are identified. The different effects will vary both in terms of their scale and their timing.

Impact of the Association Agreement	Balance of payments	Factor movements	Competition
Positive	-Service exports Increase of factors income - Capital - Wages - FDI from foreign countries	-Technology transfers related with FDI - Transfers of know-how due to training acquired abroad - Improvement of quality standards	- Limitation of distortions - gains for the consumer - gains as regards competitiveness
Negative	- FDI towards foreign - Service imports		- Risk of disappearance for local service suppliers.

2.1.2 Legislative and regulatory aspects of the Association Agreement on Lebanese law.

At the time of the mission, the Association Agreement was still under discussion. The text regarding services is still a draft whose contents have to be redefined and supplemented.

Lebanese restrictions contained in the legislation on services cover mainly the conditions of nationality. Numerous sectors are prohibited to foreigners, and strong restrictions on the share of Lebanese in the Boards of Directors, the share of the actions which have to be held by legal or physical Lebanese entities in the public limited liability companies, constitute many obstacles to the liberalisation of services. Another important restriction relates to acquisition.

The general principles of the GATS are not in contradiction with the maintenance of many such provisions. However, it is mainly the lifting of this type of provisions that could be considered as a set of concessions that Lebanon could grant. It is impossible at present to have an idea of the extent of the concessions that will be made.

All the previous elements do not enable us to build a precise set of hypotheses. It is possible that the Agreement leads to some modifications without genuine effects as it is possible (but in our opinion, not very likely) that the principal nationality restrictions are raised. Our working hypothesis is rather the latter case, namely a genuine opening movement. Even under this extreme scenario, the impact on Lebanese economy will not be too negative.

2.1.3 Impact of the Agreement

To describe the impact of the Association Agreement on services, several categories are distinguished according to two criteria: a positive or a negative impact of liberalisation (short, medium and long term) and the export potential.

Regarding the high degree of competition and the role of the private sector in services in Lebanon, the impact of the agreement will be felt mainly on the balance of payments and more exactly on exports. Among the various effects of liberalisation (see table below.) it is therefore more relevant to devote our attention to the export potential. This also answers one fundamental question concerning the point of including services in the Euro-Med association agreements, namely, will increased export of services compensate for a possible increase in deficits on goods trade.
We distinguish between services with weak, average, or strong potential for export. Combining these two criteria, one obtains new categories that enable us to classify services.

Services		Potential for export		
		Weak	Average	Strong
Impact of the agreements	Positive in the short run	Retail trade; Ancillary services to agriculture, to hunting and forestry; fishing, Research-development; Supervising authorities of quality, analysis and inspection of the materials	Congress services;	Wholesale trade.
	Positive in the medium and long run	Maintenance and repair services of equipment; Building, cleaning; Preparation and packing services	Legal Services; Accounting services. audit and book-keeping ; Engineering; Urban development and landscape architecture; Integrated engineering services; Insurance and services related to insurance; Insurance broking services; Banking services and other	Services connected with the new economy Computer services and related services Consultation as regards installation of computer equipment; Data processing services; Software construction services; Basic data services; Creation and realisation services on multimedia supports; Market research and

			financial services other than insurance	survey; Impression and publications; Persons' employment office abroad
	Slightly positive or without effect	Postal services; Leasing; Property; Film projection; Press agency services; Ancillary services to the distribution of energy; Photography; Servant; Mail services; Production and distribution of films and video; Garbage collection; Show services; ; Library services; Museums and other cultural services; Commercial vehicle hiring with driver; Maintenance and repair of the means of road transport.	Telephone services; radio and television; construction of building; construction of work of civil engineering; facility and assembly laying work; work of completion and of completion of the buildings; Franchising services; Higher education services; Wards; other human health Services; passengers' maritime carriage; passenger's road carriage; transport by control;	Hotel trade and catering services; Tourist travel agency and organisation services; Tourist guide services; Publicity; Air transport services; Aircraft hiring; Maritime carriage of goods; Hiring; Passenger transport,

