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ORIGINAL ARTICLE

Can Lebanon's Economy Be Saved? A Plan for Revival

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Abstract

The recent financial and economic meltdown in Lebanon is the result of 30 years of social, economic, financial, and fiscal mismanagement, amplified by the Covid-19 pandemic and further exacerbated by the Beirut port explosion. Lebanese citizens' trust, as well as the international community's trust in the government, have unfortunately been destroyed. Consequently, Lebanon's sole option is to rebuild confidence in the government and public institutions by implementing economic reforms and to seek an IMF program to pave the way for additional financing from other international sources. The most important confidence-building step is a clear financial and economic plan that has the support of all key stakeholders. This article presents a road map for a reforms-driven, export-led growth strategy for Lebanon. Ultimately, the goal is to jump-start the economy and put it on a path of sustainable, inclusive, and equitable economic growth. Such growth should be grounded in a small, open-economy model and driven by low tariffs, a flexible exchange rate regime, and a dynamic export sector built on competitive and comparative advantages. This plan partially builds on proposals and recommendations provided by previous economic plans and policy notes.

Lebanon's recent financial and economic meltdown is a result of 30 years of social, economic, financial, and fiscal mismanagement, amplified by the Covid-19 pandemic and further exacerbated by the Beirut port explosion. Given that the country does not have the fiscal space to boost its economy through a massive injection of funds, it has one remaining option: to seek international aid. However, aid will not come without reform. Hence, the necessity and urgency of embarking on structural reforms, the key to economic recovery.

It is clear that Lebanon's sole option today is to seek an IMF program that will pave the way for additional financing from other international sources. This can only be accomplished by building political consensus around a financial and economic plan that provides the right environment to rebuild the confidence of the international community, as well as local investors and the Lebanese diaspora.

Rebuilding confidence in the government and public institutions is key. Citizens' trust in the government, as well as that of the international community, has unfortunately been destroyed over the past few years. We realize this will take time, reflected in an old Dutch saying that "trust arrives on foot but leaves on horseback." The most important confidence-building step is a clear financial and economic plan that has the support of the principal stakeholders. In parallel, it is essential to show progress in adopting low-hanging-fruit reforms.

This article presents a road map for a reform-driven, export-led growth strategy for Lebanon. Ultimately, the goal is to jump-start the economy on a path to sustainable, inclusive, and equitable economic growth. Such growth should be grounded in a small, open-economy model and driven by low tariffs, a flexible exchange rate, and a dynamic export sector built on competitive and comparative advantages. This plan partially builds on proposals and recommendations provided by previous economic plans and policy notes and is guided by the following long-term vision: a friendly, culturally diverse, economically productive, competitive, innovative, and sustainable country that embraces inclusive and equitable growth for all Lebanese citizens.

STRUCTURAL WEAKNESSES

Among the most significant and deeply rooted structural impediments to be addressed are: a rentier economy focused on low value-added products, a constrained business-enabling environment, significantly damaged financial and real sectors, insufficient infrastructure investments, and, last but not least, rampant corruption and weak governance.

The postwar reconstruction phase was plagued by poor governance, involving corruption and opaque reporting and accounting practices. This mismanagement led to overspending, which resulted in budget deficits and a heavily inflated public sector (government salaries are 9 percent of GDP versus a 6 percent benchmark[1] and 46 percent of government revenue).[2] Meanwhile, the central bank (BdL) maintained a fixed nominal exchange rate, and for years the inflow of foreign capital remained uninterrupted. The choice of fiscal and monetary policies resulted in high real interest rates and real exchange rates. The large size of fiscal deficits and the growing number of funding requirements de facto crowded out the private productive sector, which could not afford to compete for credit at high real interest rates and an overvalued real exchange rate that placed local industry at a disadvantage relative to imported goods.

Lebanon's current-account deficit as a percentage of GDP grew from 20 percent in 2010 to 27 percent in 2019—reaching levels close to 58 percent during this time—while the fiscal deficit as a percentage of GDP grew from 7.4 percent in 2010 to close to 12 percent in 2019. Public debt as

[1] "2016 Article IV Consultation—Staff Report; Press Release; and Statement by The Executive Director for Lebanon," IMF Country Report No. 17/19, Washington DC, January 2017.

