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Lebanon

Promoting Poverty Reduction and Shared Prosperity

Systematic Country Diagnostic

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Abbreviations

ANS	adjusted net savings
BdL	Banque du Liban
EdL	Electricité du Liban
GCC	Gulf Cooperation Council
GDP	gross domestic product
GNI	gross national income
CPI	consumer price index
GTAP	Global Trade Analysis Project
HOI	human opportunity index
ICRG	International Country Risk Guide
ICT	information, communication, and technology
NBFI	non-bank financial institution
NGO	nongovernmental organization
OECD	Organisation for Economic Co-operation and Development
PLO	Palestinian Liberation Organization
PPP	purchasing power parity
SCD	Systematic Country Diagnostic
SME	small and medium-size enterprise
TIMSS	Trends in International Mathematics and Science Study
UNDP	United Nations Development Programme
UNHCR	United Nations High Commissioner for Refugees

Executive Summary

Since independence, Lebanon's political development has been influenced primarily by its evolving confessional system. However, this system, originally established to balance the competing interests of local religious communities, is increasingly seen as an impediment to more effective governance, as it has resulted in a paralysis in decision making and a general hollowing out of the state. Lebanon's confessional system has also proven to be extremely vulnerable to external influence, which has bred and exacerbated local conflict and violence.

The Lebanese economy has grown at a moderate pace over the past decades, but growth has been uneven due to large, frequent, and mostly "political" shocks. Real gross domestic product (GDP) grew, on average, an estimated 4.4 percent from 1992 to 2014, but this performance masks the impact of many domestic, international, political, and confessional shocks during this period. The latest such shock is the ongoing conflict in the Syrian Arab Republic, which, given the strong links between the two countries, is generating large and negative spillover effects in Lebanon. The country's macroeconomic framework has, nonetheless, proven resilient to all of the large shocks it has faced.

Lebanon has struggled to reduce widespread poverty and to generate inclusive growth, as job creation has been weak and poorly distributed. Poverty incidence has been elevated and broadly unchanged for the past 25 years. Since the end of the civil war, extreme poverty has hovered at between 7.5 to 10 percent; according to the upper poverty line, about 28 percent of the population is poor. The distribution of poverty has also been unequal, with poverty levels highest in the north and south of the country and in small, dense pockets in the suburbs of large towns, reflecting the unevenness of economic growth and development. A key factor underlying the lack of inclusive economic growth is low employment-growth elasticity. In Lebanon, job

creation has trailed high growth in the labor force, and jobs have typically been of low quality. More recently, both poverty and jobs have been negatively affected by the Syrian conflict and, in particular, by the large influx of refugees. Lack of quality jobs at home continues to push a large share of Lebanese, especially educated youth, abroad.

In this context, the World Bank Group has undertaken a Systematic Country Diagnostic (SCD) to identify the main constraints that make it difficult for Lebanon to generate jobs (both in quantity and in quality), which is recognized in the country as the pathway to reducing extreme poverty and promoting shared prosperity (the Bank's twin goals). The SCD is based on a comprehensive analysis of available evidence (noting data deficiencies) and has benefited from extensive consultations with Lebanese experts, private sector representatives, members of the community of nongovernmental organizations, and the government of Lebanon, among other stakeholders.

The SCD posits that at the root of Lebanon's failure to generate inclusive growth and jobs is the presence of two mutually reinforcing and pervasive (overarching) constraints. These are (a) elite capture hidden behind the veil of confessionalism and confessional governance and (b) conflict and violence (stemming, in part, from the broader dynamics of conflict in the Middle East). These overarching constraints impose a heavy burden on the economy, with the cost of confessional governance estimated at 9 percent of GDP annually. Illegal activities are not sanctioned by the state when they involve politically or confessionally connected or wealthy actors, exacerbating elite capture and the patronage system. Economic stakeholders and personal connections (known as *wasta*) are more likely to influence the execution of policy and enforcement of the rule of law. Thus elite capture and corruption are endemic and undermine the achievement of

the Bank Group's twin goals in Lebanon. Similarly, the costs of the conflict and violence are large and recurrent. These include the 1975–90 civil war, which halved the country's economy, the 2006 conflict with Israel, which caused direct damages estimated at US\$2.8 billion and indirect damages estimated at US\$700 million, and the Syrian conflict, which has cost the Lebanese economy an estimated US\$7.5 billion in forgone output and widened the fiscal deficit by US\$2.6 billion through 2014.

The SCD posits that other (more traditional) constraints are *nested* within the two overarching constraints. Nested constraints affecting Lebanon's potential to deliver sustained, high economic growth to its people include macro-economic instability, weak business environment, insufficient investment in infrastructure (especially in lagging regions), mismatch of skills with labor market needs, and weak institutions and regulatory framework. The SCD posits that, absent the destabilizing impact of confessional governance and domestic and regional conflicts, these nested constraints would be significantly less binding than they currently are. Thus constraints specific to the electricity sector or the education system, for example, are “nested” within these overarching constraints, which makes reform at the sector level especially challenging and compounds sector constraints.

To prioritize Lebanon's development constraints, the SCD team designed a voting methodology that captures the complexity of Lebanon's constraints, is transparent, and is verifiably robust. The prioritization process included the following steps: (1) establish a comprehensive list of specific constraints, based on the analytical work done in the SCD; (2) request each World Bank Group expert who worked on the Lebanon SCD to score each of these constraints from least to most binding based on five criteria (impact on goals, time horizon of impacts, preconditions, complementarities, and strength of the evidence); (3) rank the expert scores based on the average score of each individual constraint so that the resulting prioritization was conducted at the

intensive margin, enabling reformers to tackle the country's specific bottlenecks directly. As common themes and sectors emerged from the resulting list of constraints, a list of 11 *ranked* priority areas was established. This list includes the twin overarching constraints of confessional governance, and conflict and violence, eight nested constraints, and one foundational constraint related to the availability and quality of data. The final step was to perform sensitivity analysis and robustness checks, which found that, reassuringly, the priorities identified are robust to all reasonable alternatives used.

While Lebanon's twin overarching constraints are deep-rooted, potential ways to mitigate them do exist. These can be classified in two types of strategies: (1) those that aim to lessen the overarching constraints directly and (2) those that aim to lessen the nested constraints by designing a reform program that is incentive-compatible with the overarching constraints.

The first strategy carries the potential of a large development payoff, but, given the deep-rooted and symbiotic nature of the overarching constraints, it will take time to bear fruit. Examples include implementing key outstanding elements of the Taef Accord, such as adopting a decentralization law and creating a lower chamber of parliament to be elected on a non-confessional basis, improving access to (statistical) information, and promoting political stability and institutional reform and development.

The second strategy is more suited to delivering gains in the short term, but given the weight of the overarching constraints, these gains are likely to be more limited in scope. Examples include conducting a political economy and conflict exposure analysis of nested sectors, devising a grand-bargain package of reforms, adopting an opportunistic approach (that is, readiness to seize windows of opportunity when they arise), working around elite capture, showing a willingness for “horizontal” social engagement, and managing the influx of Syrian refugees.

Subject to the design of reforms that are incentive-compatible with the overarching

constraints, the following opportunities could materially improve Lebanon's development prospects:

- Reduce macro-fiscal vulnerabilities
- Improve governance and effectiveness of public institutions
- Address energy gaps to increase productivity of the private sector and reduce the macro-fiscal burden
- Strengthen information and communication technology so that Lebanon is fully connected to the global economy and can develop jobs needed in the twenty-first century
- Modernize the education sector to ensure that youth have skills relevant to employers

- Improve the business climate to ease the burden on the creation and operation of firms
- Increase investments in transportation so that people and products can move efficiently
- Address environmental issues to protect Lebanon's natural resources, including water.

Reforms in these areas must be tackled with a sense of urgency if Lebanon is to generate the number and quality of jobs needed for its citizens and to achieve progress toward reducing extreme poverty and promoting shared prosperity, to avoid further deterioration in the well-being of citizens, and to manage the added pressures stemming from regional conflicts.

Résumé Analytique

- i. **Depuis l'Indépendance, le développement politique du Liban a été influencé principalement par l'évolution de son système confessionnel.** Initialement établi pour maintenir l'équilibre entre les intérêts des communautés religieuses locales, ce système est toutefois perçu de plus en plus comme un obstacle à une gouvernance efficace, dans la mesure où il a entraîné une paralysie au niveau de la prise de décision et un blocage général de l'Etat. Le système confessionnel du Liban s'est avéré également extrêmement perméable aux influences externes, ce qui a nourri et exacerbé les conflits et la violence internes.
- ii. **L'économie libanaise s'est développée à un rythme modéré au cours des dernières décennies, mais la croissance a été inégale en raison de chocs importants et fréquents, notamment "politiques", auxquels l'économie a été résiliente.** Le PIB réel a augmenté en moyenne d'environ 4,4 pour cent de 1992 à 2014, mais ce rendement masque l'impact de nombreux chocs (nationaux, internationaux, politiques et/ou confessionnels) auxquels le Liban a fait face au cours de cette même période. Le dernier choc est le conflit en cours en Syrie, qui, compte tenu des liens étroits entre les deux pays voisins, génère d'importantes retombées négatives sur le Liban. Il n'en demeure pas moins que le cadre macroéconomique du pays a pu résister à tous les chocs importants auxquels il a été jusqu'à présent confronté.
- iii. **Avec une croissance de faible qualité, le Liban a peiné à réduire son large taux de pauvreté et à générer une croissance partagée (trop peu d'emplois créés et peu productifs).** L'incidence de la pauvreté a été élevée et globalement inchangée au cours des 25 dernières années. Depuis la fin de la guerre civile, l'extrême pauvreté a oscillé dans une fourchette allant de 7,5 à 10 pour cent tandis que le seuil supérieur de pauvreté a oscillé autour de 28 pour cent de la population. La répartition de la pauvreté a également été inégale avec des niveaux qui sont plus élevés dans le nord et le sud du pays, ainsi que dans certaines banlieues de grandes villes, reflétant ainsi le caractère inégal de la croissance économique et du développement. La faible élasticité de la croissance de l'emploi est un des principaux facteurs contribuant à l'absence d'une croissance économique inclusive. Au Liban, la création d'emplois a été inférieure à la croissance de la population active, et les emplois ont généralement été de faible qualité. Plus récemment, la pauvreté et l'emploi ont probablement été affectés par le conflit syrien et, en particulier, par l'afflux massif de réfugiés. Le manque d'emplois de qualité dans le pays contribue à l'expatriation de nombreux Libanais, en particulier les jeunes diplômés.
- iv. **Dans ce contexte, le Groupe de la Banque Mondiale a mis en place un Diagnostic Systématique du Pays (DSP) afin d'identifier les contraintes auxquelles le Liban est confronté dans ses efforts de création d'emplois.** L'emploi est reconnu dans le pays comme la voie primordiale à la réduction de l'extrême pauvreté et à l'accès à une prospérité partagée (ce sont les deux objectifs du Groupe de la Banque Mondiale). Le DSP est basé sur une analyse complète des données disponibles (en tenant compte des carences des données existantes) et a bénéficié, entre autres, de consultations approfondies avec des experts Libanais, des représentants du secteur privé, des membres d'ONG, ainsi qu'avec le gouvernement Libanais.
- v. **Le DSP fait état de deux contraintes dominantes générales se renforçant**

mutuellement, et qui sont à l'origine de l'incapacité du Liban à générer une croissance inclusive et forte en emplois.

Première contrainte : l'accaparement des ressources par une élite qui se cache derrière le voile du confessionnalisme / gouvernance confessionnelle. Deuxième contrainte : les conflits et la violence (attribuables en partie à la dynamique générale de conflit au Moyen-Orient). Ces deux contraintes dominantes générales sont un lourd fardeau pour l'économie. Par exemple, le coût annuel de la gouvernance confessionnelle est estimé à 9 pour cent du PIB. Les activités illégales ne sont pas sanctionnées par l'Etat lorsqu'elles impliquent des personnalités ayant des connections confessionnelles/politiques et/ou étant riches, ce qui exacerbe l'accaparement des ressources par une élite et renforce le favoritisme omniprésent. Ce sont l'influence des partenaires économiques et les liens personnels (appelés "*Wasta*") qui sont le plus susceptibles d'influer sur l'exécution des politiques et l'application des lois. L'accaparement des ressources par une élite et la corruption sont ainsi endémiques et compromettent la réalisation des objectifs doubles de réduction de l'extrême pauvreté et l'accès à une prospérité partagée au Liban. Parallèlement, le coût du conflit et de la violence est important et récurrent ; ceux-ci incluent la guerre civile de 1975-1990, qui a réduit de moitié la taille de l'économie, le conflit de 2006 avec Israël qui provoqué des dégâts directs estimés à 2,8 milliards de dollars et indirects évalués à 700 millions de dollars, et, plus récemment le conflit syrien qui aurait coûté à l'économie libanaise 7,5 milliards de dollars en perte de production et creusé le déficit budgétaire de 2,6 milliards de dollars de 2012 à 2014.