2.1.4 The pre-eminence of the positive aspects of service liberalisation

In the analysis of the subsectors, it appears that none of them are threatened by a greater liberalisation and enhanced competition with international service suppliers. The impact of the Association Agreement or any liberalisation on services in Lebanon will be overall positive for reasons that have been mentioned frequently by Lebanese officials and private sector representatives:

-Lebanon has comparative service advantages.
-Lebanon is a developed, liberal and already open service country.
-Lebanon is an intermediate country between the industrialised countries and the Middle East.
-The foreign presence is more complementary than a serious threat for local services.
-Service trade is less fluid and more complex than goods trade.
-The existence of the Diaspora is decisive in the exporting of services by Lebanon.

All these elements show that the effect of service liberalisation does not reduce to only a matter of the dismantling of of tariffs on commodities The effects on the balance of payments or on local producers are therefore weaker and less mechanical, and also more difficult to measure.

2.2 The agricultural sector

The assessment of the impact of the Association Agreement between Lebanon and the European Union on the Lebanese agriculture requires a prior analysis of the Lebanese agricultural sector, which needs to focus on two key elements: the competitiveness of Lebanese agriculture and the structure of trade between Lebanon, the European Union and other trade partners (in particular, other MENA countries.)

2.2.1 *Overview of the analysis on agriculture*

The first part of the analysis examines the structure of the Lebanese agricultural sector, in its production and marketing aspects. After detailing basic facts and figures on input and output decomposition, we propose a productivity assessment based on farm-level data and on trade statistics. This assessment is based in particular upon a detailed breakdown of agricultural production costs, revealing that land rent and labour are important components of production cost. We then present recent trends in food balance and trade flows between Lebanon and its trade partners grouped in three main regions (EU, MENA countries, rest of the world.) This helps in assessing the degree of competitiveness of selected Lebanese agricultural products on foreign markets.

On the demand side, it is necessary to explore household expenditures on food products, as well as the relationship between food consumption and income. To do so, we use results from surveys on household expenditures and on household standards of living in several regions of Lebanon. The institutional framework for agricultural policies in Lebanon is briefly presented, together with recent development and reconstruction projects. Finally, a price decomposition is proposed for a selection of agricultural products, using data on average wholesale and retail margins.

The second part of the analysis is concerned with the evaluation of the impact of the Association Agreement. The methodology employed makes use of import price and trade diversion elasticities for agricultural products, which are important elements for supplying a quantitative answer in terms of import quantities and values. The approach consists in particular in estimating a demand system for imported goods from the European Union and other import regions, in order to compute such elasticities.

The impact of the Association Agreement is evaluated along three different lines. First, we simulate a full reduction in customs tariff rates for EU agricultural imports to Lebanon. The expected increase in demand for these products depends not only on income and price elasticities of individual goods imported from the EU, but also on the degree of trade diversion. Second, we consider the agricultural protocols proposed by the EU and Lebanon in 1998, concerning EU agricultural imports in Lebanon and Lebanese agricultural exports to the European Union. In particular, we compare Lebanese and European proposals (in terms of import quota and customs duty rate reduction) to recent trends in trade flows between both trade partners. Third, we assess the impact of the Association Agreement on the Lebanese agriculture profitability, by exploring the consequence of a reduction in customs duties on major agricultural inputs (machinery, chemical fertilisers.) The methodology used consists in estimating elasticities of substitution between agricultural inputs, both imported and local.

2.2.2 *Summary of major results*

Major constraints on Lebanese agriculture make the transition to free trade problematic for some crops and animal productions, particularly in northern and eastern parts of the country. Credits for rural and agricultural activities are scarce and as a result, productivity remains low on average and switching to higher-value added productions is difficult. Land fragmentation, the high cost of labour and raw materials. and information gaps are also reported. But Lebanon has nevertheless many assets to consider in the future, as crops and animal productions are diversified, and water availability is less a problem compared to other MENA countries.