[2] "Government of Lebanon McKinsey Report," Lebanon Economic Vision, 2018.

a percentage of GDP increased from about 50 percent in 2010 to an unsustainable 150 percent in 2019, while the real GDP growth rate remained on average below 3 percent per year and has recently turned negative (expected to be −19.2 percent in 2020). Over the past few years, the private sector's performance has been weak. Firms have started downsizing and reducing the number of employees—negative trends that have accelerated rapidly since October 2019.

According to a study by McKinsey, Lebanon attracted more than $90 billion between 2005 and 2015, 70 percent of which ($72 billion) was used to buy real estate and imported goods. Approximately $22 billion was deposited in banks at high interest rates and ultimately invested in government bonds aimed at financing public-sector deficits. About 36 percent of total government spending goes for debt servicing and 58 percent for salaries, while only 7 percent is allocated to urgently needed capital investments.[3] Even prior to the crisis, the contribution of investment to real GDP growth fell sharply, from 1.3 percent in 2011 to 0.1 percent in 2015. Foreign direct investment has been steadily declining since 2010, from $3.7 billion to $2.7 billion in 2015. Similarly, exports dropped from $4.2 billion to $3.2 billion from 2010 to 2018.

The chronic structural distortions faced by the Lebanese economy over several decades have made it extremely vulnerable to internal and external shocks. Starting in November 2017, when Prime Minister Saad Hariri resigned while abroad, confidence in the Lebanese economy faltered; only a further increase of already high interest rates was able to keep the BdL's reserves at an acceptable level. The protests of October 2019, along with the BdL decision to stop pumping fresh dollars into the banks, translated into a strain on the banking sector's liquidity abroad and in the local market, further impairing confidence. These events, combined with the pandemic, had a devastating impact on Lebanon. The economic structure became unsustainable. A series of events sealed the end of the fiscal and monetary policy mix maintained since the early 1990s: a drastic reduction of capital inflows from abroad, the March 2020 Eurobond default, the dramatic reduction of BdL international reserves, and the increasing misalignments between the officially pegged exchange rate and the unofficial one.

To improve the primary budget balance, the government will have to adopt an ambitious fiscal-consolidation policy by attempting to increase revenue and reduce public expenditures. There is no doubt that government-expenditure priorities need to be redefined based on cost-benefit analysis and measurable economic and social returns. The country now faces the need for deep cuts in public-sector expenditures and imports to stabilize current accounts and revise its monetary and exchange-rate policies.

As a result of the current economic environment, tax collections have fallen and receipts on interest income have dropped, resulting in a decrease in the tax-to-GDP ratio from 16.2 percent in 2019 to 13.6 percent in 2020. Even before the crisis, Lebanon's ratio was low compared with other countries in the region, such as Jordan (21 percent) and Egypt (17 percent), and extremely low compared to Turkey (25 percent) and the EU (35.7 percent). To contain the increasing balance-of-payments deficit, which had reached alarming levels, it is worth noting that, even without government intervention, the shortage in foreign currency along with the decrease in consumer purchasing power led to a 50 percent reduction in imports in 2020. Moreover, the de facto currency devaluation will, in its turn, lead to an increase in exports and a boost for the tourism industry (post-Covid), attracting much-needed foreign currency.

However, the government cannot rely on a shortage of foreign currency and the devaluation of the domestic currency to close the balance-of-payments gap. The government should aim to implement reforms and design policies to restore confidence and attract investment (with a focus

[3] Ibid.

on efficiency and strategic-asset seeking) in an effort to increase the inflow of hard currencies. It is important to note here that even prior to the crisis, foreign-investment volumes and their composition were suboptimal. About 70 percent of investment announcements in Lebanon between 2003 and 2017 were in market-seeking sectors; only 16 percent were in efficiency-seeking and 14 percent in strategic-asset-seeking sectors. Most investments were not conducive to the creation of value-added jobs.

