ECONOMIC Bulletin

FIRST QUARTER 2012

90 YEARS SINCE 1921

FRANSABANK

ECONOMICBulletin FIRST QUARTER 2012

Report - Lebanon's Economic Performance in Q1 2012

Study - Lebanon's Prospects Amidst The Current Turmoil: How to Foster Economic Growth

Lebanon Economic Performance in Q1 2012

Executive Summary

The Lebanese economy has recorded a relative slowdown in its performance in the first quarter of 2012 relative to the same period of 2011, due to the regional turmoil in some Arab countries, especially in Syria, which has affected the Lebanese economy. Lebanon's major economic indicators are presented in the following:

- Construction permits decreased by **3.87%**.
- Number of real-estate sales transactions decreased by **3.40%**.
- The number of tourists decreased by **7.87%**.
- The number of passengers at the Hariri International Airport (HIA) grew by **21.40%**.
- The value of cleared checks increased by **2.47%**.
- Fiscal deficit decreased by **34.07%**.
- Net public debt increased by **2.85%**.
- Inflation rose by **4.00%**.
- The Central Bank of Lebanon's gross FX assets increased by **6.58%** to USD 32.40 billion.
- The banking sector's total assets grew by **9.20%** to USD 144.70 billion.
- Market capitalization of Beirut Stock Exchange (BSE) fell by **10.74%** to USD 10.80 billion.
- The trade deficit widened by **31.50%.**
- Capital inflows surged by **37.50%** to USD 4.40 billion.
- The balance of payments recorded a deficit of **USD 373.20 million**.
- Economic growth is forecasted at **3.00 to 4.00%** in 2012 and inflation rates at 7.00%, as per the International Monetary Fund (IMF) and the Institute of International Finance (IIF) estimates.

I. General Introduction

The Lebanese economy has recorded a relative slowdown in its overall activity during the first quarter of 2012 relative to the corresponding period last year.

This is indicated by the realized decline in several indicators of the real sector, such as construction permits (-3.87%), number of tourists (-7.87%), number of ships via Beirut Port (-6.90%), and SMEs loans (-21.50%).

In parallel, inflation rose by 4.00% during the same period, coupled by an increase in net public debt (2.85%) and trade deficit (31.50%), with a decline in fiscal deficit (-34.07%).

Also, the total trading volume at BSE fell down by 46.82%, coupled by lower capital inflows (-37.50%), and a deficit of USD 373.20 million in the balance of payments.

On the other hand, the Central Bank of Lebanon's foreign-currency denominated assets increased by 6.58% to USD 32.40 billion at end-March 2012, and consolidated assets of the banking sector grew by 9.20% to USD 144.70 billion during the same period.

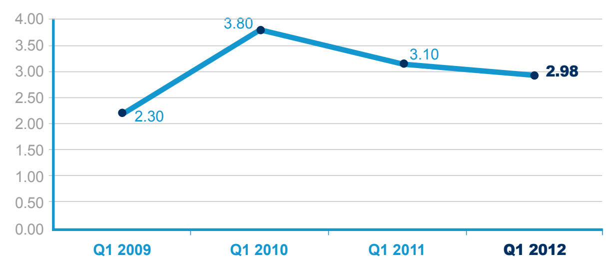
Economic growth is forecasted at 3.00% to 4.00% in 2012 and inflation rates at 7.00%, as per the International Monetary Fund (IMF) and the Institute of International Finance (IIF) estimates.

II. Real Sector

1- Construction and Real Estate

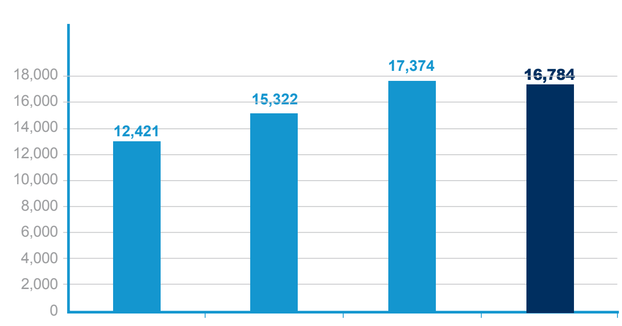
Based on the figures released by the Order of Engineers of Beirut and Tripoli, the construction permits totaled 2.98 million square meters in the first quarter of 2012, down by 3.87% from 3.10 million square meters in the same period of the previous year. Mount Lebanon accounted for 49.70% of the total construction permits, followed by South Lebanon with 17.40%, North Lebanon with 16.60%, Bekaa with 8.20%, and Beirut with 8.10%.

- Construction Permits (Square meters, million) **-**



The number of sales transactions has decreased by 3.40%, to reach an amount of 16,784 transactions in the first quarter of 2012, as compared to 17,374 transactions in the same period of 2011.

- Number of Sales Transactions -

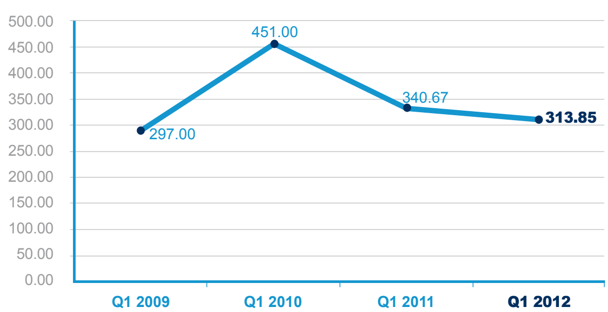


2- Tourism

According to the figures released by the Ministry of Tourism, the number of tourists visiting Lebanon decreased by 7.87% in the first quarter of 2012 relative to the same period of 2011 to reach 313,854 as compared to 340,670 in the same period of 2011.

As for the distribution of tourists by countries, it shows that the greater part of visitors were from Arab countries with 43.20% of aggregate visitors, followed by visitors from Europe with 28.00%, visitors from the Americas with 11.30%, visitors from Asia with 10.80%, visitors from Africa with 4.40%., and visitors from Oceania with 2.30%.