The impact of the Association Agreement with the European Union on imports to Lebanon will be the following. As expected, trade quantities will increase for a variety of goods, mostly those whose Lebanese production is not sufficient to cover local needs, the rate of increase being less than the reduction in customs duty rates. Trade diversion will be significant with other Arab countries and the rest of the world, mainly on the same products. The rate of change in EU imports will also depend significantly on the expected household income variation during the period considered.

Competition between Lebanese agricultural products and EU imports is likely to be important for some critical commodities, which makes special provisions necessary. We propose three lists of products that may serve as a basis for future agricultural protocols. A first list concerns agricultural products whose protection is required through import quotas or excise taxes over a 10-year period. Non-tariff barriers to trade will have to be replaced by customs duties and/or excise taxes. A second list concerns products for which temporary protection is necessary during the 10-year period, through reduced but constant customs duty rates. And for the third list of products, protection is less needed and the same customs tariff reduction scheme may apply as for other, non-agricultural products.

The consequence of the Association Agreement on agricultural profitability will be positive, as the cost share in imported fertilisers and agricultural machinery will decrease. But this positive impact will be accompanied by a significant reduction in labour demand, as more intensive fertiliser use and technical capital stock are increased. This is because fertilisers and machinery are complementary inputs, both being substitutes to agricultural labour.

2.2.3 *Recommendations*

Suggested recommendations are based on the productivity and competitiveness assessments produced earlier. These recommendations draw upon the major constraints and prospects of the Lebanese agriculture that were discussed earlier. Two broad categories of recommendations are: a) recommendations on trade relations between Lebanon and the European Union, and b) recommendations towards enhancement of the Lebanese agricultural productivity.

Recommendations for accompanying policies to be funded by the European Union are the following. Whenever possible, these recommendations are accompanied by quantitative elements based on recent development projects in Lebanon (already funded or in preparation.)

- Temporary protection from EU imports for selected Lebanese agricultural products
- Explore the possibility for deregulating protected crops
- Promote better marketing information and quality standards
- Encourage vertical integration with the agro-food industry
- Explore the possibility for high value-added products and e-commerce
- Consider incentive-driven tax credit or cost refund schemes for rural activities
- Continue the effort towards technical assistance and research extensions in agriculture
- Develop new rural activities.

2.3 The industrial sector

The objective of this section is to present the results of the analysis of Lebanese industry and of the impact assessment of the Euro-Med Association Agreement. It is inevitably partial because the information that we have provides only a number of snapshots based largely on the censuses of 1994 and 1998 augmented with data on trade and information on the registration of new enterprises. Although the analysis tries to be conjunctural, we are hampered by the lack of more timely data on industrial activity. However, it is unlikely that the features that we have been able to identify will have been reversed since 1998; if anything there is likely to have been a further deterioration.

We have established the following features of Lebanese industry.

- Total industry value added in 1998 was at the same level as in 1994 so that the contribution to national income declined from 18.7 percent to 10.6 percent.
- Within this total, value added in textiles and clothing declined by almost 40 percent. Food products and beverages rose slightly by 2.5 percent, while pulp and paper, printed matter and recorded media, chemicals and metal products increased significantly.

- In 1998, net investment (gross investment minus depreciation) was negative in all major sectors except food products and beverages.

There is a temptation to draw the conclusion that Lebanese industry is in too parlous a state to withstand the effects of more competition from the European Union if tariffs on imports were abolished. However, the difficulties that industry faces are an inevitable consequence of the post-war re-construction programme that has raised real interest rates and crowded out private sector activity. In the pre-war years industry was an important source of export-led growth.

As the re-construction phase comes to an end, and the macroeconomic stabilisation programme pursued by the government brings fiscal policy and the public finances under control, there should be an opportunity for a fall in interest rates and a decline in the exchange rate that will help industry to grow into overseas markets.