Corruption in Lebanon is widespread at all levels of society. Political parties, public administration, the Parliament, and the police are perceived as the country's most corrupt institutions. In the 2019 Corruption Perceptions Index,[4] Lebanon ranked 137th out of 180 countries. The Global Corruption Barometer asserted that nearly one of two Lebanese is proposed a bribe in return for a vote, while one in four is subject to blackmail by refusing to vote a certain way. Lebanon has yet to establish appropriate integrity structures supported by the political will to fight corruption. Lebanon's confessional power-sharing arrangements fuel patronage networks and clientelism, which further undermine the country's governance system. Reducing corruption is associated with higher economic growth: sinking from the 50th to the 25th percentile in an index of corruption is associated with a decrease of 0.5 percent in per-capita GDP growth.[5]

THE WAY FORWARD

One of the main sets of reforms should target the business environment, to attract investment as well as help existing businesses perform better. Lebanon ranks as one of the least competitive economies in the world, not only among Arab countries. According to the Ease of Doing Business 2020 rankings, Lebanon ranks 143rd out of 190 economies and 15th among the 20 MENA countries.[6] In fact, since 2013, only one reform has been implemented, adopting the judicial-mediation law of 2019, while on average each MENA country has implemented 13 reforms since 2013. The World Economic Forum ranks Lebanon 88th out of 141 countries surveyed.[7]

Starting a business, obtaining licenses and credit, managing labor, paying taxes, trading across borders, and closing a business are all costly, cumbersome, and time intensive. Reforming the business environment focuses on updating, streamlining, or simplifying inconsistent, outdated, and complex regulations that constrain business and facilitate corruption. The suggested actions are crosscutting, to benefit all sectors of the economy. The approach evaluates the environment along the three phases of the business lifecycle: entry, operations, and exit, with an enabling policy landscape. However, crosscutting reforms need to be coupled with strategic reforms within specific priority sectors. Ultimately, the aim is to have a pro-enterprise political and regulatory environment, through encouraging innovation, increasing productivity, and improving competitiveness.

Transactional costs associated with business entry and registration remain high and continue to burden firms, especially for startups and small and mid-size enterprises (SMEs). Lebanon ranks

[4] "Corruption Perceptions Index 2019," Transparency International, https://www.transparency.org/whatwedo/publication/corruption_perceptions_index_2019.

[5] "IMF Annual Report 2018," https://www.imf.org/external/pubs/ft/ar/2018/eng/assets/pdf/imf-annual-report-2018.pdf.

[6] "Doing Business 2020: Comparing Business Regulation in 190 Economies," World Bank, https://openknowledge.worldbank.org/bitstream/handle/10986/32436/9781464814402.pdf?sequence=24&isAllowed=y.

[7] "Global Competitiveness Report 2019," World Economic Forum, October 9, 2019, https://www.weforum.org/reports/global-competitiveness-report-2019.

151st out of 190 economies in starting a business, according to the World Bank's 2020 *Doing Business* report, registering a 0.4 percent decrease in score compared to 2019. Currently, it takes 8 steps and 15 days to register a business, with a cost approaching 42.3 percent of per-capita income. While many countries have abolished archaic rules such as a high paid-in capital requirement and the use of notaries, Lebanon continues to impose them. The average cost to establish a business in the MENA region is 16.7 percent of per capita income, significantly lower than that in Lebanon. In addition, paid-in capital has been abolished in more than 117 countries. Online business registration is also not yet available.

The licensing and permit regime involves several challenges that create unnecessary burdens for business. These include complex procedures for issuing licenses and permits, a lack of risk-based approaches for licensing, a lack of transparency and predictability in the process, and difficulty in obtaining information about procedures, requirements, fees, and documents. These are not necessarily published online. For example, Lebanon ranked 164th out of 190 economies in dealing with construction permits in 2020, a 0.5 percent decrease compared to 2019. It takes about 22 procedures and 276 days to secure a permit, compared to 15.7 and 123.6 for MENA. A major issue is the high incidence of bribery and corruption. According to the World Bank's 2019 Enterprise Surveys (WBES), 56 percent of firms in Lebanon are expected to give gifts to get a construction permit. It is important to streamline construction, manufacturing, and other types of permits and initiate an assessment of key operating and sectoral licenses and permits across priority sectors such as technology and exports.

Although a tax-management modernization program was initiated in 2010, Lebanon still has a long way to go, ranking 116th out of 190 countries in paying taxes, scoring 0.4 percent less than the year before. Tax collection is extremely low, at 42 percent.[8] Among other problems, firms face a high number of tax payments,[9] lack of transparency in compliance requirements and inspection reports, and the absence of a grievance reporting and redress mechanism. The whole structure needs to be revisited. However, corporate tax rates should not be increased, as they are instrumental in attracting foreign direct investment and creating employment. In fact, a pro-growth tax policy should aim at broadening the tax base, maintaining low maximum tax rates, eliminating unnecessary tax expenditures, and improving progressivity.