- vi. **Le DSP fait état d'autres (mais plus traditionnelles) contraintes imbriquées dans les deux principales dominantes que sont l'accaparement des ressources par une élite, et la fragilité et les conflits.**

Ces contraintes nichées affectent le potentiel du Liban à assurer une croissance économique forte et durable; elles comprennent l'instabilité macroéconomique, un environnement des affaires difficile, une insuffisance des investissements au niveau des infrastructures (notamment dans les régions qui accusent un retard au niveau du développement), un déséquilibre des compétences par rapport aux besoins du marché du travail, des institutions et un cadre réglementaire faibles. Le DSP part du principe qu'en l'absence de l'impact déstabilisateur de la gouvernance confessionnelle et des conflits nationaux et régionaux, ces sous-contraintes imbriquées auraient nettement moins de conséquences qu'elles ne le sont actuellement. Ainsi, ces deux contraintes dominantes ont des conséquences négatives au niveau des secteurs (par exemple, l'électricité, l'éducation) et rendent toute réforme au niveau sectoriel particulièrement difficile.

- vii. **Pour établir un classement des obstacles au développement du Liban, l'équipe DSP a conçu une méthodologie de vote permettant de saisir de manière transparente et robuste la complexité des contraintes libanaises.** Ce processus de priorisation comprend les étapes suivantes: (1) établir une liste exhaustive des obstacles spécifiques, sur la base du travail d'analyse effectué dans le DSP; (2) demander à chaque expert du Groupe de la Banque Mondiale qui a travaillé sur le DSP Liban de classer chacun des obstacles précédents sur la base de cinq critères (impact sur l'objectif; durée de l'impact; conditions préalables; complémentarités; force de la preuve); (3) classement des notes des experts en fonction de la moyenne des notes obtenues pour chaque contrainte individuelle de sorte que l'ordre de priorité résultant de ce processus est effectué sur une marge intensive, ce qui permet aux réformateurs de s'attaquer directement aux goulots d'étranglement spécifiques du pays.

Comme des thèmes et des secteurs communs sont apparus dans la liste des contraintes, une autre liste de 11 domaines jugés prioritaires a été établie. Celle-ci comprend les deux contraintes principales que sont la gouvernance confessionnelle et les conflits et la violence, huit autres secteurs sous-jacents, et une contrainte fondamentale qui est la disponibilité des données et leur qualité. Finalement (4) une analyse de sensibilité/vérification de la solidité des données a été effectuée et a permis de constater, de manière rassurante, que les priorités identifiées étaient robustes à différentes méthodes d'agrégation des votes individuels.

- viii. **Même si les deux contraintes fondamentales du Liban sont profondément ancrées, il existe des moyens susceptibles de les atténuer.** Ceux-ci peuvent être classés dans deux types de stratégies: (1) s'attaquer directement aux contraintes dominantes pour les réduire; (2) travailler sur la réduction des contraintes sous-jacentes à travers la conception d'un programme de réformes qui tient compte des contraintes dominantes existantes. La première stratégie véhicule un potentiel de réussite important au niveau du développement, mais, étant donné la nature profonde et symbiotique des deux contraintes dominantes, cette stratégie prendra du temps avant de porter ses fruits. La deuxième stratégie est plus adaptée pour donner des résultats à court terme, mais étant donné le poids des deux contraintes dominantes, ces résultats sont susceptibles d'être de portée plus limitée. Des exemples de la première stratégie incluent la mise en œuvre d'éléments clés de l'accord de Taëf jusqu'à présent suspendus : l'adoption d'une loi sur la décentralisation administrative, la création d'une chambre basse du parlement qui serait élue sur une base non confessionnelle, l'amélioration de

l'accès à l'information, la promotion d'une stabilité politique, d'une réforme institutionnelle et du développement. Des exemples de la deuxième stratégie incluent : une analyse de la politique économique et de la vulnérabilité des secteurs concernés face aux conflits, un ensemble de réformes, une approche opportuniste, une action autour de l'accaparement des ressources par une élite, un engagement social 'horizontal', et la transformation de la présence importante de réfugiés syriens en opportunité.

- ix. **Sous réserve de concevoir des réformes qui tiennent compte des deux contraintes dominantes du Liban, les actions suivantes pourraient sensiblement améliorer le développement du pays:** (1) réduire les vulnérabilités macro-budgétaires; (2) améliorer la gouvernance et l'efficacité des institutions publiques; (3) combler les carences énergétiques afin d'améliorer la productivité du secteur privé et de réduire le fardeau macro-budgétaire; (4) renforcer le secteur des télécommunications ce qui connecterait pleinement le Liban à l'économie mondiale et pourrait développer des emplois; (5) moderniser le secteur de l'éducation pour former des jeunes ayant les qualifications requises par les employeurs; (6) améliorer le climat des affaires afin d'alléger le fardeau administratif entravant la création d'entreprises; (7) accroître les investissements dans le secteur du transport pour faciliter la mobilité des personnes et les échanges commerciaux; et (8) régler les problèmes écologiques afin de protéger les ressources naturelles du Liban, y compris l'eau. Les réformes dans ces domaines doivent être traitées rapidement si le Liban veut générer le nombre et la qualité des emplois souhaités par la population, stopper la détérioration du bien-être de bon nombre de ses citoyens et, surtout, pouvoir gérer les pressions résultant des conflits régionaux.

الملخص التنفيذي

- الحاصل على شهادات جامعية، يلجأ إلى الهجرة خارج البلاد طلباً لفرص نوعية في مجال العمل لا يوفرها لبنان.
4. في هذا السياق، قامت مجموعة البنك الدولي بإعداد تشخيص منهجي للبلد بهدف تحديد العوائق والقيود الأساسية التي يواجهها لبنان في مجال خلق فرص العمل (من حيث النوعية والكمية)، العامل الذي يعتبر الأهم في عملية الحد من الفقر المدقع وتعزيز الرفاه المشترك (تلك هي أهداف مجموعة البنك الدولي). يعتمد هذا التشخيص على تحليل شامل للأدلة والحقائق المتوفرة (وتجدر الإشارة هنا إلى محدودية البيانات)، كما استفاد التشخيص من جولات استشارية مكثفة تضمنت خبراء لبنانيين، وممثلين عن القطاع الخاص، وأعضاء المجتمع الأهلي والمنظمات غير الحكومية، إضافة إلى ممثلين عن الحكومة اللبنانية وآخرين من المعنيين وأصحاب الشأن.
5. يفترض التشخيص بأن جذور الفشل في توليد النمو المتكامل وفرص العمل تكمن في عائقين أساسيين مترابطين، أولاً: الحكم الطائفي، أي تولي الحكم من قبل طبقة نخبية تستخدم ذريعة الطائفية قناعاً لها. ثانياً: الصراع والعنف الناجمين، جزئياً، عن صراعات واسعة النطاق في منطقة الشرق الأوسط. ويفرض هذان العائقان المترابطان أعباءً ثقيلة تنهك الاقتصاد اللبناني، حيث تُقدر الكلفة السنوية للخل الناجم عن الحكم الطائفي بـ 9 بالمئة من الناتج المحلي الإجمالي. وبحسب الهيكلية القائمة، لا تُحاسب الدولة المواطنين الذين يخالفون القانون إذا ما كانوا من المقربين من النخبة المسيطرة طائفيًا، أو من هم على صلة بأصحاب النفوذ الأثرياء، مما يعزز من سلطة النخبة المسيطرة ويغذي نظام المحسوبية. كما أن منهجية "الواسطة" والعلاقات الشخصية مع أصحاب النفوذ غالباً ما تؤثر سلباً على تنفيذ السياسات وتطبيق القانون. وهكذا يتقشر الفساد في أعماق الطبقة النخبوية الحاكمة ليصبح داءً مزمنًا يمنع البلد من تحقيق أهدافه التنموية. كما أن كلفة الصراع والعنف باهظة ومتكررة، فالتاريخ يشهد على الحرب الأهلية (1975-1990) التي استنزفت نصف الاقتصاد اللبناني، والصراع مع إسرائيل عام 2006 الذي تسبب في خسائر مباشرة هائلة بلغت 2.8 مليار دولار أميركي، وخسائر غير مباشرة قُدرت بـ 700 مليون دولار أميركي، والصراع في سوريا مؤخراً الذي كلف الاقتصاد اللبناني حتى الآن 7.5 مليار دولار أميركي من جراء الخسائر في القطاعات المنتجة وتوسيع العجز المالي بحوالي 2.6 مليار دولار أميركي خلال العام 2014.
6. كما يبين التشخيص بأن هناك قيود أخرى (أكثر تقليدية) متداخلة ضمن العائقين المترابطين في صميم النخبة المسيطرة، وقد تأسست تلك القيود عبر النظام الطائفي

1. لطالما تأثر لبنان، منذ أن نال استقلاله، بنظام الطائفية السياسية الذي رسم خارطة الدولة عبر العقود. وكان الهدف، في الأصل، من إنشاء نظام سياسي بطابعه الطائفي هو تحقيق التوازن بين المصالح المتنافسة للمجتمعات المذهبية المحلية، ولكن ما لبث أن تحول هذا النظام ليصبح في نظر الكثيرين عائقاً أمام الحوكمة السليمة والفعالة، حيث أدى إلى شلل واضح في عملية أخذ القرار وصناعة السياسات وبالتالي إلى إفراغ مؤسسات الدولة. كما أثبت النظام الطائفي في لبنان بأنه الوسيلة الأقوى لتعريض البلد إلى التدخلات الخارجية التي بدورها سببت في تغذية الخلافات والصراعات بين الفئات المحلية.
2. شهد الاقتصاد اللبناني نمواً معتدلاً عبر العقود الماضية، لكن تفاوتت نسبة النمو من عام إلى آخر بسبب الصدمات الكبيرة والمتكررة والتي كان معظمها من الطابع السياسي، بحيث أبدى الاقتصاد صموداً ملحوظاً في وجه تلك الصدمات. سجل الناتج المحلي الإجمالي الحقيقي نمواً بمعدل 4.4 بالمئة بين العام 1992 والعام 2014، وقد عمل هذا الأداء على إخفاء آثار العديد من الصراعات (المحلية، والعالمية، والسياسية، و/أو الطائفية) التي واجهها لبنان خلال الفترة المذكورة. ومن أحدث تلك الصدمات هي الحرب القائمة في سوريا، والتي نظراً للروابط الوثيقة بين البلدين، تتسبب في تداعيات سلبية هائلة ترهق لبنان. لكن استمر الاقتصاد الكلي اللبناني في صموده النسبي أمام الصدمات الكبيرة التي يواجهها البلد حتى يومنا هذا.
3. لقد عمل لبنان على الحد من انتشار الفقر وتحقيق نمو اقتصادي شامل، وذلك في ظل ضعف فرص العمل وتدني نوعية النمو. ولم تتغير مؤشرات الفقر التي سجلت ارتفاعاً منذ حوالي 25 سنة. وبيّنت الدراسات بأن نسبة الفقر المدقع ما بعد الحرب الأهلية تراوحت بين 7.5 بالمئة و10 بالمئة. ومن خلال استخدام الخط الأعلى للفقر، أظهرت البيانات أن 28 بالمئة من إجمالي السكان اعتُبروا ضمن الفئات الفقيرة. كما أن التوزيع المناطقي لنسبة الفقر لم يكن متساوياً، إذ بلغ أقصاه في شمال وجنوب البلاد، مع تواجد بعض البؤر الصغيرة والمكتظة في ضواحي المدن الكبيرة، مما يدل على عدم التوازن الحاصل في نمط النمو الاقتصادي ومسار التنمية. أما العامل الأهم في عدم تحقيق النمو الشامل فيكمن في نقص المرونة اللازمة بين عملية التوظيف والنمو. وقد تزامنت جهود خلق فرص العمل في لبنان مع ارتفاع ملحوظ في القوى العاملة، لكن افتقدت تلك الفرص النوعية المطلوبة. وقد تأثرت على الأغلب قضايا النمو والفقر وفرص العمل مؤخراً بشكل سلبي بسبب تداعيات الأزمة السورية على لبنان، وبالأخص التدفق الكبير للأجنيين السوريين إلى البلد. ولا يزال جزء كبير من اللبنانيين، وبالأخص الشباب

القائم، والوضع الدقيق في البلد، وظروف المنطقة المتضررة من جراء الصراعات المسلحة بشكل عام. وتؤثر القيود سلباً على إمكانيات لبنان في تحقيق النمو الاقتصادي المستدام الذي يضمن العيش الكريم للمواطنين، بما في ذلك عدم استقرار الاقتصاد الكلي، والمناخ الضعيف لأنشطة الأعمال، والاستثمارات غير الكافية في مجال البنى التحتية (وبالأخص في المناطق المحرومة)، وعدم التوازن بين الكفاءات المعروضة وحاجات سوق العمل، وضعف المؤسسات والأطر التنظيمية. كما يفترض التشخيص هذا، بأن في غياب نظام الحكم الطائفي والنزاعات الداخلية والإقليمية، تكون تداعيات القيود المذكورة محدودة أكثر. وبالتالي، القيود التي تتعلق بقطاع الكهرباء وقطاع التعليم، على سبيل المثال لا الحصر، فهي متداخلة ضمن العوائق الأخرى المترابطة، مما يؤدي إلى تعطيل العمليات الإصلاحية وإلى تفاقم التداعيات السلبية على القطاعات الأخرى.