Nevertheless, there are features of Lebanese industry that may be an obstacle to growth in the future. The very small size of the vast majority of enterprises is both a blessing and may act as a break on future economic development. The large number of family owned businesses is evidence of the entrepreneurial culture in Lebanon. One solution is to follow the model of Italy where a strong network of family businesses has developed which retain the advantages of family ownership while allowing access to modern technologies. However, given the lack of investment in the last decade it may be too late to pursue this path. Another possibility is to encourage foreign investment in Lebanese industry both from the EU and the Arab world to allow the re-equipping of industry.
However, the uncertain political climate still hampers foreign investment. But if this uncertainty were to diminish, the Association Agreement with the EU covers more than just tariff barriers to trade. It also provides the basis for scientific, technical and technological cooperation, greater integration of Lebanese enterprises into European networks that would be a spur to marketing and faster adaptation to rapidly changing market conditions; and measures to encourage investment by European enterprises in Lebanon.

The changes that need to come about to allow Lebanese industry to recover its former vigour are more likely to happen with the Association Agreement than without it.

3 A global modelling approach

Many kinds of model could have been developed to analyse the impact of the Association Agreement. The choices that have been made for this study have tried to answer the demands of the Ministry of Economy (elaboration of a Computable General Equilibrium model, desegregation by sectors) concerning the behavioural functions (in particular the investment function of each agent), the decomposition of the economy into sectors and sub sectors, the level of desegregation of the economy, the method of closure, etc., in relation to the type of questions which are to be addressed.

3.1 Overview of the analysis

The report also presents the first version of a sectoral, dynamic CGE (Computable General Equilibrium) model which has been built during the mission, designed to evaluate the costs and benefits of the suppression of tariffs on European imports.

The part of the document related to the elaboration of the CGE model has been divided into five sections:

The first section describes the background to the elaboration of the CGE model, as well as the statistical environment present in Lebanon. A short outline of the Lebanese economy and current issues as regards commercial policy is also rapidly sketched.

The second section presents the modelling approach and the theoretical choices that have been made in the elaboration of the CGE model.

The third section has been reserved for the technical description of the model and the presentation of the main equations.

The fourth section presents the results of simulations and in particular for the comparison of the results obtained using the model. Due to the fact that the CGE model built within the framework of this study is only a methodological model, the corresponding conclusions are necessarily very brief. They should be regarded as illustrative rather than definitive results and should not be compared with the results given by the sectoral analysis.

The last section presents the general recommendations for the elaboration of a more sophisticated model to analyse more deeply the impact of the Association Agreement on the Lebanese economy.

The data underlying the model are the provisional accounts for 1997, which were available, but not published yet. These data have been preferred to the official Input-Output table produced by the ACS (Administration Centrale de la Statistique) for the years 1994 and 1995.

All these elements underline the needs for a reinforcement of statistical data results from the construction of this model in order to provide more reliable results.

To support the CGE model, a Social Accounting Matrix (SAM) has also been built, gathering the original 14 sectors of the ACS Input-Output table into the following seven sectors:

- Agriculture,
- Agro-food industry,
- Textile, leather, clothes,
- Minerals, Metals, machinery,
- Wood, chemistry, furniture,
- Other. industries and public works,
- Trade & Services,...),

and six agents :

- Households
- Firms
- Importers and wholesalers
- State
- European union
- Rest of the World.

We stress that this model is only the preliminary step of a much longer work which will have to be undertaken latter on in order to be able to use such a tool for a detailed analysis of the impact of Association Agreement with the European Union. At least one man-year would be necessary to build up a reliable CGE model to analyse at both the macro-economic and sectoral levels the financial and socio-economic impacts of the Association Agreement with the European Union.

3.2 Summary of the major results

Two simulations have been conducted with the CGE model:

the first one made the hypothesis of a suppression of all the trade barriers against European Union in year 2001,

the second one simulated a progressive tariff dismantling from 2001 until 2010.

The quantitative results of the model showed that this liberalisation policy generated relatively significant gains in revenues for households, as lower prices of imports means less expensive intermediary consumption goods for the enterprises and final goods for the households.