Facilitating Access to Finance

A major hurdle to businesses, especially startups and SMEs, is access to finance. This is expected to be seriously impaired for a significant period of time due to the damage to the banking sector. According to the WBES, 47.8 percent of firms identified access to finance as a major constraint. Credit infrastructure remains weak pending key legislative reforms on a secured-transactions framework, which hampers lending to the private sector. The absence of a secured-transactions framework limits the scope of assets that businesses can take as collateral. A draft law on secured transactions, supported by the International Finance Corporation (IFC), is pending parliamentary approval. A new bankruptcy law is also pending approval and should be considered, to secure a swift and transparent process that will ultimately facilitate financing.

Resolving insolvency is another issue facing struggling firms. Lebanon ranks 151st out of 190 countries, mainly due to an outdated legal framework that is misaligned with recognized good

[8] "Government of Lebanon McKinsey Report," Lebanon Economic Vision, 2018.

[9] 20 payments per year, requiring up to 181 hours to comply, and more than 43 weeks to obtain a VAT refund.

practices and lacks the provisions needed for a dynamic private sector and effective debt recovery. Issues include low judicial capacity, hurdles for closing a company down, and an inability to resort to rescue proceedings. On average, it takes a minimum of three years for a secured creditor to recover only 30.8 percent from an insolvent firm, as opposed to 1.7 years and 70.2 percent in OECD countries. Two IFC-supported draft laws, insolvency and insolvency practitioners, were approved in 2018 by the Council of Ministers and are pending parliamentary approval. Out-of-court workouts (OCW) as complements or alternatives to the formal insolvency system can facilitate the restructuring of viable corporations experiencing temporary difficulties, achieving better financial, economic, and social outcomes. Devising an effective OCW framework has become especially relevant in the context of eventual economic recovery, given the increasingly widespread corporate distress.

Financing in general has been dominated by banking services, but there are emerging alternative sources: peer-to-peer lending, crowdfunding, direct capital markets especially for SMEs and mid-caps, and microfinance programs—by creating the appropriate regulatory and legislative environment for the new instruments. Lebanon has been doing well in venture-capital investments compared to its peers but is lagging in angel-seed funding. To further develop alternative sources of finance, it will have to establish national credit bureaus and rating agencies or encourage such entities to open in Lebanon. Several measures for ensuring post-crisis financing are laid out, among which is the granting of special incentives for international banks to open branches in Lebanon. This could potentially be done by having these banks open up in a Special Economic Zone (SEZ) that has its own regulatory authority and judicial system as proposed in this plan. In the long run, as the macroeconomic environment stabilizes, capital markets could potentially play a larger role in financing to key strategic sectors, including infrastructure and SME financing. This would, however, require strong commitments from a wide range of public authorities.

Opening Markets to Competition

An often-overlooked aspect that negatively impacts the business environment relates to market concentration and anti-competitive practices. For example, extraordinary rents accruing from monopolistic behavior represent more than 16 percent of Lebanon's GDP.[10] Although Article 14 of Lebanese Law (73/83) on the trade of goods, materials, and crops prohibits restrictive economic practices, laws on cartelization and other forms of market concentration and anti-competitive practices are not enforced. These market distortions are prevalent in sectors such as cement and agriculture, which the current crisis has exacerbated.

Moreover, exclusive rights granted to some importers based on Lebanon's Legislative Decree No. 34 of 1967, which provides specific regulations regarding commercial agencies and exclusive distribution, also hinder competition. The decree gives distribution agents registered under its provisions (including those that distribute goods and services on their own account rather than through agency agreements) the right to request customs to block the entry of goods (even secondhand goods) that have not been approved by the registered agent, essentially providing a state monopoly to registered importers/distributors.

