

# ***Bloc National Libanais***

**حزب الكتلة الوطنية اللبنانية**



## **Economic Plan:**

***Taking Lebanon From a Developing to an Emerging “Tiger” Economy***

### ***Introduction***

The Lebanese National Bloc is presenting an integrated and comprehensive socio-economic plan that aims for the economic development of Lebanon, a more equitable distribution of wealth, and the integration into an increasingly competitive global economy.

The National Bloc believes in building the capacity of the human capital, Lebanon’s principal resource - including the empowerment of women, increasing productivity, igniting the competitive spirit, and improving standards of living, while at the same time promoting basic principles, such as credibility, competency and the system of checks and balances. For this plan, or any other economic plan, to succeed a number of prerequisites must be adopted *a priori*.

### ***Prerequisites for the Successful Implementation of any Economic Plan***

- A full national sovereignty: A country run by its people for the benefit of its own people;
- A democratic political system built on the principle of checks and balances (separation of powers);
- A national security restored and maintained;
- An independent, modern, and efficient judiciary;
- A political commitment to economic reforms and institution building;
- A credibility of decision-makers: Ethics, competence, and consistency;
- The combating of conflict of interest embedded as a guiding principle;
- A comprehensive, reliable, periodic, and transparent socio-economic statistics.

The National Bloc believes that its socio-economic plan will carry Lebanon from its current developing country status to a vibrant emerging economy while addressing the existing economic challenges, notably the public debt and difficult social conditions.

A number of guidelines in this paper have already been discussed by previous governments and others, but never implemented due to the archaic nature of Lebanese politics, made worse by the destructive nature of Syria’s 30-year domination of all aspects of Lebanese affairs, a situation that effectively thwarted any post-war national growth. Simply by eliminating waste, fighting corruption, and implementing already approved projects, Lebanon can make an immediate and significant change for the better. However this cannot happen unless there is a full commitment from the

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Lebanese people and a competent and credible leadership to move the country forward.

## ***Current Environment***

Up until the time of the assassination of Mr. Rafic Hariri, Lebanon had, for the previous 18 months, enjoyed a relatively robust economic activity, which allowed for the replenishment of reserves, an increase in GDP growth rates, an upsurge in the liquidity of the financial sector, and through swaps and Paris II soft loans, a reduction in the debt service burden and a reversal of the debt dynamics for the first time since the mid 1970s (*Gross debt to GDP dropped from 185% in 2003 to 177% in 2004*). The fact that these positive gains were set back by one, albeit major, incident indicates to some extent that post-war governments have not been able to effectively build the necessary foundations to reduce the vulnerability of the economy to unexpected shocks, nor for that matter set up a sound economic policy to place Lebanon on a path towards sustainable economic growth.

This situation was aggravated by the failure of previous Lebanese governments to implement administrative reforms – especially the privatization program called for by the 2002 Paris II Conference – and to shelve attempts to reverse the current political and social status quo, which has so far been characterized by corruption, red tape, clientelisme, and incompetence. Today, there is a consensus that any political impasse will lead to erosion in international confidence that would precipitate a financial crisis and subsequently a deterioration in socio-economic conditions. It is therefore time to act with vision and tackle problems head on.

Knowing that politics and economics go hand in hand, it is essential to have a socio-economic plan to direct the efforts of all economic players and policy-makers. This will achieve the popular support needed to face and overcome the painful challenges ahead. Any post-election government should be bulging with credible and competent decision-makers who will adhere to the principles and objectives laid out in this paper, and be given free reign to reform, restructure, and rebuild the economic and legal infrastructure of the country.

## ***Headlines: How to Become an Emerging Economy***

- Address short term challenges: Public debt, international oil crisis, and social conditions;
- Integrate into the Global Economy: Reposition Lebanon's pioneering role;
- Adopt a zero-tolerance for public and private sector corruption;
- Increase productivity, eliminate waste, and promote innovation;
- Invest in human capital based on market needs;
- Catch up by modernizing the economic and legal infrastructures;

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- Promote a healthy competitive spirit and culture;
- Develop and target niche sectors;
- Commit to transparent Privatization and Paris II reforms: Regain trust and interest of the international community;
- Deepen capital markets and galvanize financial institutions: Democratize the economy;
- Introduce a new fiscal policy to foster investment and ensure an equitable tax burden;
- Thrive towards a universal but sustainable pension program;
- Institutionalize the relationship with the Diaspora.

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## **I. Public Sector Reform and Decentralization: A Modern and Flexible Government**

### ***Background and Policy***

The Lebanon of the future will have to ensure that the public administration become more of a meritocracy. In Western countries, particularly in Europe, the public sector is the major source of employment amongst the youth and specialized professionals. In Lebanon, the abysmal image of the public sector is fueled by incompetence and by the lack of accountability of civil servants, a minority of which believe in the principle of serving the interests of the people. An efficient, competent, and modern public administration would be key in attracting foreign investments, creating jobs, and restoring confidence in the local economy.

The situation in the Lebanese public sector is not very different than what is observed in many developing countries: red tape, redundant employees, below par productivity, ageing workforce and machinery, and the like. Similarly the suggested remedies are what have been called for by international organizations: reduce the size of the public sector, decentralize decision-making, introduce new technology, reduce contact between employees and citizens to reduce corruption, revamp the civil service, increase productivity, and eliminate inefficient budget-draining programs.