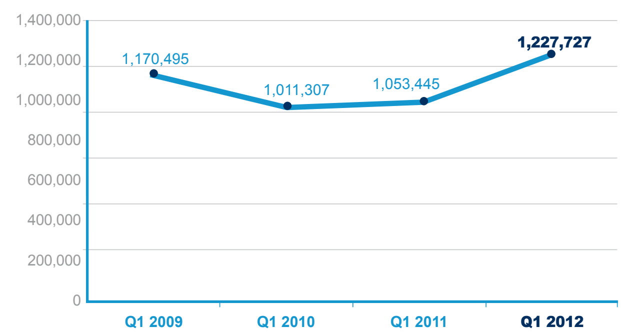
- Number of Tourists -
(Thousands)



3- Airport Activity

Based on the figures released by the Hariri International Airport (HIA), the number of airport passengers amounted to 1,227,727 in the first quarter of 2012, up by 21.40% year-on-year. As for the distribution of passengers from different countries, passengers from the UAE accounted for 21.10% of total passengers, followed by those from Saudi Arabia with 12.60%, France with 9.40% and Kuwait with 8.30%.

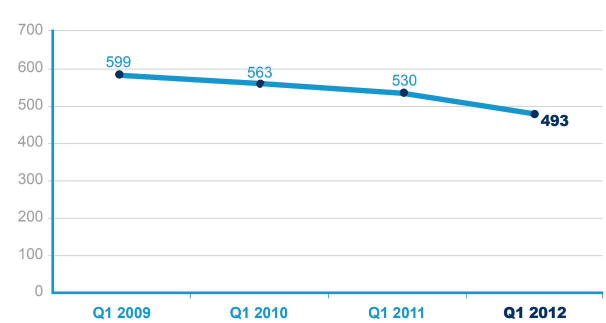
- Passengers at HIA -



4- Beirut Port

Figures released by the Beirut Port Authority show that the total tonnage of loaded and unloaded merchandise increased by 5.40% in the first quarter of 2012 relative to the same period of 2011, to reach 1.63 million tons in March 2012. The number of containers increased by 4.70% in the first quarter of 2012 as compared to the same period of 2011, to reach 137,856. Also the total number of ships reached 493 in the first quarter of 2012, down by 6.90% as compared to the same period of 2011. Whereas, total transshipments declined by 3.10% as compared to the same period of 2011, to reach 105,997 in the first quarter 2012.

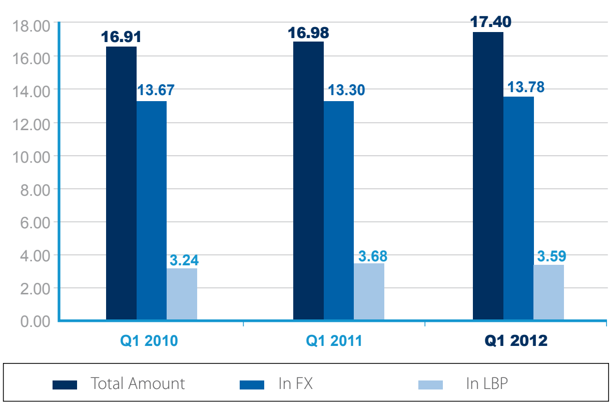
- Number of Ships at Beirut Port -



5. Clearing Activity

Based on the figures released by the Lebanese Association of Banks, the value of cleared checks increased by 2.47% as compared to the same period of 2011, to reach USD 17.40 billion in the first quarter of 2012. The value of cleared checks in Lebanese pounds declined by 2.42% to the equivalent of USD 3.59 billion, while the value of cleared checks in foreign currencies grew by 3.60% to USD 13.78 billion. The dollarization rate of cleared checks surged from 78.30% to 79.20% year-on-year.

- Evolution of Clearing Activity (USD, billion) **-**

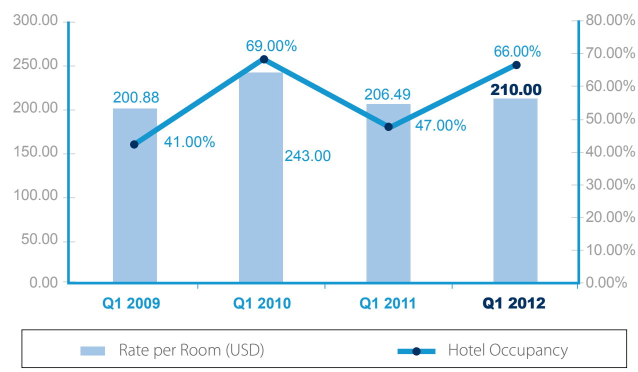


6- Hotel Occupancy

According to the survey conducted by Earnest & Young Benchmark concerning the occupancy rate at hotels, it increased to reach 66.00% in the first three months of 2012, an increase of 19.00% as compared to the same period last year.

Further, rate per available room increased by 1.70% as compared to the same period of 2011, reaching a value of USD 210 in the same said period.

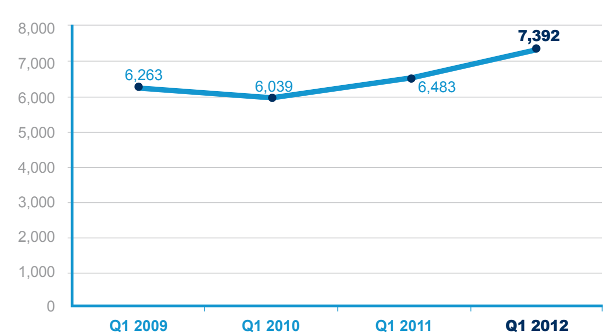
- Hotels Activity Indicators -



7- Cars Sales

Based on the figures released by the Association of Automobile Importers in Lebanon, the number of cars sold during the first quarter of 2012, reached 7,392 new cars, constituting an increase of 14.02% from the 6,483 cars sold in the same period of 2011.