7. وبهدف وضع العوائق التي تعرقل الجهود التنموية على سلم الأولويات، قام فريق البنك الدولي بتصميم نظام تصويت للتحقق من مدى حدة تلك العوائق بشكل شفاف وسليم. تضمنت عملية تحديد الأولويات الخطوات التالية: (1) إعداد لائحة شاملة بالعوائق والقيود وفقاً للعمل التحليلي الذي يستند عليه هذا التشخيص؛ (2) الطلب من خبراء البنك الدولي القيمين على التشخيص بتحديد العوائق من الأكثر إلى الأقل وقعا، وذلك بناءً على 5 معايير (تداعيات تلك العوائق والقيود على الأهداف المرجوة، والمدة الزمنية للتداعيات، والشروط المسبقة، والعوامل المكتملة، وقوة الأدلة)؛ (3) وتحديد الأولويات الناتجة عن معدل درجات التصويت بحسب الهامش المكثف - مما يسمح للإصلاحيين مخاطبة التحديات التي تواجه مسار التنمية. وقد نتجت عن عملية التصويت هذه لائحة تحدد 11 قطاعاً ضمن سلم الأولويات، وقد شملت عائق نظام الحكم الطائفي والصراعات/العنف، إضافة إلى القطاعات المتداخلة وعدم توفر البيانات. وأخيراً (4) تم التحقق من دقة التحاليل وقوة الأدلة، وقد تم التأكد من متانة المنهجية المتبعة بالنسبة إلى تحديد الأولويات.

8. في حين أن جذور العائقين التوأم المترابطين عميقة في صميم النظام، هناك وسائل للحد من تأثيرهما، نصفها كالاتي: (1) استراتيجية تهدف مباشرة إلى الحد من تفاقم تداعيات العائقين المذكورين؛ (2) واستراتيجية ترمي إلى تطوير برنامج إصلاحي كحافز أقوى يُبطل النظام القائم.

الاستراتيجية الأولى تحمل إمكانيات عديدة في مجال تحقيق الأهداف التنموية، لكنها تتطلب وقتاً طويلاً لحصد النتائج نظراً لعمق جذور العائقين. أما الاستراتيجية الثانية فهي مناسبة أكثر لتحقيق النتائج على المدى القريب، ولكن بشكل محدود نظراً لعمق القيود. نذكر بعض الأمثلة حول الاستراتيجية الأولى كتطبيق بنود أساسية من إتفاق الطائف من خلال اعتماد قانون اللامركزية، وإنشاء مجلس مصغر ضمن البرلمان يتم انتخابه على أساس غير طائفي، وتحسين كيفية الحصول على المعلومات الإحصائية، وتعزيز الاستقرار السياسي، وإصلاح المؤسسات وتطويرها. أما الاستراتيجية الثانية فتتضمن الأمثلة التالية: العمل على تحليل شامل يبين حدة التداعيات السياسية والاقتصادية بالنسبة للقطاعات المتداخلة، وتصميم حزمة كبيرة من الإصلاحات، وفرض نهج الاستفادة من الفرص حينما تتاح، والعمل على موضوع الطبقة النخبوية المسيطرة، والمشاركة الاجتماعية "الأفقية"، وإدارة قضية النزوح السوري إلى لبنان وتحويلها إلى فرصة محتملة.

9. إذا تم تصميم الإصلاحات التي تفرض حافزاً أقوى في وجه العائقين القائمين، سوف تتحسن آفاق التنمية في لبنان بشكل جوهري، وذلك عبر (أ) الحد من ضعف الإطار المالي الكلي، (ب) تعزيز الحوكمة الفعالة في المؤسسات العامة، (ج) معالجة الثغرات في قطاع الطاقة بهدف زيادة إنتاجية القطاع الخاص والحد من الأعباء المالية، (د) تعزيز قطاع تكنولوجيا المعلومات والاتصالات لربط لبنان بالاقتصاد العالمي وخلق فرص العمل المطلوبة في القرن الـ 21، (هـ) تحديث قطاع التربية والتأكيد على ضرورة تزويد الشباب بالمهارات بحسب احتياجات سوق العمل، (و) تحسين مناخ أنشطة الأعمال وتخفيف الأعباء في مجال تأسيس الشركات وتشغيلها، (ز) زيادة الاستثمارات في قطاع النقل لتسهيل حركة الأشخاص والبضائع، (ح) معالجة قضايا البيئة لحماية الموارد الطبيعية في لبنان، بما في ذلك الموارد المائية. كما يجب التنبيه إلى البعد الطارئ عند تصميم البرنامج الإصلاحي للقطاعات المذكورة آنفاً، إذا ما أراد لبنان خلق الوظائف الكافية ذات النوعية، لإفادة المواطنين وتحقيق هدف الحد من الفقر المدقع وتعزيز الرفاه المشترك، وذلك لتجنب تفاقم الأوضاع المعيشية، ومعالجة الأعباء الإضافية التي تفرضها الصراعات الإقليمية على وجه الخصوص.

Chapter 1

Country Context

Background

Lebanon is a small, open economy of high-middle-income status with a population of 4.5 million people in 2013. Gross domestic product (GDP) per capita was about US\$17,390 in purchasing power parity (PPP) terms and US\$9,905 in current dollars in 2013. Services and trade are the most important sectors, with tourism and financial services forming the backbone of the national economy. The country has experienced civil war, external conflicts, and several waves of Palestinian and, more recently, Syrian refugees. In spite of its political instability, the country is well known for its high level of human development and open economy as well as a large, educated, and diversified diaspora (World Bank 2010b).

The country is acutely fragile, with elevated risks of violence and conflict due to the impact of a confessional system of governance that has increasingly led to paralysis of decision making and is prone to external influence.¹ This fragility has been exacerbated by the ongoing spillover from regional conflicts, including the ongoing war in the Syrian Arab Republic. Fragility and vulnerability are a product of decades of recurrent conflict and violence, political instability, and deep social and economic inequalities. This situation has hollowed out the state in the face of confessional or sectarian interests and the imperative of preserving confessional peace at the expense of effective governance and efficient service provision.

Apart from the high social costs and destruction of the social fabric of the country, the Lebanese economy suffered tremendously from a prolonged civil war that lasted from 1975 to 1990 and resulted in devastating material damage to infrastructure and loss of productivity. While modest growth resumed following the end of hostilities in 1990, this growth did not result in

equitable development, but instead reinforced sectarian cleavages and grievances. Numerous donor conferences in the 2000s were successful in mobilizing much-needed financial assistance for the country, but most of it went to financing the country's burgeoning debt and stabilizing the currency. As such, donor funding contributed little to the efficient targeting of much-needed social service provision and the promotion of equitable economic growth and job creation.

Despite these challenges, the country has experienced periods of economic boom driven primarily by high growth in the banking sector in some years of global turmoil and, more recently, a “muddle through” period of low growth due to insufficient policy reform as the regional spillovers have intensified in the last two years. This situation is becoming even more tenuous as Lebanon tries to cope with the deepening and prolonged impact of the Syrian conflict, which has brought a massive influx of refugees and the need to manage tensions generated by opposing Lebanese confessions supporting different sides of the Syrian crisis. As a result, Lebanon has very little capacity to absorb or manage new shocks and stresses or to achieve long-term, sustainable growth and development.

The Lebanese economy has grown at a moderate pace over the past decades, but growth has been uneven due to large, frequent, and mostly “political” shocks, to which the economy has shown remarkable resiliency. Real GDP grew, on average, an estimated 3.6 percent from 1965 to 2014 (4.4 percent from 1992 to 2014),² but these figures mask the impact of many domestic, international, political, and confessional during this period. The latest is the ongoing conflict in neighboring Syria, which, given the strong linkages between the two countries, is generating large and negative spillover effects in Lebanon.

Lebanon has weathered repeated and large shocks relatively well and—at least compared to what many might have expected—the country has demonstrated much resilience. The country, for example, is proud to be one of few nations never to have defaulted on its sovereign debt, even after experiencing 15 years of civil war and the world's largest ratio of debt to GDP in the mid-2000s.

Lebanon has struggled to reduce widespread poverty, which remains at high levels and exhibits considerable geographic and social variation. Based on available (but unsatisfactory) data, poverty incidence has been elevated and broadly unchanged for the past 25 years. This is the case whether poverty is measured using the lower (extreme) or upper poverty lines.³ Since the end of the civil war, extreme poverty has hovered at between 7.5 and 10 percent, while, based on a wider measure of poverty (the upper poverty line), about 28 percent of the population is poor.⁴ The distribution of poverty has also been unequal, with poverty levels highest in the north and south of the country and in small, dense pockets in the suburbs of large towns, reflecting the unevenness of economic growth and development. Poverty has been widespread and persistent since 1990, contrasting sharply with progress made between 1961 and 1974, when poverty dropped from 50 to 22 percent (although data comparability is an issue, as detailed in chapter 2).

In addition to monetary poverty, a broader segment of the population suffers from nonmonetary dimensions of poverty (for example, inadequate levels of education, health care, and access to basic infrastructure). Although Lebanon is an upper-middle-income country, weak and deteriorating public institutions mean that the state is unable to deliver satisfactory public services widely to the population. While more affluent citizens are able to compensate by purchasing private goods and services (for example, private schooling, bottled water, and electricity generators), the poor and lower-middle classes are unable to compensate fully for their limited access to basic services. This inability adversely affects their living conditions and quality of life.

The prevalence of nonmonetary poverty in certain groups reflects pervasive inequities and lack of shared prosperity in Lebanon today.

Lebanon has failed to generate inclusive growth, as job creation has been weak and of low quality. A key factor underlying the lack of inclusive economic growth is low employment-growth elasticity, which, at 0.2, is low even by regional standards. In Lebanon, job creation has trailed the high growth in the labor force,⁵ and the jobs that have been created have typically been of low quality and low productivity in sectors such as services, which contributed to a third of jobs created during the 2004–09 period. More recently, both poverty and jobs have been negatively affected by the Syrian conflict and, in particular, by the large influx of refugees. Confronted with a bleak record on poverty reduction and an inability to boost shared prosperity, Lebanese stakeholders revealed in a World Bank (2014f) country survey that social protection and job creation were their second and third development priorities, respectively (after public sector governance). In fact, they ranked job creation as the most important factor for reducing poverty and the third most important for boosting shared prosperity (after a growing middle class and consistent economic growth).

Lack of quality jobs at home continues to push a large share of Lebanese abroad, especially educated youth, and this exerts a negative impact on the economy's longer-term potential and the Lebanese polity. This outmigration of qualified youth is a significant loss to the economy, as the country is losing a productive resource and having to compensate by hiring expatriate workers.

The uneven distribution of social and physical infrastructure in Lebanon is an important factor limiting economic opportunities and improvements in quality of life. Geographic disparities are exacerbated by spatial variation in infrastructure and service delivery. Areas where services and infrastructure are especially inadequate are more likely to have population groups who are excluded and have limited access to opportunities. However, beyond and above the stark spatial inequality, the country suffers from relatively

weak basic infrastructure, which lowers people's job opportunities and quality of life and stifles the country's long-term economic growth. Lebanon's underdeveloped infrastructure is one of the most important factors explaining the poor quality of growth and stagnant levels of poverty.