### ***Main Themes***

- a. **Decentralize decision-making and institutions**
  - i. Provide a greater role to municipalities and local governments;
  - ii. Create regional offices for service ministries and bodies with citizen interactions;
  - iii. Develop plans with the objective of electing regional governments;
  - iv. Enforce administrative and financial independence of regional governments.
- b. **Eliminate and/or merge “redundant” public agencies**
  - i. Eliminate unnecessary security agencies;
  - ii. Merge ministries.
- c. **Introduce E-government across all ministries**
  - i. Build on the E-commerce Project (Ministry of Economy) and ratify all related laws including a modern legislation on E-signature;
  - ii. Overhaul and mechanize “paper trail” and paper filing (adopt successful practices in some ministries);
  - iii. Create an “admin development office” within each ministry (terminate OMSAR as a ministry).
- d. **Terminate and/or reform inefficient state subsidy programs:**

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- i. Privatize and/or tailor the tobacco sector to Lebanese products (e.g., Nargileh tobacco);
  - ii. Terminate the sugar beet program and revise or phase out the wheat program;
  - iii. Revise the Export Plus (IDAL) program and ultimately merge program with upcoming “Export Promotion Agency”;
  - iv. Provide direct support to farmers (and not to crops) – the new EU model – and stop using the State as a buyer of last resort of products regardless of quality and market needs.
- e. **Reform the Pension Plan**
- i. Address the end-of-service indemnity and revise packages that are a major drain on the budget;
  - ii. Develop new packages and instruments including private pension schemes.
- f. **Reform public procurement**
- i. Embed transparency and the ‘no discrimination’ principle;
  - ii. Address and develop the role of the intermediary institution(s).
- g. **Fight corruption (public and private sector) and conflict of interest:**
- i. Develop the legal infrastructure;
  - ii. Raise awareness and promote the adoption of a code of ethics.
- h. **Overhaul civil service**
- i. Address redundancies and examine options for early retirement packages;
  - ii. Build capacity and life-long learning: develop expertise, and reduce unnecessary transfer of employees across ministries;
  - iii. Revise working hours and develop/modernize the Civil Service Board;
  - iv. Provide new incentives (e.g., offer project ownership, allow upward mobility of staff based upon merit, entrust responsibilities upon productive staff) to fight corruption and increase productivity.

### ***Suggested Immediate Measures***

1. Re-examine the list of reforms included in the 2005 budget proposal (Minister Seniora 2005 Plan);
2. Revive past decentralization draft laws and plans, and adopt a new municipalities law;
3. Continue the E-government initiative, namely in ministries with work with the public;
4. Streamline unnecessary agencies/ministries such as OMSAR, security bodies, ministry of information (empower the National Audio-visual Council to become a full power regulatory authority) etc.;
5. Adopt e-government plans aimed at reducing interaction between public institutions and citizens, as applied in developed countries.

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## **II. Human and Social Development Policy: An Investment in the Human Capital**

### ***Background and Policy***

Due to fiscal and monetary constraints, successive governments have failed (or overlooked) to devise a socio-economic plan, deposing most of the workload to NGOs and international donors, intervening only to meet the bare minimum of needs, with limited resources allocated to line ministries. A vision to address the alarming level of unemployment, the migration of skilled graduates, the high level of poverty – mostly in rural areas, as well as the empowerment of women, remains lacking. No plan of action, even at the level of general guidelines, has been proposed to deal with these challenges, and hence the new government must include a detailed chapter covering the human and social development in its “Ministerial Declaration” with objectives and concrete proposals. In the interim, and until long-term plans have been made, a number of measures can be launched immediately.

### ***Main Themes***

- a. **Create jobs for the youth**
  - i. Develop university orientation programs in collaboration with ministries, academic circles, and other relevant parties;
  - ii. Coordinate between market needs and university programs;
  - iii. Exploit the Association Agreement with the EU to foster joint business partnerships, university exchange programs, etc;
  - iv. Intensify linkages with Arab world: Export services mainly of emerging sub-sectors which employ the youth such as Information Technology and professional services (e.g., legal, design, advertising, etc).
- b. **Reduce unemployment:**
  - i. Promote economic growth;
  - ii. Create intra-ministerial committee (labor, economy, social affairs, etc.) to develop common strategy to deal with job creation and unemployment compensation;
  - iii. Address structural unemployment: Training and life-long learning;
  - iv. Address frictional and temporary unemployment: Develop sustainable safety-nets.
- c. **Develop the education sector**
  - i. Create a National Accreditation Board;
  - ii. Overhaul public school system thus making it a viable option for students;
  - iii. Revise all licenses of universities/colleges and impose review of accreditation every 5 years to overrule the current policy of having no revision after initial establishment;

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- iv. Develop and support technical schools and revise curriculum for primary schools to incorporate alternative training (consider the German Model);
  - v. Develop night schooling (evening classes) at secondary, technical and university education levels to provide workers with the opportunity to develop their skills and consequently improve their living conditions.
- d. **Reduce poverty**
- i. Promote economic growth and create jobs;
  - ii. Intensify cooperation with donors, NGOs, and “privatize” management of joint programs launched by the State;
  - iii. Develop viable and sustainable social safety nets replacing expensive and inefficient funds/bureaus at various ministries;
  - iv. Launch micro-finance programs;
  - v. Make use of numerous success practices: UNDP, ESCWA reports.
- e. **Empower the disadvantaged groups**
- i. Eliminate all forms of discrimination, starting with the legal infrastructure;
  - ii. Provide equal opportunity in education, employment, and the like;
  - iii. Combat illegal child labor and trafficking, and abuse of children;
  - iv. Engage civil society and international organizations.

## ***Suggested immediate measures***

1. Establish permanent committee – grouping civil society, NGOs, UNDP, and ESCWA - to address poverty reduction within a national strategy and to develop micro finance programs;
2. Create an intra-ministerial committee to develop common strategy to reduce unemployment;
3. Create a permanent committee – grouping universities, line ministries, and international bodies with the objective of creating a National Accreditation Board to revise licenses of academic institutions and to ensure continuous monitoring;
4. Implement (i.e., pass implementation decrees) the ratified law on disability.

### ***The Palestinian Situation***

Any Lebanese government must face up to the fact that the social and human development of the 400,000 Palestinians in Lebanon is an international responsibility and not just a local one. Lebanon must therefore seek financial and technical assistance to improve the living of conditions of the population but more importantly invest in the young Palestinian labor force that would be re-injected into the global economy as skilled labor hence offering hope and securing welfare for generations to come.

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## **III. Empower Women: Equality, Partnership and Economic Development**

### ***Background and Policy***

Violations of basic women's rights are not just detrimental to society, human rights, and the dignity of women but are also extremely damaging to the prospects of sustainable economic development. Lebanon has made some in-roads to correct the injustice inflicted on women, but substantial work is still ahead especially when we realize that some North African Arab countries have introduced new legislations which have considerably improved the social and economic status of women.