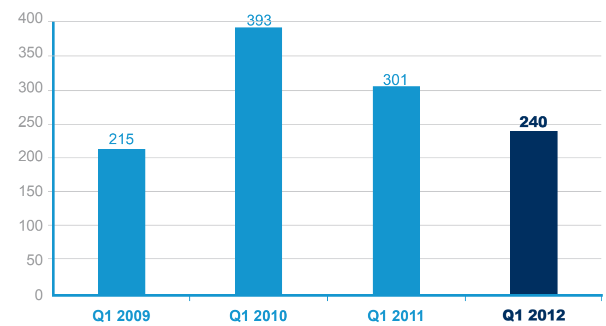
- Number of Cars Sold -



8- Kafalat Loan Guarantees

Based on the figures released by the Kafalat Corporation, loans under the guarantee of Kafalat has decreased by 20.26% in the first quarter of 2012, reaching an amount of USD 33 million, as compared to USD 41.35 million in the same period of 2011. The number of loan guarantees reached 240 in the said period, as compared to 301 in the same period of previous year. The average loan size decreased by 1.20% to reach USD 137,491 in the first three months of 2012, as compared to USD 139,161 in the same period of the previous year.

- Number of Kafalat Loan Guarantees -



Real Sector's Indicators

Indicators	Q1 2012	Q1 2011	Variation
Construction permits (Square meters, million)	2.98	3.10	-3.87%
Sales transactions	16,784	17,374	-3.40%
Number of tourists	313,854	340,670	-7.87%
Number of passengers at HIA	1,227,727	1,011,308	21.40%
Cleared checks (USD, billion)	17.4	16.98	2.47%
Hotel occupancy rate (%)	66.00	47.00	19.00%
Number of containers at Beirut Port	137,857	131,668	4.70%
Number of car sales	7,392	6,483	14.02%
Number of Kafalat guarantees	240	301	-20.26%

Sources: Official Departments

III. Public Finances

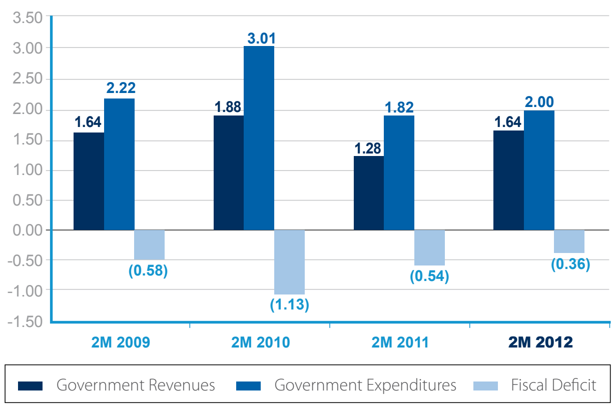
1. Fiscal Deficit

According to the figures released by the Ministry of Finance, the fiscal deficit has decreased by 34.07% as compared the first two months of 2011, to reach an amount of USD 356 million in the same period of 2012.

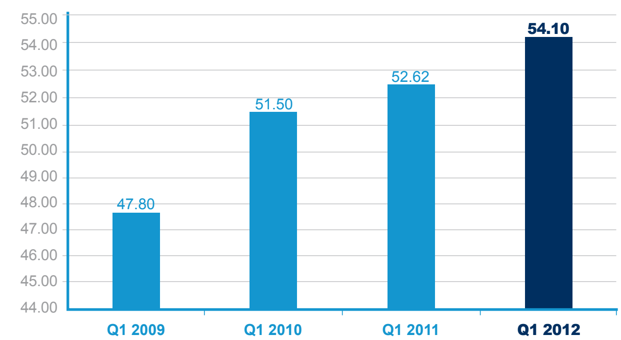
Overall government revenues which include budget and Treasury receipts, increased by 28.12% relative to the same period of 2011, to reach USD 1.64 billion in the first two months of 2012. Treasury revenues registered an increase from USD 125 million to become USD 160 million. Budget revenues increased by 34.00% to reach USD 1.50 billion due to the surge in tax revenues. Total tax revenues grew by 12.80%, to reach USD 1.20 billion. As for non-tax revenues, they dropped by 1.60% to reach USD 143 million.

While on the spending side, total public expenditures, which include budgetary and Treasury spending, increased by a yearly 9.89% in the first two months of 2012 to reach USD 2.00 billion, caused mainly by a rise in Treasury expenditures.

- Public Finance Indicators (USD, billion) **-**



- Gross Public Debt (USD, billion) **-**



Interest payments on domestic and foreign debt decreased by 25.60% as compared to the same period of 2011, to reach a total of USD 368.20 million in the first two months of 2012.

When excluding debt service, the first two months of 2012 have been enhanced with respect to the level of the primary balance, which registered a cumulative surplus of USD 410.70 million, compared to a deficit of USD 27.40 million in the first two months of 2011.

2. Public Debt

Based on the figures issued by the Ministry of Finance, the gross public debt reached USD 54.10 billion at the end of March 2012, constituting an increase of 2.81% from March 2011.

Domestic debt increased by 5.50% to USD 33.50 billion, while external debt decreased by 1.30% annually to USD 20.60 billion. Local currency debt accounted for 61.90% of gross public debt at end-March 2012 compared to 60.30% a year earlier, while foreign currency denominated debt represented 38.10% of the total at the end of March 2012 relative to 39.70% a year earlier.

Commercial banks accounted for 48.80% of total public debt at the end of March 2012 compared to 53.10% a year earlier. They were followed by the Central Bank of Lebanon with 35.70%, up from 30.50% at end-March 2011; while public agencies, financial institutions and the general public held 15.60% of the debt relative to 16.40% a year earlier. Further, bilateral and multilateral loans accounted for 6.70% of total public debt, up from 4.90% at end-March 2011, while other public debt holders held the remaining 6.00% compared to 1.80% a year earlier.

Net public debt, which excludes the public sector's deposits at the Central Bank of Lebanon and at commercial banks from overall debt figures, increased annually by 2.85% to USD 46.90 billion.