The nature of Lebanon's post-civil war reconstruction has resulted in a macroeconomic environment characterized by structurally weak public finances that create large vulnerabilities for the economy. Immediately after the end of the civil war and in the absence of donor financing, Lebanon financed its large reconstruction effort through borrowing.⁶ The interest rates at which the debt was contracted were initially very high due to a period of triple-digit inflation and a sharp devaluation of the currency at the end of the civil war. By the time inflation and the currency had stabilized, the debt stock had risen markedly, especially when compared to the recovery in economic growth. This generated concerns about the sustainability of debt and elevated Lebanon's risk premium, which, in turn, worsened debt dynamics and stymied the economy's growth potential.

While Lebanon faces stark and pressing development challenges, efforts to improve the quality of institutions and promote growth have been limited. Due to the difficulty in reaching consensus, pressing and large constraints on Lebanon's economic development remain unaddressed, although in many (maybe most) cases the solutions are well known and well documented. These missed opportunities for reform are evident in the deteriorating infrastructure sector (especially the electricity sector), inability of public institutions to provide a satisfactory level of services, antiquated business environment, and unsustainable macroeconomic environment, among others.

Major deficiencies exist in the data about Lebanon's poverty and income distribution as well as its economic and governance measurements. Beyond the weak quality, poor reliability, and limited availability of data needed to assess progress toward the World Bank Group's twin goals of poverty reduction and shared prosperity,⁷ the weakness of the statistical system is widespread and

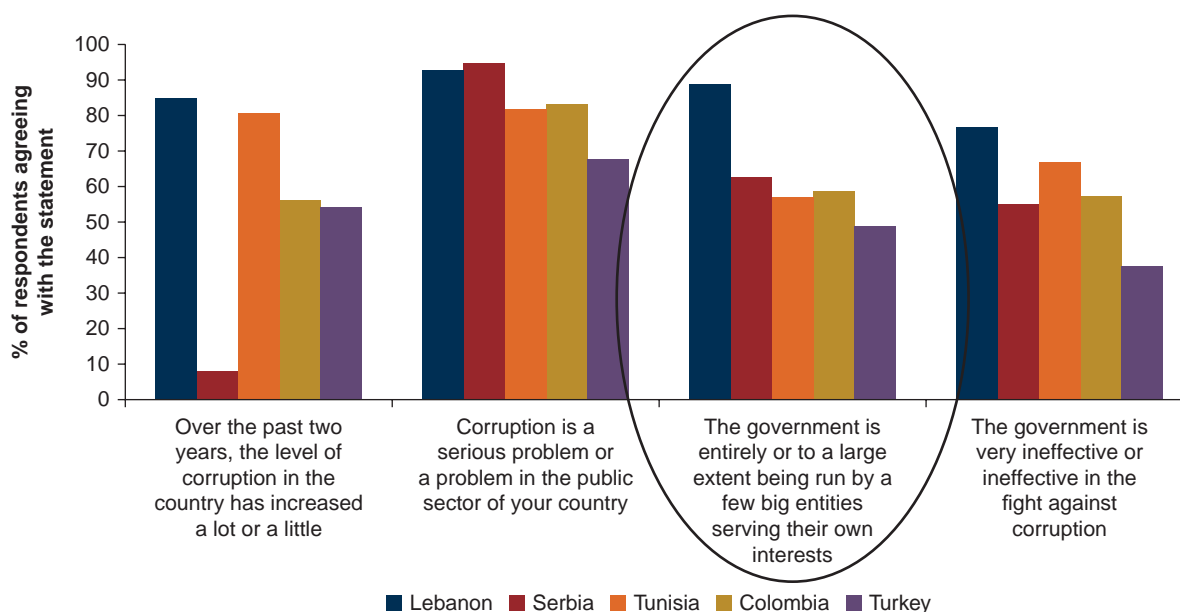
impedes economic analysis at the macroeconomic and sectoral levels. These deficiencies include (a) the lack of regular information on the development of labor markets and living conditions of households; (b) weak balance of payments statistics; (c) weak inflation statistics; and (d) long delays (up to three years) in the release of annual national accounts. Although the weaknesses of the statistical system are gradually being addressed, the current state of the system significantly limits the ability to analyze Lebanon's growth dynamics (Berthelemy, Dessus, and Nahas 2007).⁸ Most important for this Systematic Country Diagnostic (SCD), the weaknesses of the data on both poverty and income distribution constrain the analysis of progress toward the twin goals. It is with these important limitations and caveats in mind that this SCD was undertaken.

Overarching Constraints Limiting Lebanon's Development

At the root of Lebanon's failure to generate inclusive growth and jobs are two mutually reinforcing and pervasive (overarching) constraints. These are (1) elite capture hidden behind the veil of confessionalism or confessional governance and (2) conflict and violence stemming, in part, from the broader dynamics of conflict in the Middle East. While the SCD stresses the impact of these overarching constraints on the country's development, many other factors have also contributed to Lebanon's failure to reduce poverty and to achieve high, sustained, and inclusive growth. This chapter provides an overview of the origin and evolution of these overarching and mutually reinforcing/symbiotic constraints, and chapter 3 describes and analyzes them in detail.

The two constraints impose a heavy burden on the economy, with the cost of confessional governance—the first overarching constraint—estimated at 9 percent of GDP annually (Chaaban 2014). Illegal activities are not sanctioned by the state when they involve politically or confessionally connected or wealthy actors, exacerbating

FIGURE 1.1 Perceptions of Corruption and Elite Capture in Lebanon and Comparator Countries, 2013

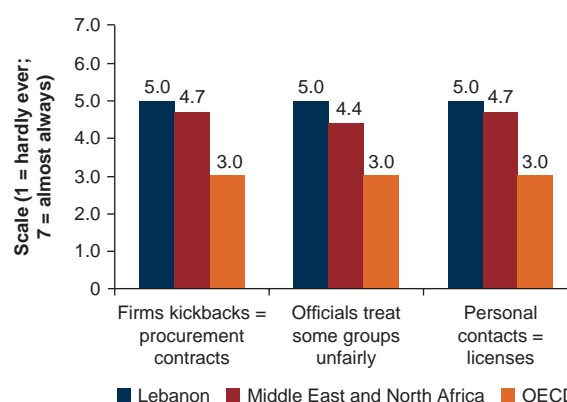


Source: Transparency International 2013.

elite capture and the pervasive patronage system (figure 1.1). Economic stakeholders and personal connections (known as *wasta*) are more likely to influence the execution of policy and enforcement of the rule of law (figure 1.2). For example, funds from the Lebanese public sector are equally as likely to flow to kin and family as to the needy and poor. Public servants or superiors directly pocket 25 percent of funds, compared to about 10 percent in the Organisation for Economic Co-operation and Development (OECD) countries (Figure 1.3). Elite capture and corruption are endemic.

The cost of the conflict and fragility—the second overarching constraint—is large and recurrent. Throughout its history as a state, Lebanon has frequently been affected directly or indirectly by domestic and regional conflicts whose economic and social costs have been high and had a long-lasting impact on the country. These conflicts include the 1975–90 civil war, which halved the country’s economy, the 2006 conflict with Israel, which caused direct damages estimated at US\$2.8 billion and indirect damages estimated at between US\$700

FIGURE 1.2 Perceptions of Corruption in Policy Execution in Lebanon and Comparator Regions, 2010

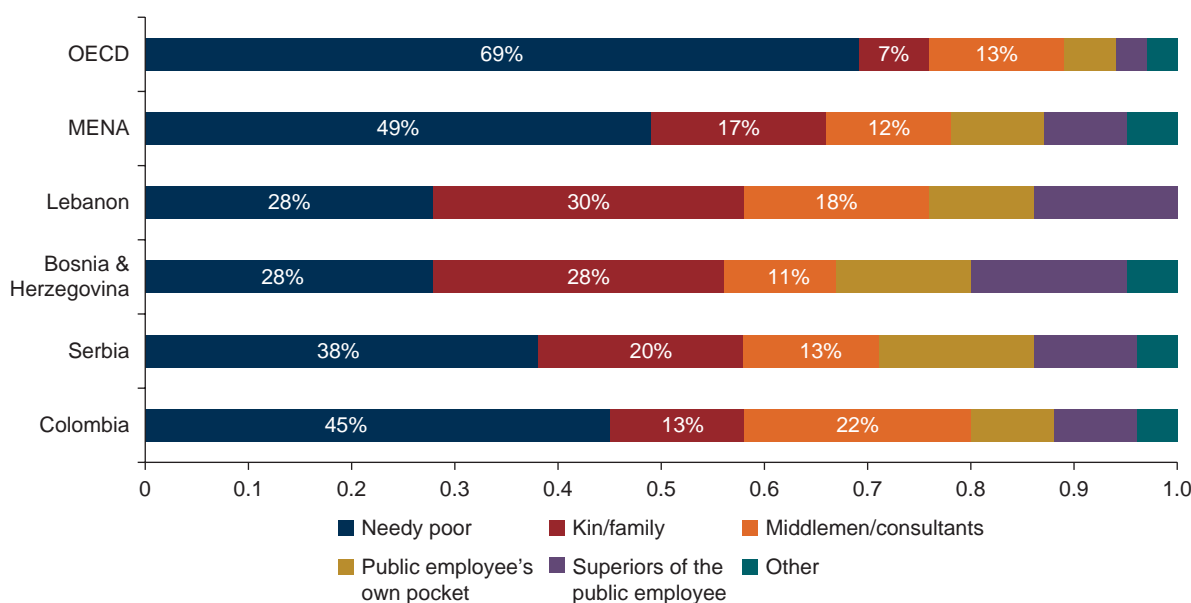


Source: Quality of Government Institute 2010.

million and US\$800 million (World Bank 2010b), and, more recently, the Syrian conflict, which cost the Lebanese economy US\$7.5 billion in forgone output and US\$2.6 billion in lost revenue and additional public spending between 2012 and 2014 (World Bank 2013c).

Other (more traditional) constraints are *nested* within the two overarching constraints.

FIGURE 1.3 Flow of Funds from the Public Sector



Source: Quality of Government Expert Survey, 2010.

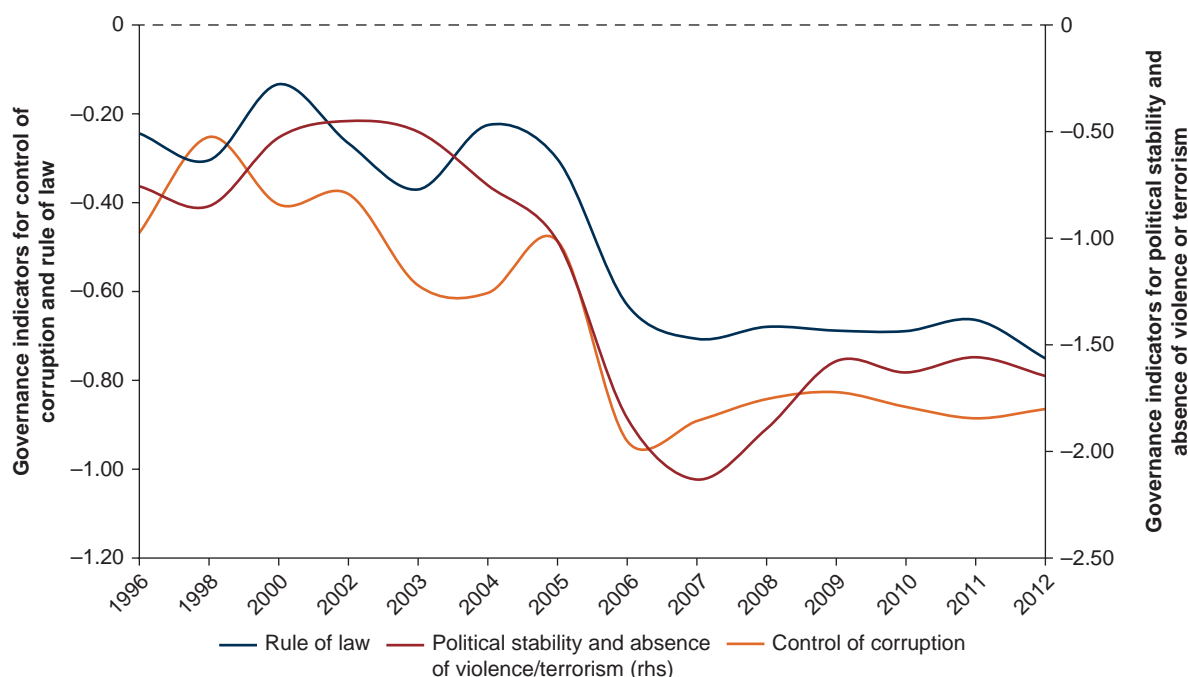
These include macroeconomic instability, weak business environment, insufficient investment in infrastructure (especially in lagging regions), mismatch between skills and labor market needs, and weak institutions and regulatory framework. Chapter 3 provides a detailed analysis of these key nested constraints. The SCD posits that, absent the destabilizing impact of confessional governance and domestic and regional conflicts, these nested constraints would be significantly less binding than they currently are. This magnifying impact is best illustrated by two examples related to infrastructure and governance.