In spite of the positive indices concerning the status of the Lebanese woman such as involvement in the labor force or level of education, these indices do not reflect the real status and role of the woman within her family and the attitude of the society towards her. Lebanon still lacks proper laws guaranteeing equal rights for women and men, whether in the public or in the family sphere.

Aside from the numerous legal constraints that discriminate against women – both at home and at the work – society continues to subordinate and outcast women, suppressing innovation, creativity, productivity, and most of all basic freedoms. Lebanon still has reservations on some major international conventions and has yet to reform domestic laws and change embedded unfair practices, which continue to entrench all sorts of discrimination against women (e.g., unequal employment opportunity, family status) and must as well combat all forms of violence. Lebanese laws must be, unconditionally, in line with international conventions and more importantly; all stakeholders must work together through a grass-root campaign to cement equality in practice. Empowering women is not only a fundamental social and human right but also a pillar for sustainable economic development.

A permanent committee grouping relevant ministries, as well as active NGOs from civil society, must be established to devise a national plan aiming to empower women at all levels, striving to outgrow taboo subjects. The plan with pre-set objectives would include immediate measures that must be introduced without delay and also measures that would be introduced in the near to medium future.

### ***Main Themes***

- a. **Create a Women's Affairs Ministry;**
- b. **Establish a permanent public sector (relevant ministries) – NGO committee to develop and monitor the progress of a National Plan;**
- c. **Raise awareness:** Support and develop projects with civil society to raise awareness on women issues;
- d. **Reform all laws and change practices where discrimination and violence exists in order to promote:**

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- i. equal pay and benefits for equal work, and equal employment and educational opportunity;
- ii. better working conditions;
- iii. protection of maternity rights;
- iv. improvement of status within family;
- e. **Encourage greater participation in the economy:**
  - i. Remove obstacles facing women from playing a larger role in the private sector;
  - ii. Encourage the private sector to appoint women to senior posts: Adopt a revised US Affirmative Action Model;
- f. **Increase participation in the public sector:** Appoint ministers, Director Generals, etc.
- g. **Create institutions, such as ‘women police departments’, for women:** Staff with trained policewomen and social workers to provide assistance and protection against any kind of harassment, violence, and discrimination.

## ***Suggested immediate measures***

1. Appoint women to political posts;
2. Create a Women Affairs Ministry;
3. Launch a long-term technical assistance project (housed at the relevant ministry and funded by the EU) to revamp laws and regulations dealing with women issues;
4. Set up a permanent committee to launch work on the national plan.

## **IV. Social Programs and Pension Reform: Universality and Sustainability**

### ***Background and Policy***

Lebanon spends about 10% of GDP on the health sector, a figure comparable to what the United States spends. Obviously, the benefits and the universality of the coverage are not comparable. The unnecessary spending may be attributed to “clientelisme”, corruption, abuse of power, and the like. “Service ministries” have become a cash cow for politicians seeking re-election.

The annual cost of certain programs, such as “end of service indemnities,” has reached unsustainable levels, surpassing the mark of LL1,000 billion and constituting one of the largest expenditure shares in the fiscal budget. The health and family care plans of the social security system have created actuarial imbalances and have reached limits that necessitate major reforms to restore viability and sustainability of the whole system.

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Aside from a couple of workshop to deal with Pension Reform, the government has failed to make inroads, often due to political bickering and the need to maintain a popular base. Efforts to streamline ‘education or health funds’ have been fruitless, a fact that can no longer be overlooked. Harsh reforms must be introduced and the public must be ready to accept an end to ‘free money’, but in return, the system must function efficiently thus eliminating the need for political intervention to gain what is rightfully due.

An adequate state pension plan ensures the renewal of the work force, particularly at the public sector level, and allows for the creation of jobs for the younger generation. At the present, civil servants work beyond their retirement age, as their pension is insufficient to sustain them in their old age, hence crowding out the younger entrants to the labor force.

## ***Main Themes***

- a. **Reform social programs: health, education, etc.**
  - i. Reform programs to reduce drainage;
  - ii. Eliminate double benefits/programs and hidden corruption;
  - iii. Revise unsustainable and wasteful social programs and create differentiated packages.
  
- b. **Reform the Social Security Fund and Pension Plans:**
  - i. Orient objectives towards universality with sustainability;
  - ii. Modernize and introduce new viable and attractive instruments in line with international best practice;
  - iii. Correct actuarial imbalances, primarily due to the family and health care components;
  - iv. Evaluate and revise the Optional Social Security Program;
  - v. Revise the “Old Age - Retirement” 2004 draft law.

## ***Suggested immediate measures:***

1. Re-launch the pension reform project between the World Bank and the Ministry of Finance;
2. Create intra-ministerial committee to review and streamline all social programs and funds;
3. Introduce new technologies for maintaining databases, spending flows, and training of civil servants;
4. Re-launch technical discussion on Old Age draft law of 2004, and start the evaluation of the Optional Social Security Program;
5. Adopt new regulatory framework and tax incentives for private pension funds schemes.

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## **V. Economic Development and Growth: Increase Productivity and Efficiency**

### ***Background and Policy***

Since its independence, Lebanon has adopted liberal economic policies whereby market forces dictated the behavior of economic agents. Although this strategic “laissez faire” policy is not in danger, the 15-year war has increased government intervention in the economy, creating obstacles for the private sector, imposing a heavy burden on the fiscal budget, and indirectly reducing economic efficiency and productivity. In addition, the war not only placed the country in a standstill mode but also has put the domestic economy at a large disadvantage vis-à-vis the world and the region. The outcome for Lebanon at the turn of the 21<sup>st</sup> century can be summarized by the following: economic infrastructures have fallen behind, living standards have worsened, wealth distribution has become polarized and inequitable, the economy has become less diversified; markets have become dominated by oligopolies, and behavior of all agents have been marred by corruption, while the government have failed to play its proper role as a visionary and a market regulator.