Public Finances' Indicators

Indicators	1st two months 2012	1st two months 2011	Variation
Public revenues (USD, billion)	1.64	1.28	28.12%
Public expenditures (USD, billion)	2.00	1.82	9.89%
Deficit (USD, million)	356	540	-34.07%
Deficit /Expenditures (%)	17.80	29.60	-11.8%
Gross public indebtedness (USD, billion) – first quarter	54.10	52.62	2.81%
Net public debt (USD, billion) – first quarter	46.90	45.60	2.85%

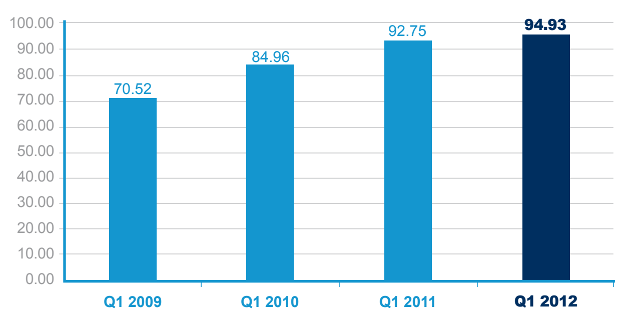
Sources: Ministry of Finance and Central Bank of Lebanon

IV. Monetary Situation

1. Money Supply

Based on the data issued by the Central Bank of Lebanon, Money supply (M3) expanded broadly to reach USD 94.93 billion over the first quarter of 2012, an increase of USD 2.18 billion or 2.35% as compared to its level during the corresponding period of 2011. This resulted from an increase in local currency denominated deposits of USD 2.23 billion, a rise in foreign currency deposits of USD 356 million, a contraction in money supply (M1) of USD 496 million, and a growth in Treasury bills held by the public of USD 85 million.

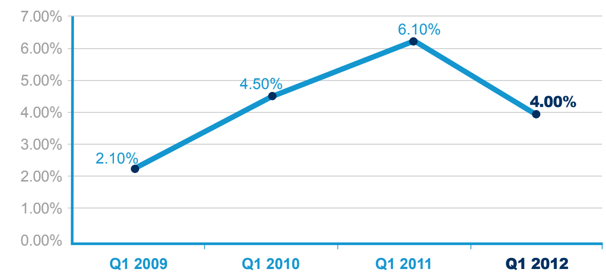
- **Money Supply (M3)** (USD, billion) -



2. Consumer Prices

Based on the figures issued by the Central Administration of Statistics, inflation rose by 4.00% in the first quarter of 2012. This is due to the increase in prices of most commodities in the Lebanese market, such as prices of education, which increased by 7.50%, followed by prices of transportation (6.60%), prices of food and beverages (6.30%), prices of recreation and entertainment (5.20%), prices of restaurants and hotels (4.70%), and miscellaneous goods and services (3.10%).

- **Consumer Price Index** -

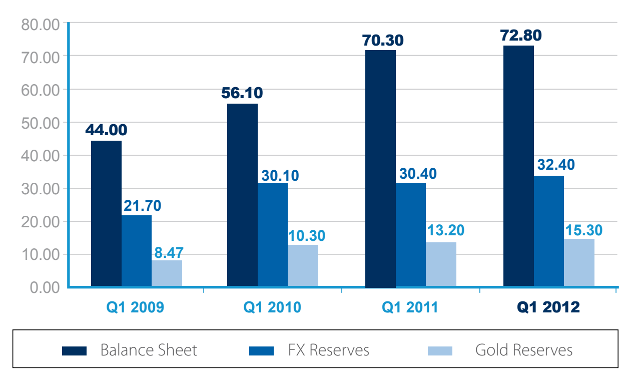


3. Central Bank of Lebanon Foreign Assets

According to the figures released by the Central Bank of Lebanon, its balance sheet reached USD 72.80 billion at the end of the first quarter of 2012 compared to USD 70.30 billion in the same period of 2011. Assets in foreign currencies increased by 6.58% to reach USD 32.40 billion, as compared to USD 30.40 billion in the same period of 2011. Its gold reserves increased by 15.90% from its value in the same period of 2011, to reach a value of USD 15.30 billion in the first quarter of 2012.

Also deposits of the financial sector rose by 16% in the first quarter of 2012, to USD 51.40 billion due to capital inflows into the banking sector. While deposits of the public sector declined by 5.70% in the first quarter of 2012, to reach a value of USD 5.10 billion.

- **Central Bank's Indicators** (USD, billion) -



Monetary Situation's Indicators

Indicators	Q1 2012	Q1 2011	Variation
USD/LBP exchange rate	1,507.50	1,507.50	0.00%
Central Bank of Lebanon assets in FX (USD, billion)	32.40	30.40	6.58%
Central Bank of Lebanon gold reserves (USD, billion)	15.30	13.20	15.90%
Money supply (M3) (USD, billion)	94.93	92.75	2.35%
Inflation rate (%)	4.00	6.10	-2.10%

Sources: Central Bank of Lebanon and Lebanese Association of Banks

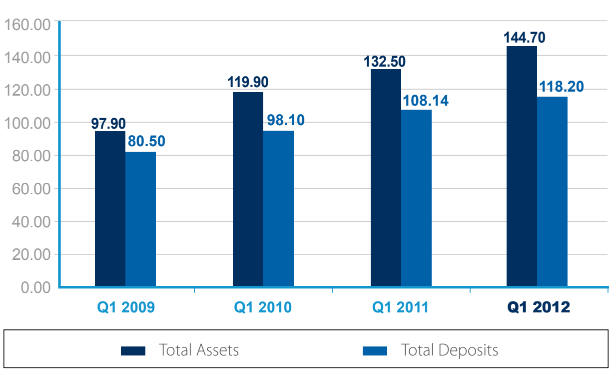
V. Financial Sector:

1. Banking Sector:

Based on the figures released by the Central Bank of Lebanon, the banking sector's total assets reached USD 144.70 billion in the first quarter of 2012, an increase of 9.20% as compared to the same period of 2011. Private sector deposits have also increased by 9.30% from the same period of 2011, to reach USD 118.20 billion.