The first example is the deleterious impact on the infrastructure sector. The strong influence of private sector and sectarian interests in government, which is facilitated by the confessional system of governance, has both impeded the equitable and efficient distribution of investments in infrastructure (both construction and maintenance) and precluded the development of a national strategy addressing infrastructure development as part of a broader vision for the country (UNDP 2009). As a result, budget spending and investments in infrastructure have tended to be guided by considerations of confessional

quotas and electoral geography rather than actual needs. With regard to the dynamics of regional conflict, the infrastructure sector has been significantly affected by both the physical damage caused by the 2006 Israeli military operation and the pressure exerted by the large number of Syrian refugees currently in Lebanon. The influx of refugees has severely strained the capacity of water, sanitation, electricity, and solid waste management and municipal services, including in terms of access, distribution and quality (World Bank 2013c).

The second example is the gradual push into a governance trap. This push has occurred through several mutually reinforcing channels. First, the confessional system of government, with its focus on balancing and seeking consensus among all ethnic and religious communities (based on the exercise of veto rights), gives rise to an unstable equilibrium in practice. Conflict is omnipresent, but contained by formal and informal mechanisms for bargaining and consensus making. When confessional interests are not satisfied, either decision making is imposed by an outside party (historically often Syria) or violence is used as a last, but relatively frequent, resort. When Syria

FIGURE 1.4 Governance Indicators in Lebanon, 1996–2012



Source: World Bank 2013.

left the country in 2005, veto rights became more powerful, sharply increasing paralysis in decision making (for example, the last voted budget law was for 2005, and it was voted in 2006).⁹ As a result, Lebanon's governance indicators have sustained a marked decline (figure 1.4). In 2008, with increasing political polarization due to the Syrian conflict, the risk of political conflict turning violent rose. Second, and linked to the first, Lebanon's government is acutely vulnerable to regional conflicts, due to the alliances that exist between regional actors and confessional organizations, some of which constitute "states within the state" and often possess capabilities stronger than those of the Lebanese government.

Evolution of Confessional Governance and Conflict

Lebanon's confessional system of governance has evolved, in part through conflict, from its original goal of protecting minority rights to one that features significant, and dysfunctional, elite

capture. In order to situate and frame the analysis of Lebanon's current development challenges, this section provides a brief historical overview of the genesis of Lebanon's system of confessional governance and context of conflict and fragility.

Immediate Post-independence Period (1943–75)

Although recognized as a state in 1920, Lebanon only obtained formal independence in 1943 with the end of the French mandate. Given the sectarian structure of its society, the Lebanese state was constituted, through its constitution and its unwritten National Pact, as a consociational democracy based on equality among confessional groupings.¹⁰ This system was intended to avoid hegemonic power of one group over others. The 1932 census, which showed that Christians were 54 percent of the population, was used as the basis for distributing seats in parliament on a ratio of six Christians to five Muslims. This ratio was later extended to other public offices. As a result, at the beginning of the republic, power was dominated by the Christian Maronites, who occupied the

presidency, controlled key civil service jobs, and held most of the country's wealth. Lebanon at that time operated as a presidential democracy, mirroring the French model. This allowed a functioning executive to lead state affairs and ensure that decisions were made. The system was relatively stable, which facilitated the development of institutions, such as the civil service bureau and the central bank, and the country enjoyed a relatively high degree of economic growth. Lebanon was, nonetheless, not impervious to external shocks during this period—notably the Arab-Israeli war in 1948 and 1967 (Makdisi 2007).

The governance model promoted political liberalism, ensured regular presidential and parliamentary elections, and temporarily strengthened the state through economic and administrative reforms (Makdisi 2007). The presidency of Fouad Chehab (1958–64) marked a period of state and public administration building. During his presidency—called the Chehabist period—Lebanon embarked on a program of reforms to strengthen the state and expand its role in the provision of social services to reduce some of the country's social and economic imbalances. State-run agencies such as the Litani River Authority, the public education system including the Lebanese University, and the National Social Security Fund were established during this period.

However, the state, through the ruling elite, practiced patron-client relationship and increasingly intervened and distorted markets¹¹ in an attempt to generate and divide rents among its constituencies (Lebanese Transparency Association 2007). The central authority of the state and political institutions weakened over time, yielding to growing elite capture of state prerogatives. What was initially a confessional system meant to provide checks and balances to protect confessional minorities evolved into the system of clientelism that prevails today.

Civil War and External Intervention (1975–90)

By 1975, the confessional formula had reached its limits. The displacement of the Palestinian

Liberation Organization (PLO) from Jordan to Lebanon in 1971 and its continued struggle (subsequently led from Lebanese territory) against Israel¹² gave rise to increasing tensions between Palestinians and their supporters¹³ and Lebanese Christians led by the Maronites. By 1975, the confessional system was no longer able to contain the growing tensions and civil war broke out.

The consequences were devastating. Over the 15 years of its duration, the conflict mutated several times, fragmenting the country into competing sectarian and militia fiefdoms. Shifting alliances, changing motivations of belligerents, and emerging powerful new domestic groups (notably Hezbollah) exacerbated by external intrusions (including the Israeli invasion of 1982, its occupation of the south until 2000, and the Syrian intervention from 1976 until 2005) significantly shaped power and conflict dynamics in the postwar period.

Given its duration and reach into the Lebanese state and society, the Syrian intervention had a particularly significant impact on Lebanon, especially with regard to governance, elite capture, capacity to build effective and independent state institutions, and quality of life. According to Picard and Ramsbotham (2012, 72), “The status of Lebanese political leaders from all factions was dependent on good relations with Syrian military officers and with Damascus.”

The civil war caused major human suffering and significant physical destruction and significantly weakened the central authority and legitimacy of the state. At the end of the conflict, the country's infrastructure was in ruins, with more than 150,000 people killed (5 percent of the population), an estimated 17,000 persons missing, and an estimated US\$30 billion in forgone output (at 1974 prices; Makdisi 2004). The war generated a new crop of leaders, weakened the executive, and created mini-states. Over the course of the war, militias developed their own economies, operated ports, imposed taxes, and set up their own institutions (Traboulsi 2007). The public administration in 1990 lacked both staff—with half of civil service posts vacant (World Bank 2011a)—and infrastructure and

was unable to deliver basic services (El-Zein and Sims 2004). To avoid a civil service implosion, the government resorted to recruiting contractual labor. This measure, however, brought in both the qualified and unqualified; in the end it created a parallel structure without injecting a new and skilled workforce into the public administration. As a result, most public services and utilities lacked capacity and lost their true function, becoming instead simply sources of rent seeking, employment, bribery, and transfers for the benefit of warlord constituencies.

As the state progressively withered during (and after) the civil war, nongovernmental organizations (NGOs) and the private sector stepped in to provide electricity, water, and social services. This situation persists today.¹⁴ Although this strong engagement enabled the continuation of basic services in the absence of functioning governments, it also meant that the state was unable to gain an adequate footing in the provision of basic services for the poor after the war ended. There is still little pressure from the population for the state to widen the scope and improve the quality of public service delivery. Nonetheless, while private provision has filled some of the gap left by the state, these nonstate actors operate on a confessional basis that fails to serve many of the poor and exacerbates inequality in the quality and quantity of services available.

Postwar Reconstruction (1990–2005)

The conflict formally ended with the 1989–90 Taef Accord, which aimed to make the confessional system more equitable; however, its partial implementation enabled the (wartime) elite to solidify its power behind a veil of confessionalism. While ending the war, the parts of the Taef Accord that were implemented did not succeed in building institutions and a functional political system. Instead, it weakened the president, failed to introduce a functioning alternative, and embedded confessionalism, which evolved into a governance structure, commonly referred to as “the *Troika*,” outside the constitutional institutions.¹⁵

The representation and powers of Christians were diminished, while those of the Sunni, the Shi’a, and others like the Druze and Allawites made gains as parliament moved from a six to five ratio between Christians and Muslims to an equal share. This ratio remains in place today.

Critical parts of the Taef Accord were never implemented, such as creation of a lower house that would not be confessionally based, coupled with an upper house that would be confessionally based, and decentralization that would move decision making on public service delivery closer to the user. Implementation of these parts would likely have significantly reduced the power of confessionalism in policy making and supported institution building and a functional political system.

With the war ended, Lebanon enjoyed relative stability between 1990 and 2005. This period was characterized by a postwar investment boom in some infrastructure sectors,¹⁶ a revamped political system that preserved stability (at the expense of effectiveness and efficiency), and a climate of relative security underwritten by the presence of Syrian forces. Economic growth was moderate, concentrated primarily in infrastructure and tourism, but ultimately unsustainable as the largely public sector–financed reconstruction, underwritten at high real interest rates in an environment of moderate real GDP growth, led to a ballooning budget deficit and, ultimately, skyrocketing public debt. Economic growth during this period was unequal, disproportionately benefiting some areas and population groups, which fueled the perception of discrimination and marginalization and kept sectarian tension alive.

The Taef-derived political system, despite resulting in confessionally-based elite capture, was manageable and functioning (though not efficient) as long as a power broker was able to impose decisions. The political governance formula introduced by Taef resulted in a government and state that operated at the lowest level of efficiency and quality of services. The system made decision making almost impossible, given the ability of key religious groups to veto decisions. Extra-institutional solutions or the intervention

of an external power broker (at that time, Syria) was needed to force key confessional groups to come to an agreement.

In the face of weak government and public institutions, sectarian institutions consolidated into de facto “states within the state” as militia members entered into public administration and warlords became politicians, ministers, and even heads of the executive and legislative branches of government.¹⁷ They were ultimately integrated into the system and became representatives of their confessions, a system that continues today. The new political class developed subsidies and transfers and used the public sector to obtain political rent and secure the allegiance of their various constituencies. Patronage and clientalism became the dominant forms of economic and social organization. Reforms were introduced only if the welfare of the *Troika* was unaffected and the power broker was in agreement, thus restricting the set of feasible reforms to a very small number.¹⁸ Over time, the quality and efficiency of public sector delivery of goods and services deteriorated even further.

Political Economy Deadlock (2006–Present)

The assassination of former prime minister Rafiq Hariri in 2005 created a new political dynamic. The Cedar Revolution that followed the assassination culminated in the withdrawal of Syrian forces (until then the de facto power broker) and the polarization of political forces into opposing coalitions. In their present form, the first coalition (March 8) is led by the pro-Syrian Hezbollah movement, the Amal movement, and a key Maronite Christian representative, and the other (March 14) is predominantly led by an alliance of Sunni and other Maronite Christian groups (March 14). Created following the Hariri assassination and without a current power broker, the political polarization of March 8 and March 14 has widened rapidly and remains the principal source of political tension today. The two camps dominate the political landscape and, given their sharp differences and mutual mistrust, has resulted in

political gridlock that has paralyzed the country. The presidential post has been vacant twice, with the current vacancy exceeding 1.5 years and ongoing; each time it has taken several months to form a government, with major decisions or measures necessitating months of discussion and extra-institutional bargaining.

Violence and conflict returned to Lebanon due to both domestic and regional events. In 2006 a 34-day assault as well as an air and sea blockade by Israel resulted in huge damage and setbacks to the country’s economic recovery. The 2006 attack generated substantial economic losses throughout the country, damaging key transport and services infrastructure and housing and reversing some of Lebanon’s reconstruction gains since 1990 (World Bank 2007b). Meanwhile, in 2008 political tensions between the March 8 and March 14 groups reached a zenith, spilling into a brief armed conflict that resulted in March 8 taking over Beirut. This domestic conflict was resolved through the Doha Accord brokered by Qatar.

The Syrian conflict that started in 2011 is destabilizing the political/confessional, security, economic, and social conditions in Lebanon. The Syrian crisis has led to both an escalation of tension between the March 8 and March 14 coalitions as well as more broadly between Sunni and Shi’a groups within Lebanon, who support belligerents on either side of the Syrian conflict. Tensions have been exacerbated by the increasing pressure on already stretched and weak public and, especially, social services and local communities, as about 1.1 million Syrian refugees have crossed the border and are officially registered with the United Nations High Commissioner for Refugees (UNHCR), constituting more than 25 percent of the Lebanese population. In addition, several violent incidents have led to a deteriorating security environment. Local communities are increasingly seeing refugees as a threat to social stability, and several municipalities have instituted curfews specifically targeting Syrians. A detailed estimate of the economic and social costs of the Syrian conflict for Lebanon can be found in World Bank (2013c); the annex to this chapter summarizes those findings.