Abolishing exclusive agencies and other forms of market restrictions that act as an entry barrier, while providing the right antitrust-enforcement framework for open-market competition,

[10] Sebastian Dessuss and Joey Ghaleb, "Lebanon- Trade and Competition Policies for Growth: A General Equilibrium Analysis," World Bank, 2006.

constitutes one of the main pillars for enhancing the business environment. The Ministry of Economy and Trade has completed a draft of the Competition Law that has been referred to a parliamentary committee for examination. The bill aims primarily at protecting the consumer and promoting a culture of competition that will drive prices down, enhance the quality of goods and services, and boost innovation and creativity. Once the law is enacted, a competition authority will be established to fight anti-competitive practices and ensure the proper functioning of the markets.

Attracting Investments, Boosting Exports

Reducing the cost of doing business, minimizing unnecessary regulatory barriers, creating a level playing field, fostering competition, ensuring the independence and efficiency of the judicial system, and improving governance will improve the competitiveness of the private sector and accelerate recovery. It will also increase the attractiveness of Lebanon for foreign investment as the economic and financial situations stabilize and prospects improve.

Key enabling policies and legislative requirements needed to support private investments and public-private partnerships (PPP) are missing, outdated, or underutilized. A review of the enabling landscape highlights a suboptimal investment policy, an outdated public procurement system, weak digital financial services, a nascent intellectual-property framework, a partially updated code of commerce, and the absence of a competition framework. In addition, the plan details the weaknesses of the investment law and makes recommendations for its revision. Lebanon needs a new investment strategy geared toward productive sectors with a competitive edge and value-added jobs. The review and update of the investment law will also include the protection guarantees required by foreign investors. Once the new investment framework is in place, the government will engage in an investor-outreach program and implement an "Invest in Lebanon" campaign. The government should strengthen the capabilities of the Investment Development Authority of Lebanon and enlarge the scope of its services to capture the whole investment cycle, from strategic planning to aftercare and policy advocacy.

Though the PPP law was enacted in 2017, it is only recently that the decree addressing the administrative structure and staffing of the Higher Council for Privatization, including a clause on financial regulations, was put into execution. The plan also emphasizes the need to write regulations that explain the critical details necessary to implement the PPP law so the framework can be effectively used. The need for PPP projects is all the more pressing since Lebanon has no more fiscal space to develop its infrastructure, and its financial sector is under severe pressure. The government needs to expedite the activation of the privatization council and develop a comprehensive infrastructure-investment finance policy spanning both public and PPP investment; these two aspects need to be closely coordinated.

A window of opportunity has opened in the midst of the current crisis and the ensuing devaluation of the Lebanese pound: boosting industries with high export potential. It is well known that currency devaluation renders exports cheaper and more competitive to foreign buyers. This, however, should be coupled with a targeted and well-designed national export policy that incentivizes the investment in export industries focused on high-value products. More important, fast-tracking Lebanon's efforts for accession to the World Trade Organization should be placed at the top of the policy agenda, as this will yield many benefits.

Besides facilitating access to finance, encouraging export activities entails financial or technical support for the following: accreditation and certification according to international standards and participation in international trade fairs, entering new trade agreements or renegotiating existing ones, providing selective tax incentives, developing e-commerce platforms, and supporting targeted interventions aimed at improving productivity, food quality, and the compliance of standards with foreign regulations. Finally, also needed are a comprehensive review of tariffs and other import restrictions and reforms to ensure that tariffs are, in general, low and consistent with a model of an open and competitive economy. For the first time in Lebanon, the Ministry of Economy and Trade has released a full list of goods and services in which Lebanon has a comparative advantage based on the revealed comparative-advantage measure. This work can be used as the basis for designing policy targeted at promoting investment in industries whose products can be easily exported. A national export strategy can leverage the influence of the Lebanese diaspora and economic attachés in various countries to promote Lebanese goods and services.

Fighting Corruption

Weak institutions, rampant corruption, and inefficiencies are often cited as major economic constraints. The imminent need to reduce waste, fraud, and abuse and to increase productivity goes beyond enhancing the business environment and highlights the need to reform the governance structure. Reforms aimed at fighting corruption, increasing transparency, and improving overall governance are emphasized in the plan. These include, but are not limited to, the independence of the judiciary, an anti-corruption strategy, digitizing and modernizing customs processes, and a public-procurement law.