Deposits in Lebanese pounds rose by 10.90% from the same period of 2011, to reach USD 40.90 billion, and deposits in foreign currencies increased by 8.50% from the same period of 2011, to reach USD 77.30 billion. Non-resident foreign currency deposits had increased by 18.20% from the same period of 2011, to reach USD 18.90 billion. The dollarization rate of deposits decreased by 0.50% as compared to the same period of 2011, to reach 65.40% at end-March 2012

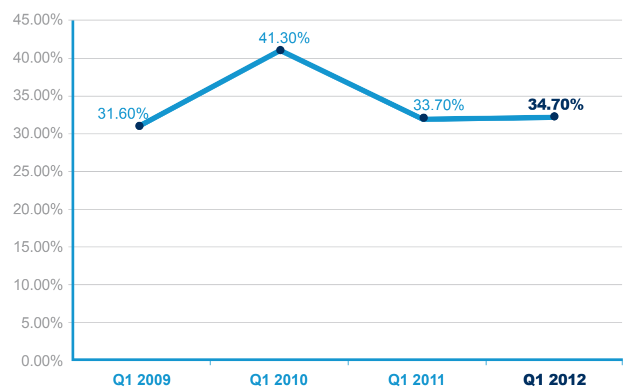
- **Banking Assets and Deposits** (USD, billion) -



Further, loans to private sector have increased by 12.57% in the first quarter of 2012 as compared to the same period of 2011, to reach USD 41.00 billion.

The ratio of private sector loans to deposits increased from 33.70% in the first quarter of 2011 to 34.70% in the first quarter of 2012. The banks' aggregate capital base has increased by 15.79% in the first three months of 2012 to reach USD 11.00 billion

- **Loans to Deposits Ratio** -



Banking Sector's Indicators

Indicators	Q1 2012	Q1 2011	Variation
Total assets (USD, billion)	144.70	132.50	9.20%
Total deposits (USD, billion)	118.20	108.14	9.30%
Total loans (USD, billion)	41.00	36.42	12.57%
Ratio of private sector's loans to deposits (%)	34.70	33.70	1.00%
Banks' capital base (USD, billion)	11.00	9.50	15.79%

Sources: Central Bank of Lebanon and Lebanese Association of Banks

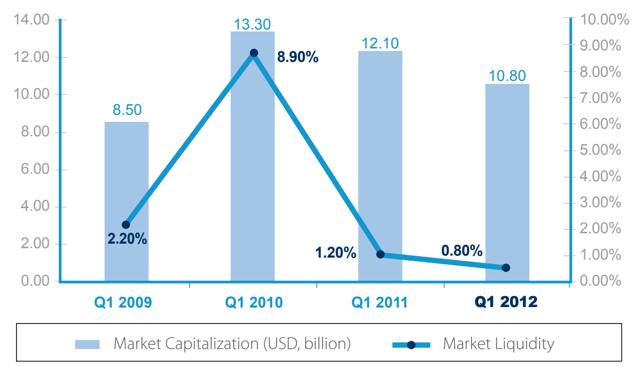
2. Capital Market

Figures released by the Beirut Stock Exchange indicate that the total trading volume decreased by 46.82% in the first quarter of 2012, as compared to the corresponding period of 2011, to reach 13.40 million shares. Aggregate turnover also declined by 39.65% to reach an amount of USD 90.40 million.

Market capitalization decreased by 10.74% to reach USD 10.80 billion, of which 74.60% was in banking stocks and 21.70% in real estate stocks. The market liquidity ratio decreased to 0.80%, as compared to 1.20% for the same period of 2011.

In terms of value of shares traded, banking stocks accounted for 74.70% of aggregate value, and real estate stocks with 24.50%. The average daily traded volume for the period was 215,965 shares for an average daily value of USD 1.50 million

- Stock Market Activity -



BSE Indicators

Indicators	Q1 2012	Q1 2011	Variation
Market capitalization (USD, billion)	10.80	12.10	-10.74%
Total trading volume (Shares, million)	13.40	25.20	-46.82%
Aggregate turnover (USD, million)	90.40	149.80	-39.65%
Average daily volume (Shares)	215,965	426,403	-49.35%
Average daily value (USD, million)	1.50	2.50	-40.00%

Sources: BSE and Central Bank of Lebanon

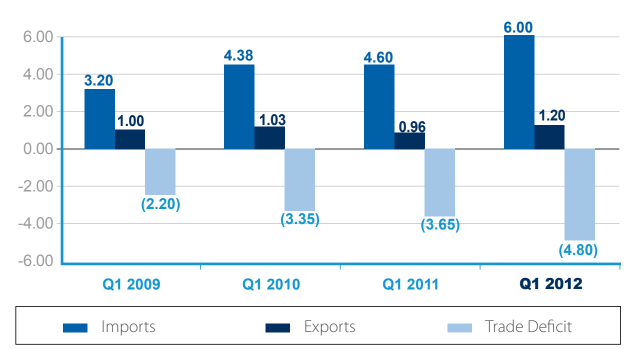
VI. Foreign Sector

1. Foreign Trade

According to figures issued by the Higher Customs Council, imports increased by 30.43% to reach USD 6.00 billion in the first quarter of 2012. Exports also increased by 25.00% to reach USD 1.20 billion in the same period, leading to an increase of 31.50% in trade deficit to reach USD 4.80 billion.

The main sources of imports are the United States with 12% of total imports, followed by Italy (9%), China (8%), France (7%), and Germany (6%). While the main sources of exports are Switzerland and UAE with 10% each of total exports, followed by Saudi Arabia (8%), Turkey (7%), Iraq (6%), and Syria (5%).

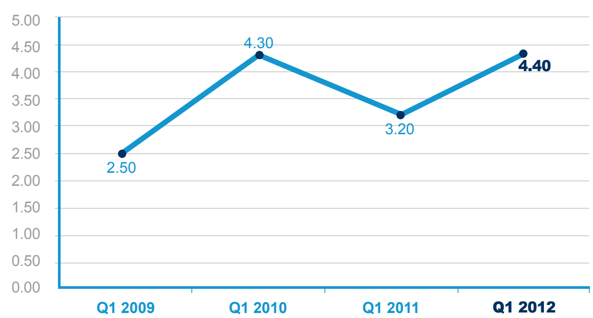
- External Sector Indicators (USD, billion) -



2. Capital Inflows

Based on the figures released by the Higher Customs Council, capital inflows increased by 37.50% to reach an amount of USD 4.40 billion, due to the increase in the major financial inflows such as non-resident deposit inflows, inward remittances and cash transfers from tourists.