Without an external power broker, the post-2006 period exposed Taef's weaknesses: severe polarization, consolidation of the sectarian "states within the state" phenomenon, and political deadlock. Without a power broker, the political divide between March 8 and March 14 widened, with each religious sect (even within coalitions) regularly exercising its veto power to block any decision—be it administrative, economic, or political—that either did not further its direct interests or risked advancing the interests of other groups.

In the political sphere, between 2005 and early 2015, caretaker governments ruled for about two years, an international accord in Doha was required to elect a president in 2008 after a six-month vacancy, and the presidency has now been vacant since May 2014. Meanwhile, parliament was unable to function regularly due to lack of a quorum. As a result, not a single law was passed in 2007, only 5 were passed in 2008, and 14 were passed in 2009. In 2013, 2 were passed, but they related to extending the mandate of parliament and delaying parliamentary elections.

In the administrative and economic sphere, basic functions of the executive and parliament, such as passing a national budget, stopped (the 2005 budget was the last one approved). Important decisions related to restructuring the labor force in the state electric utility, *Electricité du Liban* (EdL), establishing a regulatory authority for the oil sector, or removing illegal structures dating mostly from the civil war all provoked turmoil, sit-ins, and tension. Such events or failed attempts at reform multiplied and, in most cases, had a sectarian element. In short, a rules-based system ceased to exist, and a system based on compromise and political horse trading now prevails.

The Symbiotic Relationship between Confessional Governance and Conflict

The progressive hollowing out of state institutions and a turbulent environment perpetuate recurring and mutually reinforcing dynamics of conflict and

elite capture (hiding behind a confessional veil). Lebanon fits well the paradigm of conflict, violence, and fragility described in the *2011 World Development Report: Conflict, Security, and Development* (World Bank 2011d). The absence of resilient institutions and a turbulent regional and international environment perpetuate recurring and mutually reinforcing dynamics of conflict and fragility. The two overarching constraints—the confessional system of governance and the country's vulnerability to conflicts in the Middle East—create internal and external stresses that foster instability and constrain Lebanon's development prospects. In such a context, it is difficult to discern clear patterns of causality.

One consequence of the stress is the creation of a fragile and dysfunctional political system and state unable to regulate conflict and exercise sovereign authority. At the heart of Lebanon's confessional political system is the tension between the conflict-mitigating goals of the consociational approach and a social contract in which the relationship between the state and its citizens is mediated through confessional and sectarian affiliations and interests.

In order to prevent future sectarian conflicts, the Taef Accord strengthened the confessional system by spreading political power and institutional responsibilities more broadly. However, this broadening of power and responsibility paralyzed decision making (given the need for reaching broad consensus for every decision), entrenched sectarian interests at the heart of state institutions, and reduced the autonomy and effectiveness of the state. The state was in effect 'hollowed out': sovereign authority was transferred to sectarian actors and organizations, and institutions were rendered incapable of effectively carrying out basic state functions across sectors.

At the same time, the system remained deeply conflictual through the establishment of a "permanent" competition over political power, resources, and state privileges. After the civil war, the Syrian occupation ensured a degree of stability and decision making through 2005. However, the weakness of the state was highlighted following the Syrian withdrawal, when competition between

political forces, long buffered by the Syrian presence, led to immediate political deadlock and a brief resumption of violent conflict in 2008.

Another consequence is the entrenchment of sectarianism as an alternative and parallel system for organizing social, economic, and political life. During the civil war, religious groups and militias governed, administered, and defended populations. Following the civil war, territorial and administrative borders between groups were institutionalized. A key role of sectarian organizations has been to provide key social services such as education, health, and welfare support to the most vulnerable groups. While this has been beneficial in the absence of effective state institutions, it has deepened both societal cleavages and institutionalized a discriminatory and inequitable system for regulating social and economic life, given that the provision and targeting of services have often been linked to electoral campaigning. When combined with the privatization of public service delivery and direct financing by the state, this situation has created steep inequalities in access to services, as private sector actors have set exorbitant prices for service delivery.¹⁹

The sectarian politics and social relationships that evolved during the civil war have resulted in uneven growth, opaque management of public resources, and widespread corruption that have exacerbated elite capture and sectarian cleavages. Lebanon's government and economy became dominated by a small number of individuals, who controlled access to individual sectors and exerted strong influence, through clientelist practices, on the distribution of resources. Lebanon's reconstruction drive and resulting economic boom in the 1990s benefited a small segment of the population, with most investments concentrated in Beirut and profits accruing primarily to an affluent elite. During this period, social spending was not prioritized, as the benefits of reconstruction investments were expected to trickle down, which did not occur (UNDP 2009).

Regional disparities are stark in Lebanon, with the bulk of the poor living in peripheral areas (particularly the north and the south). Lebanon scores below the average for the world,

the OECD, and Middle East and North African countries on a range of policy making and service delivery indicators. Lebanon's extremely poor scores reflect obstacles to public action, quality of services delivered, and needs-based and territorial coverage of public services. This inequality, combined with the inability to implement a national development plan, has led to perceptions of sectarian-based economic discrimination—perceptions that political groups have exploited to mobilize support and action—and further reinforced political competition and conflict over control of the economic levers of power (Kraft et al. 2008).

The effects of external (that is, regional and international) dynamics in Lebanon include (1) the conversion of Lebanon into a theater for regional conflicts and the pursuit of external objectives (political and military), including the Israeli-Palestinian conflict and Syrian interventionism; (2) the use of regional political alliances by Lebanese actors to strengthen their political power domestically; and (3) the spillover of regional conflict and its destabilizing impacts (political, security, and economic)—notably the current conflict in Syria.

Over the years, some of these external factors have become an integral part of the domestic political landscape, both regarding the identity and political agenda of some groups (which are both national and transnational in nature) and regarding the role played by Lebanese groups in conflicts elsewhere in the region. The current regional conflict between Shi'a and Sunni groups in Iraq and Syria, for instance, is polarizing communities and transforming sectarian tensions and cleavages in Lebanon from a Muslim-Christian conflict to a Sunni-Shi'a conflict. This has had a strong negative impact on Lebanon's growth, poverty, and equality.

Organization of the Report

The remainder of this report is structured as follows. Chapter 2 provides an overview of Lebanon's growth, poverty, and jobs performance.

When possible—given data limitations—it takes a long-term approach to the performance of those sectors, highlighting trends and structural factors rather than short-term or cyclical phenomena. The chapter offers a diagnostic of Lebanon's performance in creating sustainable and good-quality jobs, which are necessary to reach the twin goals of the World Bank. Chapter 3 details Lebanon's challenges and opportunities for reaching the twin goals, presenting the two overarching challenges and discussing nested challenges and constraints. The chapter concludes with factors of strength, sources of resiliency, and opportunities for Lebanon. Chapter 4 delves into key risks and vulnerabilities surrounding Lebanon's development model. Finally, based on the analysis of the previous chapters, chapter 5 prioritizes a list of challenges facing Lebanon and highlights some opportunities for the future.

Annex 1A The Economic and Social Impact of the Syrian Conflict on Lebanon

Syria is closely linked to Lebanon through historical, social, and economic ties, and the conflict in Syria is having a large and negative impact on Lebanon's economy, its social fabric, and its public services.²⁰ The cumulative losses in economic activity reached an estimated US\$7.5 billion by end-2014. Social cohesion is deteriorating partly due to a combination of rising poverty, worsening labor market, rising insecurity, and deteriorating core public services. At the same time, demand for public services is rising as a result of the influx of Syrian refugees. Across all core public services, the surge in demand is being met partly through a decline in access to and quality of public services. The fiscal cost of the Syrian conflict is estimated at US\$2.6 billion through end-2014. Additional spending of US\$2.5 billion would be required to return the level of access to and quality of public services to their pre-Syrian conflict level.

Economic Impact

Lebanese growth is estimated to drop 2.9 percentage points each conflict year. This is generating cumulative losses in economic activity of US\$7.5 billion through 2014. The largest impact arises from the insecurity and uncertainty spillovers, which profoundly shake investor and consumer confidence. The resulting lower economic activity is putting downward pressure on government revenues, which, combined with rising demand for public services stemming from the large refugee influx, is generating large costs for the budget and damaging Lebanon's structurally weak public finances. These costs are largely driven by the influx of refugees into Lebanon.

After an initial negative impact on the trade sector, firms have gradually adapted to the shock and have found ways to cope with or benefit from it. Lebanon's large trade sector is significantly exposed to Syria because of its role as a trading partner, the sizable share of Lebanese trade that transits through Syria, and the risk that a destabilized Syria creates for Lebanon's large services exports, especially tourism. The first half of 2013 witnessed sharp reductions in trade flows, particularly for food products and consumer goods. However, data through 2014 reveal that, while Lebanese exporters to Syria have suffered from a drop in demand in the Syrian market (but less so than Jordanian exporters), other Lebanese exporters have started to export to Syria to fill the gap in Syrian production. Data also suggest that Syrian refugees in Lebanon provide important impetus to export Lebanese services.

The Syrian conflict and the influx of refugees have cost the central government an estimated US\$2.6 billion through end-2014. This is putting Lebanon's public finances under severe and unsustainable strains, given Lebanon's initial weak public finances. On the revenue side, spillovers from the conflict have cost an estimated US\$1.5 billion in revenue collection through end-2014, due to a combination of direct impacts on key sectors (such as tourism) and indirect impacts on economic activity. On the expenditure side, total budgetary spending by the government

alone grew an estimated US\$1.1 billion over the same period, mostly because of the sharp increase in demand for public services by Syrian refugees. The wider fiscal deficits, lower economic growth, and rising interest risk premium due to the Syrian conflict have halted Lebanon's remarkable progress in reducing its debt-to-GDP ratio; for the first time since 2006, Lebanon's debt ratio rose in 2012 and has continued growing since then.

Human Development and Social Impact

The Syrian conflict is estimated to have a fiscal cost US\$308 million in spending on health, education, and social safety nets through 2014, while US\$1.4 billion (3 percent of GDP) would be needed for stabilization—that is, to restore access to and quality of services to pre-conflict levels—including US\$166 million for short-term job creation. The conflict is estimated to have negatively and materially affected the poverty, livelihoods, health, and human capital conditions of the Lebanese people. By end-2014, some 170,000 additional Lebanese had been pushed into poverty (over and above the 1 million previously below the poverty line). The Lebanese regions with a high poverty incidence are also the ones that are hosting large numbers of refugees. An additional 220,000 Lebanese, primarily unskilled youth, are expected to become unemployed. The influx of refugees has challenged the already weak public social services sector, and social tensions, including gender issues, among refugees and Lebanese communities, are on the rise.

The conflict in Syria is affecting Lebanon's health system through (1) increased demand for health care services; (2) increased unpaid commitments of the Ministry of Public Health to contracted hospitals; (3) shortages of health workers, including specialists and nurses; (4) a sharp rise in communicable diseases and the emergence of new diseases, such as leishmaniasis; and (5) increased risk of epidemics such as water-borne diseases, measles, and tuberculosis. Overcrowding, lack of water and sanitation

infrastructure, and other poor environmental conditions also pose significant risks, as outbreaks of lice and scabies among refugees have shown. Thus demand for health services has risen sharply.

In addition, strong demand for hospital care is crowding hospitals and compromising access to health care, exerting financial pressure on hospitals, increasing costs, and giving rise to medication shortages. In the medium to long term, the impact of delayed health care could result in higher overall levels of morbidity, particularly for the vulnerable.

The increase in demand for education services arising from child refugees is leading to mounting fiscal costs, lowering the quality of public education, and creating a significant need for nonformal education. Prior to the Syrian conflict, basic education enrollment in Lebanon was stable at more than 90 percent for a decade. Although public schools only accommodated 30 percent of total students, they catered predominantly to poor children. Since the onset of the Syrian conflict, the Ministry of Education and Higher Education has provided open access to refugees in its public schools. In 2012, 40,000 refugee children were accommodated in public schools for a budgetary cost of US\$29 million. An additional US\$24 million in costs were financed by donors through United Nations agencies, which the ministry would otherwise have had to bear. These costs continue to escalate. These figures do not reflect the 65 percent of refugees who are not enrolled in formal schooling, thus creating a significant need for nonformal, out-of-school education to control the onset of child labor and other negative social consequences.

Infrastructure Impact

The fiscal costs of the Syrian conflict on infrastructure—water and sanitation, municipal services, electricity, and transport—are estimated at US\$589 million through 2014. An additional US\$1.1 billion would be required for stabilization, including US\$258 million for current spending. The country's infrastructure was severely

constrained and ill-prepared to cope with the increased demand from refugees. Cash-strapped, understaffed local and municipal governments are being severely affected by the crisis, as they now provide basic services to and tend to the immediate needs of both refugees and host communities.