The integrity of the judiciary is the cornerstone of a democratic society respectful of the rule of law. Furthermore, an effective judiciary is essential for economic development, and the degree of judicial independence is correlated with economic growth.[11] The draft bill for judicial independence being examined by a parliamentary committee aims to ensure the independence, impartiality, and efficiency of the judicial branch within a system of checks and balances that guarantees and protects the separation of powers. The proposed draft enhances judicial independence by increasing the number of elected judges on the High Judicial Council, ensuring objective criteria for nominations, and providing guarantees for judges. It also enhances transparency and accountability by reforming judicial inspection and strengthening its role. Faced with an ever-increasing influx of cases, namely those related to corruption, the other challenge facing the judiciary is to administer justice within a reasonable period of time.

Anti-corruption legislation exists in Lebanon, but it is not adequately enforced. There is legislation that prohibits public servants from requesting or receiving—directly or through an intermediary—gifts, gratuities, or incentives of whatever nature. The law on fighting money laundering permitted the formation of the Special Investigations Committee (SIC) to investigate violations and lift bank secrecy in cases under criminal investigation and authorized by a court. As a result of recent legislation and international agreements, SIC's responsibilities have been expanded to include fighting corruption, suppressing terrorism financing, the exchange of information for tax purposes, and monitoring the declaration of cross-border transportation of money. It unfortunately has been and remains ineffective.

A five-year anti-corruption strategy adopted by the government in May 2020 calls for the implementation and enforcement of the Right of Access to Information Law of 2017, the Whistleblower Protection Law of 2018, and the Anti-Corruption in the Public Sector Law and the law creating the

[11] Kenneth W. Dam, "The Judiciary and Economic Development," Coase-Sandor Working Paper Series in Law and Economics, 2006.

National Commission for Combating Corruption, both of 2020. Members of the National Commission for Combating Corruption will have to be appointed so that the commission can start exercising its role. The Illicit Enrichment Law has recently been passed by the Parliament, as have amendments to the banking-secrecy provisions that are key to facilitating the forensic audit of the central bank and major public bodies and institutions. Further pivotal legislation to counter systemic corruption is also being drafted, such as laws governing conflict of interest and recovery of public assets, which should set up the mechanism through which the state will recoup stolen funds.

Cumbersome customs processes and procedures, requirements for submission of redundant documents, low levels of customs automation, and excessive inspections of cargo are cited by the private sector as key sources of inefficiency. This is confirmed by Lebanon's low ranking of 153rd out of 190 countries in the trading across borders indicator of the ease of doing business index 2020. Key border functions, such as quarantine or standards agencies, also lag in terms of both procedural simplification and the application of automation. Lack of coordination among the control agencies complicates the day-to-day business of Lebanese traders, who spend disproportionate work hours to process their declarations. These inefficiencies lead to increased costs and time spent to import and export. In some cases, "unofficial payments" are required to speed the process. Improving the effectiveness, efficiency, accountability, and transparency of the customs administration will also enhance community protection and strengthen Lebanon's relations with its trading partners and its access to international markets.

Significant areas in Lebanon's public-procurement system remain in need of reform: (i) a weak control environment that does not enforce the implementation of rules and procedures; (ii) lack of an institutionalized and independent procurement-policy unit or a complaints-handling mechanism; (iii) lack of procurement-performance information; (iv) lack of private-sector competitiveness; (v) weak implementing agencies; and (vi) lack of transparency. The World Bank has finalized a diagnosis of the Methodology for Assessing Procurement Systems (MAPS). A draft bill for public procurement that was reviewed by the World Bank and OECD/Sigma is being evaluated by the relevant parliamentary committee. This first step should pave the way for the deployment of an electronic public-procurement platform and the building of a procurement database. A sound public-procurement system will instill in people the confidence that taxpayer money is being used in appropriate and efficient ways.