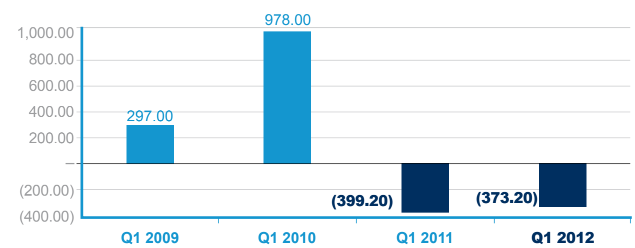
- **Financial Inflows** (USD, billion) -



3. Balance of Payments

Based on the figures issued by the Central Bank of Lebanon, Lebanon's balance of payments posted a deficit of USD 373.20 million in the first quarter of 2012 compared to a deficit of USD 399.20 million in the same period last year. This cumulative deficit over the first quarter of 2012 was caused by a surplus of USD 118 million in the Central Bank of Lebanon's net foreign assets and a deficit of USD 491.20 million in those of banks and financial institutions.

- **Balance of Payments** (USD, million) -



Foreign Sector's Indicators

Indicators	Q1 2012	Q1 2011	Variation
Trade deficit (USD, billion)	4.80	3.65	31.50%
Exports (USD, billion)	1.20	0.96	25.00%
Imports (USD, billion)	6.00	4.60	30.43%
Capital inflows (USD, billion)	4.40	3.20	37.50%
Balance of payments (USD, million)	-373.20	-399.20	6.51`%

Sources: Higher Customs Council and Central Bank of Lebanon

VII. Economic Prospects

Based on the figures released by the International Monetary Fund (IMF) in its World Economic Outlook 2012 and the Institute of International Finance (IIF) report, Lebanon real GDP growth is estimated from 3.00% to 4.00% based on the IMF estimates at 3.80% and IIF estimates at 3.00%.

This enhancement in the economic growth is mainly driven by the recovery in tourism and retail trade buoyed by an improved domestic environment and continuous growth in the GCC countries.

The IMF forecasted that the downside risks are high, mainly from the uprising in Syria, further escalation of which could have serious repercussions on several economic indicators which are already during 2011 weaker than previous years characterized by buoyant activity.

Moreover, inflation rates were expected to be around 7.00% in 2012, as per the IMF and the IIF's expectations, as per the IMF's expectations. In fact, inflation will stay elevated mainly because of wage increases and the rise in main commodities prices driven by the increase in fuel prices.

Lebanon's Prospects Amidst The Current Turmoil: How to Foster Economic Growth

I- Introduction

The Government of Lebanon is seeking to improve the use of financial resources to promote growth, create jobs, and develop productive capacities.

Indeed, Lebanon is a small, open economy that is largely impacted by foreign financial inflows. It has been consistently attracting inflows from the region, including inflows related to regional oil wealth. The country's attractive real estate assets and its vibrant banking sector have combined to consolidate the country's reputation as a financial safe destination in times of crisis. Another important factor is the large and widely diffused Lebanese diaspora, whose remittances make a steady contribution to financial flows to Lebanon economy.

Furthermore, a significant increase in the inflows can be traced back to 2007-2010 and continues to date, although at a slower pace. This recent increase was inspired by two main factors: a spike in oil prices and a deep confidence crisis in international and regional financial and capital markets.

The Lebanese authorities, in particular the Central Bank of Lebanon have tightened regulations, and followed a policy of sterilization, following the global economic meltdown. The Bank has built-up substantial foreign currency reserves, which stood at USD 30.80 billion in December 2011. The measures helped avoid asset bubbles and a further appreciation in the real exchange rate which would have further impeded competitiveness.

In the short term, economic fluctuations remain highly dependent on foreign inflows and foreign demand related to regional oil wealth and oil prices. The downside is that highly productive industries and innovative activities do not seem to benefit from financial inflows, which take the shape of short-term deposits in banks or real estate acquisitions.

The recent turmoil in neighboring countries and in some diaspora host countries underlines the vulnerability of Lebanon towards exogenous shocks that can affect the flows of goods, services, financial resources and workers. Facing this vulnerability and increasing the potential for endogenous growth can be considered a national interest for Lebanon.

Lebanon has the potential to overcome any potential threat arising from the uncertain current environment, thanks to its human capital and financial resources. From there, what is needed is the political will to engage in a process of reform that would create a more diversified, innovation-driven economy, capable of generating the high number of jobs required for the skilled labor force.

II- Potential Constraints on Lebanon's Growth

There are many structural constraints that may impede the implementation of an innovation-based growth strategy in Lebanon that is based on the application of new ideas, technologies, or processes to productive activities, through transforming traditional sectors into higher value-added, knowledge intensive sectors. These potential constraints include macroeconomic volatility; infrastructure impediment; inadequate financial support mechanisms to promote innovation; product and labor market regulations; insufficient higher education research and the role of the diaspora; and shortcomings in governance.

The macroeconomic conditions continue to be volatile, despite the overall improvement in key economic sectors in the last five years, due to high public debt level that is accounted for 146% of GDP in 2010, fostered by the ongoing fiscal deficit, which urged the government to offer large spreads to domestic banks, to encourage them to buy and hold domestic government debt, at the expense of investing in long-term development projects that stimulate the economic activity and create job opportunities. Unless government borrowing needs decline, investors will continue to prefer to invest in highly remunerative short-maturity bonds, thereby foregoing productive investments, which will remain a main constraint to achieve macroeconomic stability and attaining a sustainable growth. Thus, reducing macroeconomic instability, by restraining fiscal deficits, cutting borrowings, lowering interest rates, and promoting the private investments, would help to attract longer-term capital inflows, and as a result achieving high economic growth.