After years of slow growth, the economy picked up in 2004 with an estimated 5% growth rate. To sustain high growth rate, structural and grassroots’ measures are required. The lifeline offered by the Paris II Conference, coupled with a growth in exports and a promising tourism industry cannot maintain the positive momentum in a globalized world unless particular attention is given to increase factor productivity. The liberalization process and the opening of markets must be accompanied by internal measures to increase competitiveness, which can be best achieved by an increase in productivity and the introduction of a competition culture.

Since the overwhelming composition of the Lebanese economy is made up of micro, small or medium enterprises (SME), any long-term plan to promote economic growth must target SMEs. The World Bank Country Assistance Strategy (now being finalized) can serve as a platform to launch numerous projects across the country covering infrastructure developments and also capacity building, SME development, industrial modernization, and so forth. Finally, local mise-à-niveau programs, coupled with free trade agreements and a new export promotion agency, provide Lebanon with an opportunity to access more foreign markets and increase exports and the export/import coverage ratio from the current 19% to 50% in 5 years. This ratio was less than 10% a couple years ago and with proper policies, exports can become the driving engine behind economic growth and could be the main source of growth if we were to include the exports of services.

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## ***Main Themes***

- a. **Increase productivity:**
  - i. Launch multiple public sector initiatives;
  - ii. Support private sector initiatives;
  - iii. Promote FDI and technology transfer;
  - iv. Target key sectors.
- b. **Support SMEs and micro finance:**
  - i. Develop various schemes such as revolving and guarantee funds;
  - ii. Introduce new laws and build databases to facilitate business;
  - iii. Develop “*Kafalat*”, build on the “ELCIM” projects and the Council for Development and Reconstruction (CDR) Social Fund;
  - iv. Develop a public-private (including NGOs) partnership to lure investors: Move beyond donor-financed programs.
- c. **Promote a balanced and regional approach:**
  - i. Create economic poles outside greater Beirut;
  - ii. Launch regional programs to reduce abuse of power by politicians;
  - iii. Decentralize decision-making to promote greater economic activity across the country;
  - iv. Finalize and build upon the World Bank 2005 Country Assistance Strategy.
- d. **Diversify the economy**
  - i. Develop new high, value-added sectors: technology-based, specialized finance houses, ecology-based, heavy industries, etc.;
  - ii. Build and expand existing promising sectors: light industry, sub-sectors of tourism (e.g., religious, business, nature, cultural), banking, telecommunications, etc.
- e. **Re-build the middle class and revive the role of labor unions**
  - i. Rebuild the saving base: introduce tax reform, attract capital inflow;
  - ii. Address the brain drain and create jobs;
  - iii. Introduce new labor law and strengthen the independence of unions.
- f. **Reposition Lebanon as a regional capital and investment hub**
  - i. Develop capital markets and provide new instruments to access capital;
  - ii. Consolidate the country as a principal Arab bond issuer.
- g. **Promote export-led growth**
  - i. Establish a public-private partnership: create networks, target niche markets, negotiate jointly trade agreements;
  - ii. Develop an Export Promotion Agency and better utilize embassies;
  - iii. Promote export of services: professional, IT, etc.

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## ***Suggested immediate measures***

1. Finalize the World Bank 2005 CAS which has implications on all socio-economic sectors;
2. Launch the work on developing an Action Plan for Lebanon – under the EU Neighborhood Policy – in cooperation with all relevant ministries, private sector and civil society representatives;
3. Provide fiscal incentives to firms and educational institutes which train employees regularly;
4. Create an Economic Advisers Board linked directly to the Prime Minister composed of close advisors to the Prime Ministers but also of a core of permanent economists and staff. The board could also include representatives from relevant ministries;
5. Set up an Export Promotion Agency;
6. Set up, in collaboration with banks and the Central Bank, various funds to improve access to credit (complement the “*Kafalat*” program);
7. Continue the revision of banking laws in order to incorporate non-banking institutions providing credit into the financial sector (e.g., NGOs, micro finance institutions).

## **VI. Trade Policy: Deeper Integration in the Global Economy**

### ***Background and Policy***

Lebanon has been active in negotiating a large number of “shallow trade agreements” with Arab states as well as East European countries. When free trade agreements were signed (with over eight partners including the EU, Arab bloc or GAFTA, and EFTA which includes Switzerland), the agreements did not go beyond simple tariff reductions, which was proven by economic literature to offer little or no gain. Moving fast along the track of eliminating tariff barriers is not the main objective; non-trade barriers remain the main obstacle facing the flow of merchandise, and these barriers have been erected by both Arab and EU trading blocs, which constitute over 60% of Lebanese export destinations. Moreover, liberalizing agriculture and services, two sectors which are more important to Lebanon and developing countries have been put on hold by developed countries, starting with the EU.

At the multilateral level, Lebanon has had an observer status at the WTO since 1999 but has effectively launched the accession process in May 2001. The WTO, and contrary to what is often argued is a mechanism to protect small economies and to resolve international trade disputes, in addition to the fact that small economies cannot be marginalized in a globalized world. The accession must be completed before the Doha Round ends in order to avoid facing new conditions and commitments that may ensue after the end of the current Doha Round of negotiations.

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The Deeper Integration Strategic Scenario in the global economy offers dynamic long-term benefits and provides opportunities, notably to developing economies with potential to grow, such as Lebanon; however, integration and harmonization under globalization carries with it challenges that require major reforms and efforts to upgrade and improve efficiencies which are inherently costly, especially to “legally pampered” sectors/firms sheltered behind protectionism or not exposed to fair competition. The concept of the evolution of species states that “species that do not evolve as fast as other species are bound to disappear”. This is applicable to a globalized business world: improve or perish. Moreover and at a parallel level, intra-ministerial coordination remains a weakness and the private sector is involved on an *ad hoc* basis, even though it is the party most affected by all trade agreements.

## ***Main Themes***

- a. **The bilateral track:** Revise shallow agreements and revive joint committees;
- b. **The Syrian and Arab track:** Revise agreements with a particular focus on the agriculture component;
- c. **WTO accession:** Adhere in 2006 before end of Doha Round;
- d. **The EU Partnership track:** Join the European Neighborhood Policy striving for Deeper integration, larger market access, higher competitiveness, and more foreign direct investment (FDI);
- e. **The “rest of Europe” track:** Implement the EFTA (i.e., Switzerland, Norway, Iceland, Lichtenstein) free trade agreement;
- f. **Modernize and upgrade the domestic economy:** increase competitiveness, build capacity, learn from international practices, adopt international norms and standards, etc.