Concerning the sectoral results, it appeared that it will be mainly the services sectors and some sectors of the industry which will benefit from the dismantling of taxes on European products, whereas the impact on the agricultural sector will be very weak. But this sector has not been desegregated, and the results of the simulation rely mainly on the price and substitution elasticities computed from the provisory Input-Output Matrix from the ACS. The time period of the mission was too short to corroborate theses elasticities with the calculation made by the agricultural expert, thus the impact on the agriculture sector can only be taken relatively by comparison with the other sectors than in absolute way (positive or negative impact).

On the government side this trade diversion led to a significant net loss of tariff revenues (-23%) which could be only compensated by the introduction of VAT.

Besides, considering some positive impacts which could not be taken into account in this analysis because of lack of time and data, we can also assume that even the protected sectors could take benefit from a liberalisation process as the decrease of the cost of their imported inputs would reduce their production cost and reinforce the competitiveness of their products. In the case where entrepreneurs would take this opportunity to increase investment, this situation could lead to a virtuous circle of modernisation of the Lebanese production apparatus and an increase in Lebanese exports to their Mediterranean neighbours. In view of this complementary analysis, we can assume that the welfare effects could be likely much higher than anticipated in the CGE model, as the main positive impacts of the Association Agreement – mainly on the service sector - could not been quantified.

A second interesting fact given by our dynamic CGE model is that the gains of the Association Agreement also tend to increase every year, which stress the positive dynamic benefit of the Agreement on the whole Lebanese economy. On the other hand, the major positive effects on the Lebanese economy and the fiscal revenues from the introduction of VAT will give to the government more possibilities to support the non competitive sectors.

Nevertheless, a complementary analysis should be carried out to supplement the results of the CGE model. The results act in no point as real predictions and one should be regarding only the amplitude of the effects of the association agreement. The object of this initial work was initially to assess within an applied framework the discussed ambiguous impact of Association Agreement.

4 General conclusion

The Lebanese government is perfectly aware that the Association Agreement follows a general world trend towards liberalisation of markets and institutions, and that it is a necessity for Lebanon to move with this trend since it is a small country with a large services sector already orientated towards the outside world.

In the study of the impact of the Association Agreement, the government was searching for positive arguments to be presented to the sectors which would potentially suffer from the liberalisation of the Lebanese economy.

The results of the model as well as the sectoral studies have clearly shown that some industrial sectors and to a lesser extent the agricultural sector would suffer from the Association Agreement, but this will be largely compensated for by the overall positive results on the competitive sectors and the service sector.

In fact, the general outcome of this study is that the industrial and agricultural sectors will suffer more or less from the Association Agreement due to their lack of competitiveness, the absence of motivation of the entrepreneurs to invest, and the very low increase in export potential of Lebanese products to European countries after the signature of the Agreement. But these negative impacts will be rather marginal in comparison with the forecasting benefits – unfortunately these benefits are more difficult to measure than the negative impacts -. It must also be stressed that this situation also results from the general, monetary orientated economic policy of the government.

As a result, the main challenges for the government will be to assume its choice toward the civil society, to be convincing about the general interest of the Association Agreement for the Lebanese Economy, and to provide help and reconversion programmes for the sectors that will suffer from competition.

This should not be such a difficult task, as Lebanese society is perfectly aware of the importance of signing the Association Agreement. In fact, the reluctance does not seem to concern the Agreement itself, but the way it was proposed to the Lebanese. More precisely, the main discordance was about the rules of origins that were considered too strict and would prevent the reconversion of the agricultural and industrial sectors towards more competitive products.

Unlike countries which have already signed the Association Agreement like Morocco or Tunisia, focusing more their exports to European countries, this study pointed out that Lebanon will not find any advantage with the Association Agreement in this strategy. Lebanon should rather consider the Association Agreement with the European Union as an interesting and positive initial step on the road to a broader liberalisation policy which Lebanon cannot afford to avoid.