Lebanon receives massive financial transfers and capital inflows from abroad. Net foreign inflows of services, capital, income, and remittances reached 57% of GDP in 2009, and an average of 37% of GDP during the period 2002-2011. However, a large part of these financial resources are consumed or invested in sectors that are not directly productive, implying therefore a limited impact on economic growth and job creation. The real estate sector, in particular, has accounted for 60% of these inflows; most of them were used for speculative purposes. The remaining investments go to metallic industries that provide the construction sector with intermediate goods. The banking sector has attracted around 10% of these funds. While financial inflows and Foreign Direct Investment (FDI) in knowledge-intensive or innovation-prone activities remain very small. Consequently financial institutions would need to invest elsewhere than in government debt or in Central Bank's highly remunerated CDs and would provide the resources to finance private sector activity, outside the real estate and trade sectors, to develop real economic sectors and create more job opportunities.

Core infrastructure promotes growth not only via its impact on private capital formation and increasing innovation, research and development, but also indirectly, by promoting foreign investments. Lebanon's core infrastructure in electricity, roads, and sanitation remains deficient in several respects. As a result, access to reliable and cost-effective infrastructure services remains a major constraint on economic activity. According to the 2010 Business Climate Survey for Lebanon conducted by the World Bank, 76% of firms identify electricity as a constraint to activity and 42% identify transportation. The percentage of sales lost to power outages alone amounted to 8.7% (compared to 8% in Syria, 3.3% in Egypt, 2.1% in Jordan, and 1.5% in Morocco), whereas the percentage of sales lost to communication outages, and water outages amounted to 8.7%. Thus the Lebanese government needs to invest heavily in core infrastructure to eliminate infrastructure constraints, such as water shortages, electricity outages and difficult road access, which can reduce production and adjustment costs and facilitate the process of shifting private resources to more productive sectors. Moreover, by reducing costs, improved provision of infrastructure services will tend to raise expected rates of return and therefore stimulate private capital formation, which may translate into permanent growth effects.

Regarding labor market regulations in Lebanon, it is not clear that they represent a significant constraint on firm activity and job creation. Based on the 2011 Doing Business Report of the World Bank, the overall index of employment rigidity in Lebanon is quite similar to the other countries of the region and OECD countries. Although hiring appears to be significantly more difficult than in other countries of the region, firing costs (measured in terms of weeks of wages upon dismissal) are quite low. In addition, the degree of enforcement of labor regulations is quite limited in practice, implying that there is a great deal of informality in the labor market.

Employing Workers Indicators

	Lebanon	Middle East & North Africa	OECD Average
Difficulty of hiring index	44	21.3	26.5
Rigidity of hours index	0	22.1	30.1
Difficulty of redundancy Index	40	30	22.6
Rigidity of employment index	28	24.5	26.4
Redundancy costs (weeks of salary)	8.7	53.4	26.6

Source: World Bank (2011)

However, Lebanon is traditionally recognized for its human capital and the entrepreneurship skills of its citizens; with 54% gross enrollment rate in tertiary education, the country by far exceeds the 26% and 23% rate registered respectively for the Middle East and North Africa (MENA) region and for middle-income countries in general.

In Lebanon, the gross private returns to education are relatively low compared to international standards (9% against 21% worldwide). This partly reflects low levels of productive investments in sectors that are intensive in skilled labor. In addition, Lebanon has faced significant migration and brain drain, although the country invests heavily in human capital, many of its best-trained people migrate abroad. Along with political instability, low returns for education is a major factor behind the brain drain. Migration is traditionally a large phenomenon, with the Lebanese diaspora considered to be one of the largest in the world in terms of proportion to resident population. The Lebanese diaspora has maintained strong linkages to their home country, the country has one of the highest ratio of remittances to GDP in the world; remittances inflows are in fact larger than FDI.

Based on the World Bank Doing Business 2011 Indicators, the country performs poorly by international standards whether in terms of dealing with construction permits, registering properties, enforcing contracts, or closing a business. Narrowing the scope of incentives to innovate, an important aspect of the business climate, relates to the need to respect and enforce intellectual property rights. There are significant problems with patents and the legislation for patent protection in Lebanon. Specific legislative protection for entrepreneurs is important, as it ensures that innovators (both domestic and foreign) are economically rewarded for their innovations. Thus, improvements in the business environment, especially greater enforcement of property rights, are important not only for Lebanese companies and potential innovators in a wide range of sectors (including creative industries, as discussed in British Council, 2008), but it also sends important signals to the international community at large.

Lebanese Rank in Global Doing Business Indicators (2009 – 2010)

	2010	2009	Change (%)
Overall	**113**	**104**	**-9**
Starting a business	103	108	5
Dealing with construction permits	142	140	-2
Registering property	111	110	-1
Getting credit	89	87	-2
Protecting investors	93	92	-1
Paying taxes	36	35	-1
Trading across borders	95	95	0
Enforcing contracts	122	122	0
Closing a business	122	122	0

Source: The World Bank, Doing Business Indicators Report, 2011

III. Policy Implications

The Lebanese government needs to adopt structural reform policies that may help the country to alleviate the constraints identified earlier and achieve its long-term growth and employment objectives. Specifically, the following policies are considered:

1. **Higher Investment in Infrastructure:** Infrastructure gaps are a major constraint to Lebanon's economic and social development. It has long been argued that lack of public investment in the last decade had detrimental effects on the welfare of the overall population as basic services such electricity, water, transportation, and telecom services worsened. Serious deficiencies in the infrastructure sectors deepened the impediments to Lebanon's competitiveness, fiscal stability, and economic growth.

Moreover, in the absence of major reforms and public investments in the country's infrastructure, private sector operations are hindered as the cost of producing inputs increases. There is a crucial need to increase public investments in key service sectors over the medium-term, financed by a reduction in other components of public expenditures, or through the mobilization of unused donors' lines of credits to avoid putting undue pressure on the budget. The policy objectives behind reforms in each sector are different and can be summarized by the following:

• Electricity sector:
  - Improving service delivery through tackling increase in generation capacities.
  - Reducing fiscal burden.
  - Improving institutional and legislative set-up for further private sector participation.