## ***Suggested immediate measures:***

1. Set-up an intra-ministerial committee to launch negotiations with EU on Neighborhood Policy;
2. Establish a EU unit linked directly to the Prime Minister that include representatives of all relevant ministries;
3. Fast-track the accession process to the WTO by passing all draft laws;
4. Set up a new intra-ministerial committee, under the leadership of the Ministry of Economy and Trade, to revise most bilateral trade agreements with a particular focus on the agricultural component.
5. Set up a committee grouping public and private sector representatives to develop a plan (mise-à-niveau programs) to improve the competitiveness of the private sector using MEDA funds

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## **VII. Monetary Policy: A Deeper Capital Market**

### ***Background and Policy***

In order to curb a spiraling inflation and the dollarization of the economy, and to ensure monetary stability as well as the effectiveness of monetary policy, the Central Bank (BDL) and the government have adopted for most of the 1990s a pegged exchange rate regime supported by high returns on treasury bills and deposits in Lebanese Pound surpassing the 40% yield in the mid 1990s. This monetary policy succeeded in meeting the set objectives, however at the expense of increasing and alarming budget deficits. Finally, and after Paris II, the structure of interest rates began to decline, bringing down the debt service payment, and for the first time since the mid 1970s, reversing the debt dynamics. This major achievement of reducing the debt to GDP ratio is surely insufficient if no reforms complement the soft cash injection from Paris II. If 2004 witnessed an unprecedented growth of GDP by 5%, such a positive momentum as well as the declining debt dynamics cannot be sustained in 2005 and onwards especially after the assassination of Prime Minister Rafic Hariri. In addition to much needed reforms, coordination between the fiscal and monetary authorities is weak and at some instances the relationship is tense.

The banking sector is very liquid with M3 (broad money supply) growing in double digits for a number of years. On the other hand, banks have remained conservative in providing new products and reaching to new clients knowing that a major client – the State – is ready to absorb all the liquidity, and at high return. The crowding-out effect has not only depressed investment but suppressed any need on behalf of banks to be innovative and competitive. On top of that, the lending mechanism, even through the safe medium of "*Kafalat*", remains limited to a closed circle of clients as banks adopt a conservative, risk-averse lending policy, probably also due to the lack of an effective credit system.

The new government must consider adopting a long-term fiscal and monetary policy. Even though exchange rate stability is needed in the short run, it cannot be maintained forever. Rigidity in that market (balance of payment constraint) implies that the economy has to suffer a cost when market forces change, be it international reserves, export competitiveness, or the like. The long-term vision must also include a revamping of banking laws, policies, infrastructure, etc. especially that in light of globalization, competition even from Arab banks can be stiff and ruthless.

Finally, and in order to move from the status of a developing country to an emerging economy, Lebanon has to deepen its capital market allowing a more transparent and “democratic” economy and channeling savings and remittances into productive activities.

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## ***Main Themes***

- a. **Address the exchange rate regime:** Maintain existing regime, revise only when at a positive cross-road (e.g., Paris III or after successive high growth years);
- b. **Adopt (gradually) a flexible interest rate management:** to better absorb monetary fluctuations;
- c. **Modernize the banking system:**
  - i. E-banking: intra-banks and business to consumer;
  - ii. Offer new products to wider clientele (various consumer loans, SMEs, etc.);
  - iii. Establish credit system which will reduce risk and risk-averse policy of banks and modernize the legal framework of credit guarantees and debt recovery procedures and reduce their costs.
- d. **Institutionalize the Central Bank (BDL) –Ministry of Finance (MoF) relationship**
- e. **Develop and deepen the capital market**
  - i. Work on a new legislative framework and agenda;
  - ii. Introduce a regulatory body;
  - iii. Introduce new investment schemes (e.g., funds).

## ***Suggested immediate measures:***

1. Maintain exchange rate regime (for now);
2. Increase capital of *Kafalat* and develop new instruments to increase access to credit by SMEs;
3. Create a Credit Bureau, reducing risk factor and expanding the clientele of banks;
4. Set up a permanent committee grouping BDL and MoF officials to coordinate fiscal and monetary policy;
5. In coordination with the Bourse de Beyrouth, MoF, and BDL, provide a set of fiscal incentives to invite family-owned business to turn public;
6. Introduce new debt instruments (e.g., T-bills, bonds) with long term maturities to revive the *Bourse de Beyrouth* and smooth out the debt burden.

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## **VIII. Fiscal Policy: A New Tax Policy after the VAT and the 1990s Policy**

### ***Background and Policy***

The public debt is the main challenge facing any future government, and more specifically for the next two decades. After Paris II, and if there would be any chance to have another donor conference, genuine structural and institutional reforms must be introduced, and at all levels. The government can begin with short-term measures to inject a positive momentum, but structural reforms such as privatization, public sector reforms, etc., cannot be postponed any longer. The government and the Central Bank have been innovative in the debt management and restructuring policy; more of the same must follow but with longer-term and more diversified instruments.

Fifteen years since the end of the war, and following two waves of fiscal restructuring and the emergence of a more developed statistical database permitting a better analysis of the tax burden, at least at the fiscal level, the government must revise its tax policy. The new policy must introduce new instruments, change strategies and rates, and undertakes what is necessary to promote private investments and greater economic activity.

In sum, the fiscal reform policy must rely on three basic pillars: Increase the primary surplus and rationalize expenditures; introduce institutional reforms to improve credibility, transparency and better planning; and initiate structural reforms to increase competitiveness and economic growth.

### ***Main Themes***

- a. **Overhaul fiscal policy:**
  - i. Broaden tax base with a more equitable tax burden;
  - ii. Revise VAT thresholds and rates;
  - iii. Introduce new (long-term) instruments via developed capital markets.
- b. **Increase primary surplus and rationalize spending**
- c. **Introduce institutional reforms**
- d. **Re-launch efforts for Paris III:** a final debt reversal shock.