Improving Infrastructure

Decades of low public spending on capital improvements has resulted in very weak infrastructure, hampering productivity and intensifying inefficiencies. Lebanon ranks 89th out of 141 countries in infrastructure (transport and utilities).[12] According to the Lebanese government's capital-investment program, presented to the CEDRE conference in Paris, high-priority infrastructure sectors in need of investment are electricity, telecom, transportation, and customs. Higher infrastructure spending, coupled with the establishment of technically competent regulatory and supervisory agencies for sectors traditionally viewed as natural monopolies (electricity, telecom, water, and others) will be essential to economic growth. While effective regulation might work in some cases, in others it is necessary to vertically restructure the sector (for example, electricity) and open parts of it to competition. It is worth noting here that the electricity sector accounts for

[12] "Global Competitiveness Report 2019," World Economic Forum, https://www.weforum.org/reports/global-competitiveness-report-2019.

about one-third of Lebanon's public debt. An electricity plan approved by the Council of Ministers in 2019 sets out three main objectives: reduction of technical and commercial losses, increase in generation and reduction of fuel costs, and increasing consumer tariffs.

Getting Ready for the Digital Economy

The export of services has always been a major contributor to exports. It is expected that, in the next few years, the export of knowledge services will boom. However, the government should work on providing the right environment and policies for knowledge-based activity to thrive. For example, strengthening digital financial services, enhancing the intellectual-property framework, and providing affordable and high-speed Internet will go a long way toward building a knowledge- and innovation-based economy that can potentially become the main engine for growth.

Digital financial services are lagging due to regulatory constraint, and more recently due to the banking crisis. According to Global Findex 2017 data, only 33.1 percent of Lebanese adults made or received digital payments in 2017, compared to 31.9 percent in 2014. The share of Lebanese adults that made or received digital payments in 2017 is the 43rd lowest among 144 countries. It is also lower than the average rate of MENA countries, 37.7 percent. In addition, 13.8 percent of Lebanese reported using the Internet to buy goods or services online in 2017, of whom 16.4 percent paid online for the purchase and 83.4 percent paid cash on delivery. While there is significant interest from market players (banks, telecoms, fintech, money-transfer operations) to offer digital financial services, still-pending implementation texts following Law 81 are needed to clarify the legal status of e-money and agent banking.

Lebanon has a nascent intellectual-property framework, which currently acts as a disincentive for startups and SMEs to develop new technologies and technical innovations, further anchoring the economy in traditional industries. The World Economic Forum ranks Lebanon 120th out of 141 countries in intellectual-property protection.[13] Patent awards in Lebanon are based on a deposit system with limited examination, significantly reducing application worthiness. Moreover, high rates of software piracy constitute a drag on digital-market growth. Intellectual-property enforcement (by Lebanon's internal security forces, customs, and judiciary) is weak.

Lebanon ranks 90th out of 100 on the Digitization Index,[14] which assesses the factors that enable a country to fully leverage its information and communication technology for increased competitiveness and wellbeing. The government should adopt a unified vision for the tech sector, given its vital role as the real driver of growth in today's knowledge economy. Affordable and high-speed Internet is a must for the development of the economy, especially the Knowledge Economy. The sector should open to competition, to trigger creativity and competitiveness, and engage in the necessary reforms to attract investments and concessionary projects. The reform will standardize the terms and conditions of all data-service providers, including revenue sharing, the right to build infrastructure, spectrum usage, and other things. It will also define clear, transparent, and non-discriminatory terms for access to the fiber-optic infrastructure, whose penetration is still very limited due to legal and technical problems.

While these reforms are being implemented, SEZs for financial and knowledge-based services could be a more expeditious way to prepare for the digital economy and simplify access to finance. SEZs that have their own regulatory authority and judicial system (for example, based on UK law

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[13] Ibid.

[14] Noelia Cámara and David Tuesta, "DiGiX: The Digitization Index," February 2017, https://afyonluoglu.org/PublicWebFiles/Reports/2017%20BBVA-Digitization%20Index.pdf.

with an international panel of judges) can address the numerous constraints hindering economic growth. Examples of incentives to be provided to firms located in the SEZ include zero percent customs duties, unrestricted capital and profit repatriation, one-stop shopping for registration, and generous tax incentives. These areas will provide the confidence needed to attract foreign investment, incentivize multinational corporations to open offices in Lebanon, create jobs, promote exports, integrate domestic firms into global value chains, and introduce new technologies into the domestic economy.

Sustainable, Inclusive Growth

To make sure growth is as inclusive and equitable as possible, several measures are emphasized, such as the need for a new labor law, strengthening social safety nets, multiple propositions aimed at the economic empowerment of women, and improved vocational training.