• Water sector:
  - Improving service delivery and fiscal situation of sector.
  - Increasing investment in water storage and revisiting the wastewater strategy.

• Transport sector:
  - Unlocking access to regional centers across the Lebanese territory.
  - Reducing transportation costs for individuals and firms.

• Telecom sector:
  - Moving away from the para-fiscal trap.
  - Improving competitiveness between sector stakeholders.
  - Enhancing the quality, quantity, and diversity of services as to keep up with rapid changes in technological advancements around the world.

Higher investment raises the public-private capital ratio. In turn, this promotes the production of final goods; the accumulation of human capital; and R&D activities, given the assumption that public infrastructure is an essential input in all sectors. Note also that the increase in access to public capital tends to increase the productivity of labor, and thus wages, in both the final goods sector and the R&D sector.

2. Improved Efficiency of Public Expenditure: The increase in government spending efficiency corresponds to a rise in the efficiency of public spending on infrastructure, and in the efficiency of public spending on education. This is in line with the need to improve the institutional underpinnings of the reform process in Lebanon, particularly with respect to its public sector governance aspects, and to continue the process of rationalization of public spending.

However, Lebanon needs to engage in a broader set of reforms that tackle issues of public finance management with the objective of introducing a more rigorous fiscal discipline that reallocates constrained fiscal resources to ensure the highest social and economic returns to public spending. Lebanon's huge public debt is a key binding economic constraint to future growth and social progress; and needs to be contained and reversed by deep-seated fiscal adjustment.

Going beyond education and infrastructure, efficiency gains for all public spending with inter-sectorial linkages and influence over growth should be addressed. Consequently this policy also tackles reforms in expenditure programming and budgeting, budget execution, monitoring and audit. Such operational type of reforms will have implications on ensuring the sustainability of the needed fiscal adjustment while maintaining public services at levels where they no longer remain impediments to growth.

Public investment efficiency could be addressed through examining the different phases of project cycle. To examine the bottlenecks at the different phases of the public investment management system in Lebanon, four phases were identified:

- Strategic guidance and project appraisal: strategic guidance implies that investment decisions are made under the umbrella of a national development plan over the medium to long run. Rigorous appraisal standards are applied with projects evaluated and prioritized according to their financial and economic return. A system of checks and balances is also introduced to account for any safeguards and validate the soundness of the evaluations.

- Project selection and budgeting: investment project selection and appraisal phase needs to be linked to the budget cycle of the country. Due to multi-year nature of capital spending and its future implications on recurrent expenditure (through maintenance mainly), Medium-term Budgeting Frameworks play a key role in integrating macro-fiscal targets, development objectives and investment programs into an implementable plan that goes beyond wishful thinking and links sector strategies to the overall resources of the country.

- Project implementation: execution of the capital budget is a fundamental phase in tackling investment spending

efficiency. Competitive practices for contract awards, sound procurement systems, firm internal controls in various implementing agencies and credible internal audits functions are all important factors that contribute to maximizing economic returns from public capital projects.
- Project evaluation and audit: ex-post evaluation of completed projects is often a phase that is neglected in developing countries, but has proven to comprise significant benefits. Comparing the projects actual to design costs enables government to improve its costing abilities and therefore reduce fiscal waste (as a result of under or over valuations). The assessment is complemented by an asset recording system and external audit that inform on future project design and implementation.

3. Enforcement of Property Rights: A reform of property rights is specifically designed to promote R&D activities, such as improved functioning of the bureau of patents, a relatively weak institution in Lebanon. The improved enforcement of property rights will also promote entry of foreign investors in the R&D sector and make them more responsive to changes in the rate of return on domestic capital.
The key point is that reforms aimed at better enforcing property rights have not only direct effects, stemming from the fact that they provide greater incentives to engage in research and development activities; they may also generate large positive externalities as well, in the form of increased incentives to foreign investors to allocate more resources to technology-driven sectors in Lebanon, and increased sensitivity to changes in rates of return on domestic productive assets.
In Lebanon, there is a lack of familiarity with laws and regulations, general guidelines of the intellectual property rights, and shortages in specialized legal and technical staff are the main impediments facing the enforcement of property rights. Three areas of major drawbacks to the implementation of property rights were found in Lebanon: (i) lack of familiarity with the intellectual property right laws and regulations; (ii) dissatisfaction in the areas of independence from political interventions, technical competence, enforcement authority, human and financial resources, speed of reaching decisions, and clarity and transparency of procedures; and (iii) lack of specialized intellectual property rights court staff and judges. All these issues are areas of potential improvements where some quick-win type of reforms can be implemented to start enforcing property rights in Lebanon and reap the long-term growth benefits.

IV- Conclusion

Structural reforms can have a strong effect on potential growth in Lebanon. Although it is difficult to quantify the precise effects of reform on economic outcomes, the results of policy simulations carried out in this study illustrate the potential for structural reform to improve growth outcomes. In particular, reducing the deficiencies in public infrastructure by increasing investments and enhancing the efficiency of spending are shown to be crucial.
However, Lebanon stands to gain from a wide range of structural reforms beyond infrastructure; including enhancing competition and protection of property rights. The growth payoff will be stronger when macroeconomic volatility reduced. Indeed, implementing the structural reforms discussed in this study while reducing macroeconomic volatility would propel long-term growth to a level that can contribute to generating capital inflows endogenously. Such scenario is desirable for Lebanon since it leads to a better use of foreign inflows to promote long-term growth.
The size of the growth payoff depends not only on the magnitude of the actual reform effort in infrastructures, public finance management (to increase spending efficiency), competition, and property rights, but promoting SME's access to finance would be essential if firms are to exploit the opportunities offered by better and cheaper infrastructure services and enhance their competitiveness. Putting the right institutions to strengthen the capital market and improve the management of capital inflows and resource allocation would also be important. The whole question of banking intermediation and financial resources intermediation deserves a particular attention. There is a need for a deep investigation about regulations, institutions, and mechanisms needed to channel these resources towards long-term productive activities and, when needed, to compensate for a drop in aggregate demand.