### ***Suggested immediate measures:***

1. Finalize the 2005 budget;
2. Immediately launch debate on 2006 budget considering new VAT rates and thresholds;
3. Launch work on a new tax policy (after 15 years of experience): Reach a more equitable tax burden and develop effective and innovative instruments;

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4. Introduce modeling techniques to Ministry of Finance (MoF) to assist in evaluating impacts of various fiscal instruments and better define the new tax policy;
5. Launch the debt department within the MoF;
6. Initiate immediate measures to stop the drain caused by the EDL/power sector (awaiting full and comprehensive development of this sector);
7. Finalize debts securitization draft law.

### **IX. Brain Drain: Institutionalize Relationship with Diaspora**

#### ***Background and Policy***

We have to accept the fact that Lebanon produces more university graduates than its economy can absorb. We can slow down the brain drain to “normal levels” since it is not expected that the country can stop this historic exodus caused by an excess of skilled labor. Creating high-skilled jobs can help normalize the trend. Lebanon can – at a parallel level - benefit from its Diaspora by maintaining strong links and networks and hence capitalizing on its valuable resources to ensure technology transfer, inflow of capital, etc. and hence widen the economic space of Lebanon beyond its geographic borders. So far, this unbroken chain between the Diaspora and the homeland has been not been captured by the formal economy and overlooked by government policy. Forums or state visits have helped strengthen some ties, especially with Lebanese in Brazil or Argentina but this relationship, often characterized as the lifeline for the home economy (4bn USD per year worth of inflow), must be institutionalized.

#### ***Main Themes***

- a. **Create jobs;**
- b. **Capitalize on the Diaspora:** technology transfer, joint ventures, networks, etc.;
- c. **Revise the naturalization law** to reintegrate the Diaspora;
- d. **Strengthen link with expatriates**
  - i. Institutionalize relationship with expatriates;
  - ii. Promote “back to your roots” campaign for the Diaspora and support Lebanese cultural clubs abroad;
  - iii. Create investment fund: Adopt model used in many African nations;
  - iv. Lure professional as visiting professors, short-term project experts, etc.;
  - v. Promote alliances and partnerships with foreign universities, think tanks, etc.

#### ***Suggested immediate measures:***

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1. Set up Investment Fund to channel Diaspora remittances to households consumption and also to investment projects with a particular focus in rural development;
2. Provide fiscal incentives to universities/centers that link ex-pats with Lebanon (e.g., hire short or long-term Lebanese experts living abroad, encourage visiting professors programs etc.);
3. Institutionalize the relationship with the expatriate community;
4. Organize numerous forums in Lebanon and abroad.

### **X. Legal and Economic Modernization: Catch-up and Leap Forward**

#### ***Background and Policy***

If trade and economic integration is one strategic pillar, the modernization of the domestic economy including legislative reforms must be another pillar of the government economic policy. Lebanon, not only has to keep pace with a fast-moving globalized economy, but must also take a giant leap forward in order to make up for lost time during the 15-years of war. Most of the legislative infrastructure dates back decades and by no mean provides the private sector with the proper environment to incite it to invest, and to launch productive long-term activities. In fact, the private sector is bogged down with red tape that slows the economic activity and often dissuades investors from mobilizing capital into future projects. Economic modernization also necessitate a firm re-launching of the privatization program in order to increase economic efficiency, improve quality, attract foreign capital, and yield welfare gains. Finally, Lebanon continues to lack proper statistics, upon which the formulation of economic policy need to be based. Efforts so far to build a statistical database have been sparse, not coordinated, and insufficient; hence, the need for a master plan with the objective of building a long-term database memory.

#### ***Main Themes***

- a. **Tackle the legislative agenda:** Competition (including mergers and acquisitions), anti-dumping, intellectual property, SME-related laws, quality-enhancing laws (WTO-compatible), bankruptcy and insolvency laws, companies laws, real estate promotion, construction regulations, creation of a small debts recovery simplified procedure.
- b. **Re-launch the Privatization Program:**
  - i. Introduce sectoral laws and set up regulators;
  - ii. Re-establish Privatization Higher Council.
- c. **Remove obstacles before private sector:** facilitate trade and investment
- d. **Promote corporate governance:**
  - i. Adopt code of ethics;

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- ii. Raise awareness;
- iii. Encourage private firms to turn public.
- e. **Combat money laundering and corruption:**
  - i. Modify bank secrecy law and anti-money laundering law (*Ex-officio* lift of bank secrecy on Lebanese and foreign public servants – operating in Lebanon, Members of Parliament, and Ministers);
  - ii. Amend and modernize Illegal Enrichment Law and adhere to international agreements in this regard.
- f. **Liberalize daily business:**
  - i. Reduce and simplify bureaucratic regulations;
  - ii. Eliminate *ex ante* licenses (e.g., importation of non-durables and technology-based goods, etc.);
  - iii. Reduce unnecessary export/import paperwork, etc.
- g. **Develop a Statistical Master Plan**
  - i. Revamp and develop the Central Administration (hire, train, etc.);
  - ii. Map the institutions entrusted with various statistical tasks;
  - iii. Develop the Master Plan.

### ***Suggested immediate measures:***

1. Re-establish the Privatization Higher Council;
2. Fast-track the legislative agenda, namely the laws on: competition, anti-dumping, etc.;
3. Provide the Ministry of Economy and Trade with the needed resources to fully implement the new modern consumer protection law;
4. Revamp the Central Administration of Statistics;
5. Provide a new concession (Port Authority) and overhaul and organize ancillary activities at the Port of Beirut;
6. Amend the Audio-visual Medias Law and related regulations to promote FDI in this sector and define the borders between the sector and Telecom, ICT, etc.