Water supply and sanitation systems, already facing acute pre-crisis challenges, have had to meet additional demand for water equal to 7 percent of the pre-crisis demand. This higher demand resulted in severe water shortages in 2014, a dry winter year in which limited water was accumulated in the country's reservoir.

Stabilization interventions to reinstate pre-crisis levels of service to host and refugee communities include (1) humanitarian relief interventions such as distribution of bottled and tanked water, chlorination kits, and storage tanks to the most vulnerable populations; (2) additional capital for operation and maintenance, provision of urgent equipment, and additional short-term infrastructure for restoring water supply infrastructure; and (3) acceleration of infrastructure investments and institutional reforms such as storage and transfer infrastructure, distribution network rehabilitation and replacement, water and wastewater treatment, and irrigation expansion and improvement.

The level and quality of solid waste management and municipal services have declined visibly as a result of the sudden and sharp increase in demand by Syrian refugees. Solid waste generation has doubled in several areas of the country, which is contributing to groundwater contamination, pollution of water resources, and spread of water-borne disease.

Efforts to reinstate pre-crisis levels of service to host and refugee communities include

(1) closing and rehabilitating open and uncontrolled municipal solid waste dumps; (2) establishing composting, separating, and landfilling facilities; and (3) extending financial support to host municipalities to cover the additional operational and capital expenditures.

Increased demand for electricity is estimated at 251 mega-watts by end-2014. The Syrian crisis, through the sharp increase in electricity demand, has added to the sector's structural deficiencies, including insufficient installed capacity, low efficiency, high losses, and inadequate infrastructure, resulting in poor reliability, inadequate levels of supply, and extensive load shedding.

The interventions required to reinstate pre-crisis levels of electricity service to the Lebanese population and meet the needs of refugee communities include (1) capital investment in generation capacity and associated transmission and distribution networks and (2) institutional capacity and technical assistance for project preparation and implementation.

Regions with high influx of refugees witnessed sharp traffic increases on some roads, resulting in accidents and the rapid deterioration of the transport network. The Syrian crisis has affected Lebanon's transport sector in the form of (1) increased wear and tear of the road and transport network; (2) substantial increase in the volume of traffic and congestion; and (3) a near halt of Lebanon's thriving transit business, particularly for freight.

In order to restore transport sector performance to precrisis levels, investments are needed in the following areas: (1) asset preservation, primarily including enhanced road maintenance, (2) capacity increases, including network reconstruction, widening, and expansion, and (3) public transport solutions, such as mass transit.

Notes

1. Throughout this report, the term *confessional* is used to refer a consociational system of government based on an equitable distribution of political and institutional power among religious communities. In Lebanon, *confessionalism* is

often used interchangeably with *sectarianism*, although the latter is commonly used to denote forms of political and social identity, organization, and action based on religious difference and often exclusive interests. We use the term *confessional*

- to denote the political system and its functioning and the terms sect and sectarianism to denote the specific interests, actions, and organization of religious and identity-based groups.
2. GDP figures between 2004 and 2011 are based on the Lebanese national accounts published by the Central Administration of Statistics in July 2013, while data for 2012, 2013, and 2014 are based on projections pending final GDP estimates.
 3. Poverty lines are defined in chapter 2.
 4. Extreme poverty was 7.5, 10, 8, and 8.7 percent in 1993, 1997, 2005, and 2007, respectively. Using the upper poverty line, poverty was 28 percent in 1993 and 28.5 percent in 2005. As detailed in chapter 2, progress in reducing poverty has been unlikely since the 2005 surveys.
 5. The labor force has been growing robustly due to an increase in the working-age population, in addition to a modest increase in labor force participation, particularly among women (see chapter 2).
 6. Donor financing arrived, starting with the Paris I conference of 2001, after Lebanon's public debt level became a concern.
 7. Lack of microdata affects the quality of other statistics as well—for example, the national accounts are estimated without adequate underlying surveys, in contrast to standard practice in most countries.
 8. Growth diagnostics is a methodology developed by Ricardo Hausmann, Dani Rodrik, and Andrés Velasco to determine the underlying reasons why some developing economies are not growing as fast as expected. The growth diagnostic approach is based on the idea that there may be many reasons why an economy does not grow, but each reason generates a distinctive set of symptoms. These symptoms can become the basis for a differential diagnostic in which the analyst tries to distinguish among potential explanations for the observed growth rate of the economy (Hausmann, Rodrik, and Velasco 2008).
 9. No postwar budget has been voted within the constitutionally mandated time period. The last officially closed fiscal accounts are for 2003, and those for 1993 to 2003 need major adjustments.
 10. Consociationalism is a form of government that guarantees group representation and is often suggested for managing conflict in deeply divided societies. It is often viewed as synonymous with power sharing, although it is technically only one form of power sharing. When consociationalism is organized along religious lines, it is known as confessionalism, as is the case in Lebanon.
 11. Such as awarding public contracts to and securing employment for their constituencies.
 12. The Cairo Agreement of 1969 brokered by the Arab Republic of Egypt legalized the military presence of the PLO in Lebanon with the underlying objective of fighting the Israeli army. PLO fighters soon set up check points across the country, raising tensions with various communities, chief among them the Christians.
 13. Behind them was Syria, a major supplier of arms, which in June 1976 dispatched Palestinian units under its control.
 14. Religiously affiliated NGOs provide services such as education grants, food stamps, or services for battered women and orphans.
 15. The *Troika* included the president of the republic and the heads of government and parliament, respectively, representing the three largest religious groups: the Maronites, the Sunnis, and the Shi'as.
 16. The majority of the investment was in the road network, the airport, the telecommunication sector, and the sewage network.
 17. Leenders (2003) finds that 39 cabinet posts were held by former militia leaders between 1989 and 2003.
 18. An example of such reform is the introduction of a value added tax in 2002, at a time of severe fiscal stress when a failure to act would have had negative consequences for all groups and their leadership.
 19. For an analysis of the impact of service privatization and confessionalism in the health sector, see Kasturi and Mehio-Sibai (2004).
 20. This annex derives largely from World Bank (2013c).

Chapter 2

Growth, Poverty, and Jobs

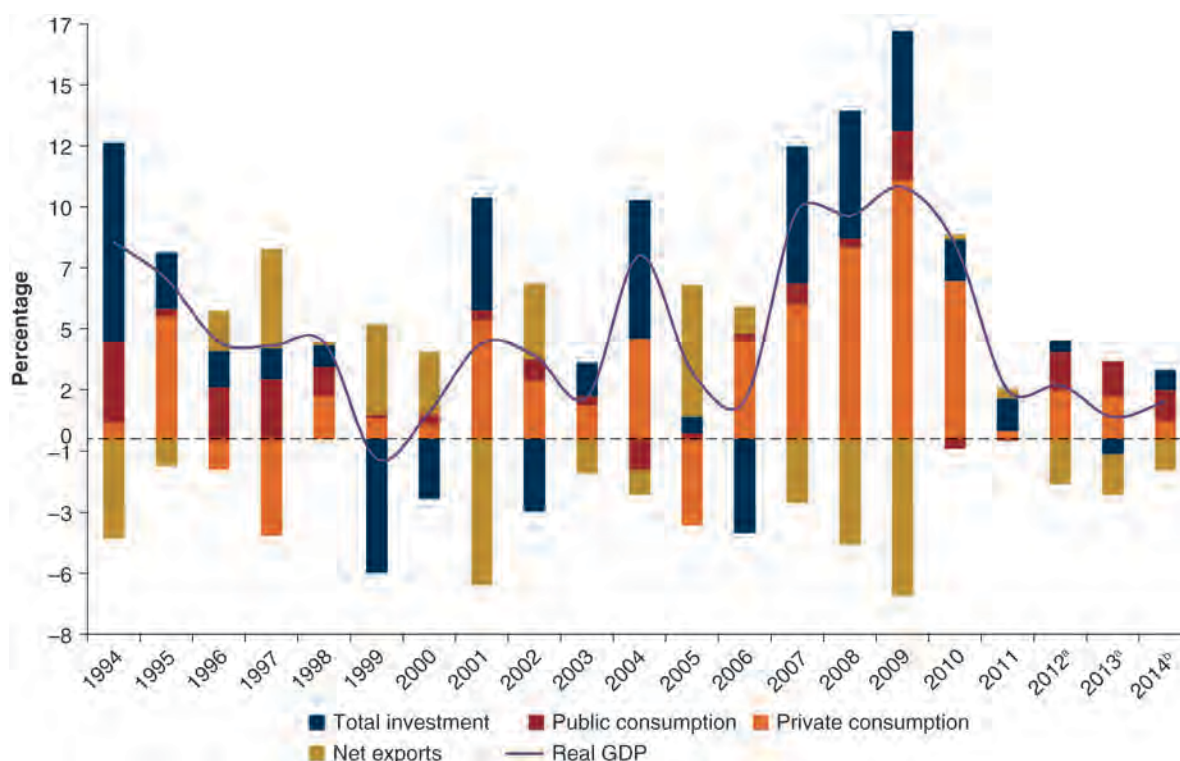
Economic Growth

Since the end of the civil war, the Lebanese economy has expanded at a moderate pace, but growth has been volatile due to frequent shocks (figure 2.1).¹ While real gross domestic product (GDP) grew an estimated 4.4 percent, on average, from 1993 to 2014,² the volatility around that average was large, at 3.2 percent (1 standard deviation).

Six periods of growth are evident for the post-civil war period:

- *Postwar recovery and reconstruction boom (1991–95)*. Growth averaged 12.9 percent due to large public investment aimed at reconstructing the country's infrastructure and Beirut's center as well as large public consumption.
- *Public debt concerns (1996–2000)*. Growth decelerated significantly to average 2.4 percent, due to shocks (conflict with Israel in April 1996) and mounting concerns regarding the rapid growth of public debt, which exceeded 100 percent of GDP. Private consumption and investment slumped, leaving net exports as the only driver of growth.
- *Resumption of growth (2001–04)*. While public deficits expanded briskly and pushed the country toward the highest debt-to-GDP ratio in the world, confidence nonetheless improved thanks to the Paris I and II international donor conferences of 2001 and 2002. As confidence improved, private consumption drove growth, with real GDP growth averaging 4.1 percent.
- *Domestic and external political shocks (2005–06)*. The assassination of Prime Minister Rafic Hariri in February 2005 and the conflict with Israel in 2006 severely affected the economy, with real GDP growth averaging only 2.2 percent.³
- *Recovery and safe-haven economic boom (2007–10)*. Buoyed by the January 2007 Paris III international donor conference, the economy grew 9.2 percent, on average, a record average despite repeated security incidents and the global financial crisis.⁴ Part of the economic recovery stemmed from a “base effect” following two years of weak economic performance (2005 and 2006). Seen as a relative safe haven by the Lebanese diaspora and given excess liquidity by the Gulf countries (driven by record high oil prices), deposits flowed into Lebanese banks and fueled a surge in real estate investment. While the global financial crisis spread to most countries, Lebanon's banking system attracted depositors concerned with the viability of banking institutions in other countries and attracted by Lebanon's tightly regulated banking system, high liquidity, focus on traditional commercial banking, and little exposure to the toxic assets, such as mortgage-backed securities, at the heart of the financial crisis. Lebanon's strict bank secrecy and relatively high rate structure were additional factors for some depositors. Surging private consumption also contributed to growth during this period.
- *An overstretched economy hit by domestic and external political shocks (2011–14)*. As the real estate boom ran its course (with prices overextended), investment decelerated. Meanwhile, private consumption was sharply and negatively affected by the political vacuum in early 2011 following the fall of Saad Hariri's unity government and the onset of conflict in the Syrian Arab Republic, which brought numerous security issues and an influx of refugees. With confidence falling, average real GDP growth slumped to 1.7 percent in this period.

FIGURE 2.1 Drivers of Growth on the Expenditure Side in Lebanon, 1994–2014



Source: Central Administration of Statistics.

a. Estimated.