Firms face constraints related to hiring and firing of labor. High social-security contributions (particularly for startups); expensive firing regulations; lack of flexibility in employing non-fulltime employees; work permits for foreign labor; discretionary granting of work permits; and expensive and cumbersome firing processes are some of the issues raised by the private sector as constraints on their business operations. The Ministry of Labor is currently preparing a draft for an updated law addressing the issues of high labor costs and labor-market inflexibility. It aims at extending rights protection to additional productive sectors in order to organize part-time work and cover seasonal agricultural workers, remote workers (those using new technologies), and houseworkers.

Unemployment in Lebanon has remained stubbornly in excess of 10 percent, with youth unemployment close to 25 percent, in spite of the high rate of emigration—about half of every cohort goes abroad to find employment, the trend increasing year after year. A big part of the problem is due to a mismatch between the labor market needs and the education system, which lacks the flexibility to adapt to changing skill requirements. Better coordination between job-market needs and higher-education programs is crucial. For example, partnerships can be forged between certain industries and academia to fulfill their needs for specific skillsets and credentials. Tertiary education in Lebanon is considered high quality, though Lebanon trails its peers in terms of primary and secondary education. According to the Universal Scale Score, Lebanon is classified as "poor," and its public expenditures per student are low compared to peers.

The structural constraints on the economy have resulted in the creation of only about 20 percent more new jobs annually in the last two decades as a percentage of the number of new job seekers coming into the labor market. This has been further exacerbated by the inflow of refugees from Syria, who have increased the labor supply. Most of the jobs created in the Lebanese economy are in low-value-added sectors such as wholesale and retail trade, repair and maintenance, transport and storage, and food and hospitality services.

Women's empowerment is a prerequisite for sustainable and inclusive growth. The labor-force participation rate of women in Lebanon is a mere 26 percent. It has been estimated that raising women's labor force participation by 25 percent would increase Lebanon's GDP by 9 percent.[15] Moreover, Lebanon ranks very low (147th out of 167 in 2019) on an index measuring women's empowerment constructed by National Geographic and the Georgetown Institute for Women,

[15] "Republic of Lebanon Women's Economic Empowerment National Action Plan," World Bank, January 2019, http://pubdocs.worldbank.org/en/940761574447198430/pdf/Lebanon-WEEAP-Jan-8-2019-en.pdf.

Peace and Security. According to the World Economic Forum's 2020 Gender Gap report, out of 153 countries, Lebanon ranked at the bottom (145th).[16] A new World Bank-IFC initiative, the Mashreq Gender Facility, aims at enhancing women's economic empowerment and opportunities.[17]

In order to avoid further increasing social hardship and to cushion the negative effects of a deep recession and devaluation, the government will scale up the National Poverty Targeting Program to reach around 200,000 families. The Emergency Social Safety Net loan for an amount of $246 million was approved by the World Bank in January 2021. It is supposed to be used to pay for one year of direct cash transfers to approximately 200,000 families. There is a proposal by the Ministry of Economy and Trade to replace the current inefficient subsidy scheme with unconditional cash transfers, as well.

Lebanon ranks very low in its quality of vocational training (107th out of 141 countries).[18] There is an urgent need to strengthen and promote technical schools and vocational training to complement the needs of the manufacturing sector and other sectors, as well as to help youth and the unemployed to secure employment. Technical/vocational training is associated with academic failure and poor working conditions, resulting in only 26 percent of students enrolled in secondary education to opt for a vocational track.[19] The average among OECD countries is at least a third of the population.[20] Efforts should be made to remove the stigma surrounding technical and vocational training.

Concluding Remarks

Lebanon aspires to shift its economy to a productive, competitive, and sustainable economy. This transformation implies a focus on comparative advantage and knowledge-based industrial activities, aided by government policies and driven by a vibrant and pioneering private sector. The aim is to achieve sustainable, diverse, and inclusive economic growth in a fair and equitable manner, such that all Lebanese can enjoy decent living standards and reach their full potential. Such growth should come mainly from the productive sectors, with an emphasis on the knowledge economy; in a few years, knowledge-based activity and innovation should be the main engine for growth. The complete economic plan, technically supported by the World Bank and UK's Department for International Development, can be found at https://t.co/PdlpptStl5.

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[17] More information on MGF's activities and work can be found at https://www.worldbank.org/en/programs/mashreq-gender-facility.

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