## **XI. Development of Key Sectors: A Sectoral Approach**

### ***Background and Policy: Select Sectors***

- Agriculture: Currently in an abysmal state, subsidies for agriculture are constantly diverted and dilapidated. There has not been a State master plan for the agriculture sector. Lebanon's climate and abundance of water are appropriate for the country to become an exporter of agricultural products, including high value-added agro-food, as well as exotic or ethnic products. Lebanon has successful practices to build on, such as the wine industry, and stands to learn from international success stories such as in Chile;

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- **Industry:** This sector is suffering from high operational costs (electricity, fuel, social security, rigid labor laws, etc.), unfair competition from neighboring countries, and a lack of access to capital. Lebanese industry needs, among other, private equity and venture capital funds, as well as specialized financial institutions that would cater to their financing and financial advisory needs;
- **Tourism:** Despite the boom in 2004, this sector is still under-exploited, due to a lack of adequate marketing and investments in the infrastructure, and the absence of a long term State policy. Lebanon possesses a great potential in all the sub-sectors of tourism (e.g., cultural, religious, business, etc.) and has a promising future. With a proper strategy and a welcoming environment, the country can attract large investments in this sector.
- **Banking and Finance:** Still undiversified and under-developed, new types of institutions need to be created, mainly housing finance, public works finance, financial engineering and securitization, and industrial finance. The current banking sector must also be restructured to allow the creation of various “classes” of banks such as saving banks, merchant banks, and international universal banks.
- **ICT (Information and Communication Technology):** With solid intellectual property laws and significant subsidies to develop research and development, the potential of the Lebanese in this sector is significant but under-exploited. Lebanon should also position itself, in a similar vein to India, as a major outsourcing of ICT services for Western countries as well as an export platform to the Arab east;
- **Health Care and Education:** Lebanon has a comparative advantage in terms of the quality and service in both health care and higher education and hence should develop a strategy to become a regional center. Funds allocated for inefficient subsidy programs must be directed towards education and health. Investment in these two sectors is in fact an investment in the Lebanese human capital.

## ***Special Focus: Power and Telecom***

Key sectors such as telecommunications or power can turn into a new tax on the economy if they are inefficient, unjustifiably expensive, and outdated. On the other hand, if these sectors are properly run and operated, they can turn into a major source of Foreign Direct Investment (FDI) and a primary catalyst for economic growth.

Power and telecommunications (mobile and fixed) have gone through different experiences. The power sector has siphoned from the state budget hundreds of millions of dollars while the service and the physical infrastructure has worsened. The fixed telecommunication sub-sector was turned into a more modern service, only to witness a halt in its growth, opening the way for a more booming mobile sector. However, and once this sector started to generate major revenues, this cash cow

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duopoly was politicized and eventually nationalized and ultimately service worsened. Lebanon has effectively adopted the opposite logic of all international best practices and ultimately paid the price. In 1994, when LibanCell and Cellis entered the market and created a duopoly, the cost structure in Lebanon was among the lowest in the world. In less than ten years, the cost followed a constant upward trend (with no additional services or offers such as peak or off-peak rates) whereas the costing around the world declined considerably, even in the Arab World. The world foresaw the dynamic effects of privatizing the mobile telephony hence allowing for continuous injections of capital and technology transfer whereas the Lebanese government was tempted by the static short term fiscal benefits from nationalizing the sector, a policy that effectively halted the development of the sector.

Turning back the sector (and eventually the power sector / Electricité du Liban (EDL) after its restructuring) to private hands and introducing competition (3<sup>rd</sup> or 4<sup>th</sup> license) is the way back to re-galvanizing this strategic sector and reducing the cost of service, hence reducing the cost of production in related sectors and increasing the competitive edge on the global market. The same logic applies to a large extent to the power sector, which must also develop the gas network/pipeline and overhaul its administrative structure. Moreover, the strategic operations have to be revised in light of new technologies and the increasing role of the private sector.

### ***Special Focus: Water and Transport***

The development of the water and transport sectors is crucial to the future diversification of the Lebanese economy and the creation of jobs. Although Lebanon is blessed with substantial water reserves, due to its favorable geographic layout and weather, nothing is being done to exploit them and to utilize this precious resource to the well-being of the people and the increase of economic activity.

The creation of an efficient water distribution system would create significant revenues for the country and establish Lebanon as a strategic geopolitical nexus. Selling water to its neighbors, while being self-sufficient at home, is a scenario that many countries would have worked hard to realize decades ago. Likewise, a developed motorway and rail network, linking Lebanese ports and cities to neighboring countries would not only create important direct revenues, but also make Lebanon a regional hub. The development of water resources and their distribution, as well as transport links (mainly through toll roads and passenger and freight railways) would boost the GDP considerably.

The development of the water, and transport sectors must be privatized (and various scenarios of privatization exist), with the government maintaining a regulatory role in these newly privatized companies or probably becoming a partner following several successful international practices. Such major and strategic projects must take a

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regional dimension, as the Lebanese market on its own is too small. Privileged relations with countries like Syria, Iraq and Jordan are crucial to the future economic prosperity of Lebanon, which as a country, must exploit its comparative advantage in terms of know-how, geopolitical positioning (on the Mediterranean coast and in-between Europe and the rest of the Middle East), and wealth in water resources, to position itself as a regional intermediary and springboard.

## ***Main Themes***

- a. **Power (Electricité du Liban)**
  - i. Launch administrative reforms;
  - ii. Lay groundwork towards privatization (various scenarios exist);
  - iii. Exploit the gas option and set up a gas pipeline, ultimately providing gas to households;
  - iv. Adopt new technologies (best if the private sector has a stake in the operation);
  - v. Address new EU plans to link energy pipeline around the Mediterranean region.
- b. **Telecommunications**
  - i. Privatize the mobile sector (allow the private sector to have a stake in the sector) in order to introduce new technology, provide a better service, and offer competitive prices;
  - ii. Launch Liban Telecom and a 3<sup>rd</sup> mobile license;
  - iii. Introduce competition to the mobile telephony sector;
  - iv. Establish the Regulatory Agency as stipulated by 2002 law.
- c. **Water**
  - i. Follow-up to the consolidation of Water Authorities;
  - ii. Regulate drinking water including mineral water industry;
  - iii. Prepare plans to exploit Euro-Mediterranean Partnership;
  - iv. Adopt or revise dam building plan;
  - v. Exploit water to develop energy;
  - vi. Privatize select sub-sectors;
  - vii. Introduce competition.
- d. **Transport**
  - i. Establish National Authorities for Maritime, Land, and Air Transport;
  - ii. Address the EU Neighborhood Plans to link Euro-Med. region;
  - iii. Privatization: Various scenarios are applicable;
  - iv. Introduce competition;
  - v. Regulate inter and intra-city public transport.

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## ***Suggested immediate measures***

1. Finalize gas pipeline and extend it to the Zouk power plant;
2. Review all past studies (e.g., The Sehnaoui 2005 Plan) and develop a power strategy aimed at privatizing the sector after consulting with the World Bank (Country Assistance Strategy 2005);
3. Set up the long awaited telecommunication regulator;
4. Set up Liban Telecom and provide a third mobile license as called for in the 2002 law;
5. Finish the railway between Tripoli and the city of Homs;
6. Revise all licenses granted to mineral water firms and introduce annual monitoring;
7. Revise all licenses granted in the public transport sector and devise new strategy;
8. Launch domestic work on Energy and Transport Plants in light of the European Neighborhood Policy and the Regional Indicative Program under the MEDA II program

## **XII. Develop Niche Sectors: A Globalized Lebanon before Globalization**

### ***Background and Policy***

As it was the case when free trade was first promoted at the turn of the century, the second wave of liberalization – i.e., globalization – is built upon the concept of specialization and deeper integration. Lebanon can penetrate global markets if it targets sectors with high value-added, or focuses on “Made in Lebanon” production such as ethnic products or organic food. Moreover, the highly skilled labor force can turn into an “India-like” outsourcing hub providing and exporting numerous services from IT to legal and medical services. The Arab World is the principal export destination for Lebanon for similar services, but expanding into East Europe or Africa should not be a challenging endeavor.

### ***Main Themes***

- a. **Agro-food:** Mineral waters, wine, dairy, olive oil, nargileh tobacco, etc.
- b. **Organic food and ethnic products:** low-cost, high value-added;
- c. **ICT:** A hub towards the Arab world and a job generator for the youth;
- d. **Professional services:** Source of exports and jobs;
- e. **Outsourcing.**

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## ***Suggested immediate measures***

1. Follow-up and build upon the existing E-commerce project, and institutionalize a joint public-private partnership;
2. Provide incentives and/or launch initiatives to promote potential sectors (e.g., tax breaks, fund specialized conferences, launch awareness campaigns, etc.);
3. Choose sectors with high-value added or ethnic value such as olive oil or organic foods to promote exports or services using high-skill labor hence creating jobs;
4. Re-Launch the IDAL Damour project (BETZ).

## **XIII. Cost of Production: Become More Competitive**

### ***Background and Policy***

The factors behind the high cost of production and henceforth the lack of a competitive edge are both structural and exogenous. A rise in the price of petroleum or a pegged Pound to the US dollar implies more expensive imports (inputs) - if they come from the Euro-zone; but also the high cost of services (telephony, power, transport, etc.) and an uncompetitive internal market implies economic inefficiencies and hence above-market prices. All these factors, and others, increase the burden on producers. The remedy lies mainly in major structural reforms such as introducing competition or improving access to capital for SMEs. Protectionism and other state measures to shelter domestic producers serve more harm than good.

### ***Main Themes***

- a. **Reduce the cost of production:** address the rising cost of fuel, the appreciation of the Euro, and the high cost of domestic services;
- b. **Introduce Competition:** ratify the new law, build capacity, and promote a new culture;
- c. **Improve access to credit:** target SMEs and micro firms (90% of firms);
- d. **Strengthen public-private partnership.**

## ***Suggested immediate measures***

1. Temporarily, provide solutions such as low power rates at off-peak hours;
2. Pass the new competition law, which is a structural, long-term solution to high cost;
3. Examine the suggestions provided by the Association of Industrialists.



### ***Privatization***

The principal objective of privatizing state-owned enterprises is to promote growth and modernize the economy, and not to generate revenues. Privatization, which can take several forms (e.g., Built-Operate-Transfer (BOT), management contracts, full or partial sale, partnership with strategic international investors, etc.), remains the main bridge that is expected to transform the Lebanese economy from a developing status to an emerging economy status.

The privatization program has been stalling since its inception by the Hoss government in the last quarter of 1998 when a framework law was passed and later a Privatization Higher Council was created. In the late 1980s and 1990s a privatization boom was taking over the developing and emerging markets attracting billions of dollars in investments and state-of-the-art technologies which eventually transformed their economies and developed their capital markets. On the other hand, and in Lebanon, the privatization wagon was missed: the Beirut Stock Exchange remains a ghost institution, the Higher Privatization Council was first paralyzed, then dissolved, BOT telecom contracts were prematurely canceled, litigation and disputes with international investors were spurred, all of which dropped Lebanon from the radar screen of the international community at a time when local state enterprises were disintegrating, losing market value and efficiency and costing the government millions of dollars annually.

While restructuring and legislative development – including the introduction of a competition law and regulatory authority – remain a prerequisite to any successful privatization program, the government must politically and fully commit to the privatization option and announce its intention to resume the privatization program. The Privatization Higher Council must be re-established with a wider mandate in order to monitor and regulate the entire privatization process and ensure transparency. The state should also sort out the mess that has been created in the mobile phone operators' case, and restore its credibility with international investors.

Privatization is and should not be considered as option to generate revenues to meet short-term fiscal needs, but must be viewed as a process that will yield dynamic economic benefits. In fact, there is a consensus following international practices which prove that privatization, among other things:

1. Attracts foreign and domestic direct investment and injects capital,
2. Develops capital markets,
3. Invites new technologies and increases productivity,
4. Provides better service at lower cost to domestic consumers, and
5. Promotes economic efficiency and competitiveness.

The list of candidates to be privatized in Lebanon is not as extensive as in countries where the state owned most resources and directed the economy, such as in East Europe or North Africa. The list includes most state-owned service providers such as telecommunication, power and energy, transport facilities and authorities, water authorities, MEA, as well as the tobacco *regie* industry.