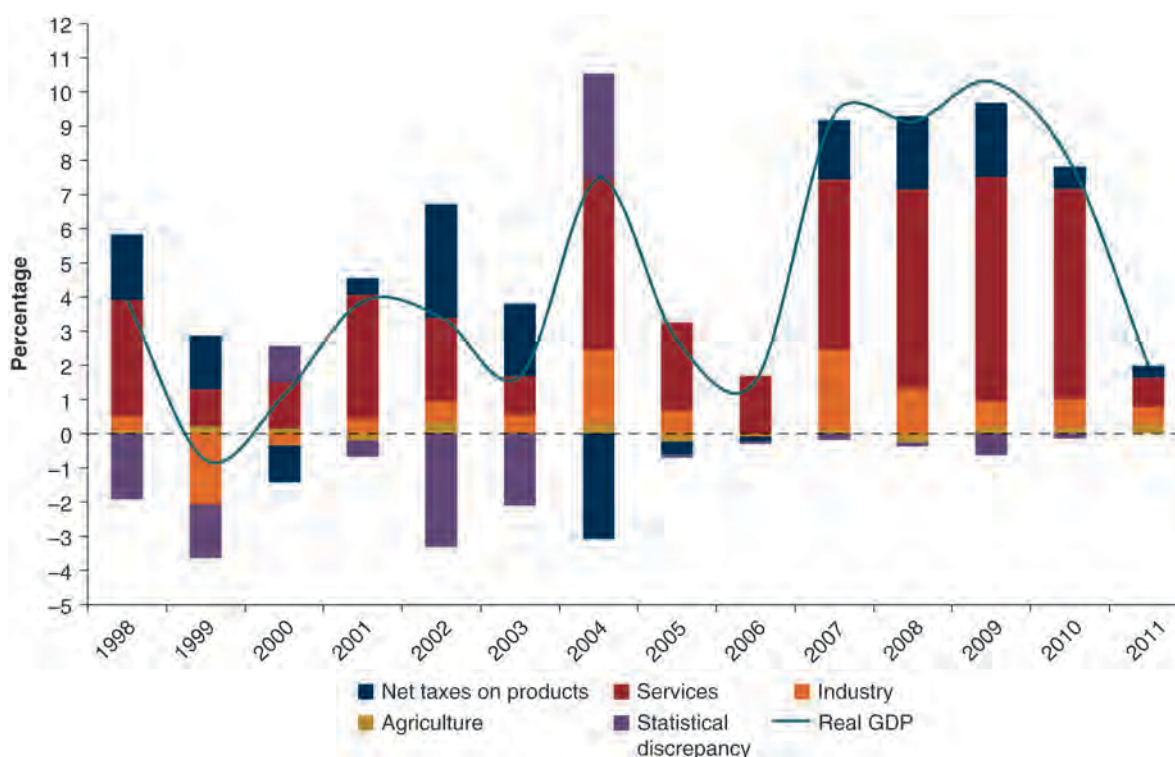
b. Forecast.

The services sector—historically a key driver of growth—has been severely affected by events since 2011 and has contributed significantly to Lebanon’s low growth in recent years (figure 2.2). Between 1997 and 2011, the services sector accounted for an average of 74 percent of real GDP compared to 49 percent in a group of comparator countries.⁵ In contrast, the agriculture sector accounted for, on average, 5.6 percent of real GDP. The services sector has a dominant share of the Lebanese economy, and its decelerating growth, led primarily by domestic trade and tourism, was a significant drag on the Lebanese economy.

The high dependence on the real estate and tourism sectors—which are sensitive to security shocks—imparts strong and relatively frequent volatility to the Lebanese economy. The real estate sector has accounted for 50–70 percent of total gross fixed capital formation since 1997. However, the sector tends to attract mainly

unskilled labor, which in Lebanon is provided by cheaper foreign workers. For this reason, economic growth from the sector has not resulted in significant employment gains for Lebanese nationals. Since 2004, the real estate and construction sectors have accounted for a large share of GDP (17.1 percent, on average, between 2004 and 2011), but employed only a small share of the Lebanese workforce (7.8 percent, on average, between 2004 and 2009). The same is true across the Middle East and North Africa region, where the real estate sector accounts for around 46 percent of foreign direct investment, but contributed only 19 percent of jobs created between 2003 and 2011 (World Bank 2012b).⁶ In the tourism sector, hotels, restaurants, and wholesale and retail trade accounted for 16.8 percent of GDP between 2004 and 2011, but are highly susceptible to political and security shocks. Consequently, the deteriorating security and political situation since 2011 has negatively and severely affected

FIGURE 2.2 Drivers of Growth on the Production Side in Lebanon, 1994–2014



Source: Central Administration of Statistics.

these sectors. The negative impact of the Syrian conflict on the real estate sector has, to some extent, been mitigated by repeated stimulus packages from the Banque du Liban (BdL) in the form of subsidized loans offered by commercial banks. These stimulus packages aimed to improve access to affordable mortgages, which enabled the real estate sector to stabilize somewhat in 2012–14.

On the demand side, private consumption has been Lebanon's dominant driver of growth during the twenty-first century, but it is highly sensitive to confidence and security shocks. Private consumption accounted for 75 percent of real GDP growth between 1998 and 2010. This contribution, however, shrank to 17 percent in 2011 and has been subdued ever since. Low levels of exports and an overreliance on imports to meet domestic demand resulted in a persistent trade balance deficit that hovered between 22 and 33 percent of GDP during 1997–2011 (based on the July 2013 national accounts release). Squeezed by a lack of

fiscal space and lack of an approved budget since 2006, public investment dwindled from 6.3 to 1.4 percent of GDP between 1997 and 2011, far below the average of 3.6 percent in the group of comparator countries. Available indicators suggest that sluggish economic activity since 2011 has been the result of a severe drop in private consumption as the deteriorating security and political situation has negatively affected consumer confidence.⁷ Demand from the large influx of Syrian refugees, however, has partially offset the decline in private consumption.

Poverty and Jobs

In a World Bank (2014f) survey, Lebanese citizens ranked public sector governance reforms as the top development priority for the country. Key aspects of this governance challenge include elite capture of business, discretionary implementation of regulations, and rampant corruption,

which all affect achievement of the World Bank's twin goals. In fact, international evidence shows that an increase in the quality of governance can help to reduce absolute poverty up to 20 percent (figure 2.3). Transparency also matters for effective government (figure 2.4).

Lebanese ranked social protection and job creation or employment as their second and third development priorities, respectively, behind public sector governance.⁸ Moreover, 66 percent

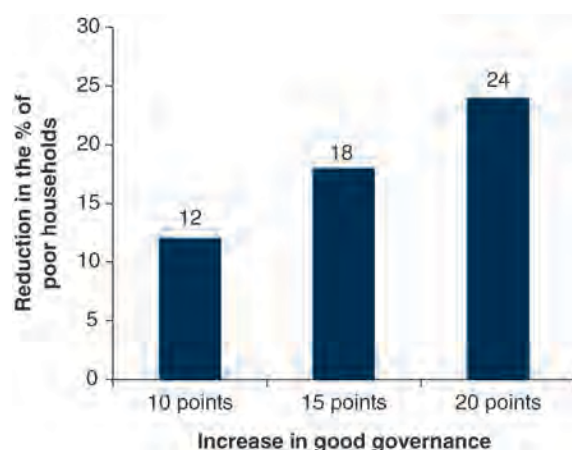
said that the country is headed in the wrong direction (with only 8 percent saying it is headed in the right direction), which reveals a profound dissatisfaction with current policies. These views are consistent with growth not having been inclusive, as employment growth elasticity is weak, even compared to that of other countries in the region.

Although data are lacking, inadequate creation of productive jobs has likely stymied poverty reduction and shared prosperity in Lebanon. As discussed below, we know little about medium- to long-term poverty trends in Lebanon. However, global evidence suggests that wages and employment are the primary drivers of poverty reduction (Inchauste et al. 2014). In Lebanon, job creation has trailed labor force growth. Data analysis also suggests that developments in labor markets have not been conducive to creating more domestic employment opportunities, especially formal private sector jobs. Most job creation has been in low-productivity sectors, especially in trade. Only about one in three labor force participants have a formal sector job. Without more and better earning opportunities, households in Lebanon will continue to have difficulty improving their welfare.

Moreover, ineffective government and inadequate fiscal space have limited the reach of the public safety net, which could have augmented the income of the poor. In Lebanon, social protection interventions include social insurance and labor market interventions (including contributory schemes such as pensions), social services (access to services such as health and education), and narrowly targeted social assistance programs. However, these programs reach only a small share of the population and are not considered adequate to address the needs of the poor. Thus the population remains heavily reliant on earnings and possibly on private safety nets (such as remittances), although little is known about the role of this source of income in poverty reduction.

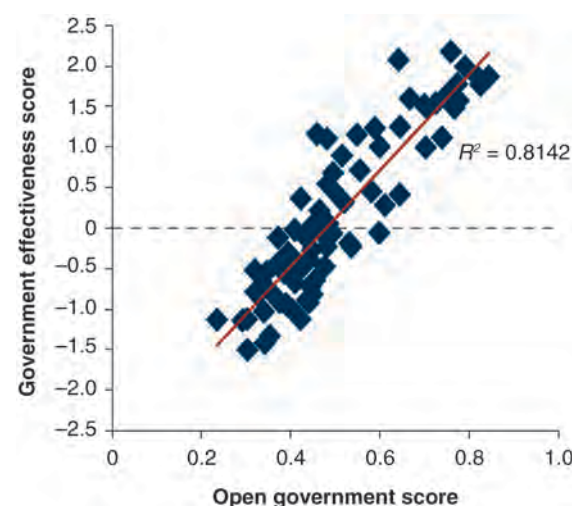
In recent years, the supply of low-skilled workers has grown rapidly due to the Syrian crisis, lowering incomes for low-income and

FIGURE 2.3 Impact of Good Governance on Absolute Poverty



Source: Knack 2002.

FIGURE 2.4 Correlation between Transparency and Government Effectiveness Worldwide, 2014



Source: World Justice Project.

poor Lebanese. The jobs that have been created have typically been of low quality (for example, low skills, often informal) and gone to foreign workers, not Lebanese (for example, laborers in the construction sector). Both poverty and jobs have been severely and negatively affected by the Syrian conflict and, in particular, the large influx of refugees into Lebanon. Thus the prospects for poverty reduction in the near term are grim, although government reforms in the medium term could have a significant impact on raising the welfare of the poor.

Measurement of Monetary Poverty and Inequality (1961–2012)

Despite the lack of microdata, sporadic attempts have been made to measure living conditions in Lebanon since the 1960s. Table 2.1 summarizes the main findings from different reports between 1961 and 1997. However, there is little basis to compare these estimates over time, since the surveys used different methodologies and sample sizes. Further, there is very little documentation

on how welfare aggregates and poverty lines were constructed across time. The trends presented in this section are subject to this strong caveat.

The pre-civil war Lebanese economy was characterized by high income inequality and falling, but still elevated, poverty. Notwithstanding the comparability issues among early studies, high levels of income inequality and poverty in the 1960s were followed by rapid declines in poverty in the 1970s. The first poverty study, published by Mission IRFED (1961), showed that 50 percent of the population in Lebanon had income below the poverty line and documented wide regional disparities in living standards and high inequality among the population. Schemeil (1976) showed that 22 percent of the population was poor in 1973–75 before the civil war. According to Gaspard (2004), income inequality was relatively high, with Gini coefficients of 0.51 and 0.55 in 1960 and 1974, respectively.⁹

After the civil war, poverty and inequality remained high. The United Nations Economic and Social Commission for Western Asia (UNESCWA 1995) estimated consumption-based poverty to be at 28 percent and extreme poverty at 7.5 percent in 1993 and 10 percent

TABLE 2.1 Measurement of Poverty and Inequality in Lebanon, 1961–2014

Author	Survey year	Main findings
Mission IFRED 1961	1960	50% of population below poverty line
Schemeil 1976	1973–75	22% of population below poverty line
UNESCWA 1995	1993	28% of population below poverty line and 7.5% in extreme poverty; poverty concentrated in Bekaa and North Lebanon regions; higher poverty rates among agricultural workers
UNDP 2008b	Summary	Share of low-income population declined from 50% in 1959–60 to 22% in 1973–74 and increased again to 52% in 1994–95
Gaspard 2004	Summary	Income-based Gini declined from 0.5 in 1960 to 0.47 in 1997
UNDP 2008a	2004–05	28.5% of population living in poverty and 8% living in extreme poverty in 2004–05. The Gini coefficient was about 0.361. Large regional disparities in headcount poverty rates, with the North, South, and Bekaa being the poorest; highest, deepest, and most severe poverty among illiterate and unemployed individuals; agricultural, self-employed, and nonsalaried workers more likely to be poor. Based on backward and forward simulations, extreme poverty declined from 10% in 1997 to 8% in 2004–05, but increased to 8.4% in 2007
Central Administration of Statistics	2011–12	Data to be analyzed once the large nonresponse bias has been addressed
World Values Survey, Arab Barometer Survey, and the Survey on Financial Literacy and Capabilities	2010–13	About 30–32% of population estimated to be poor using questions about subjective well-being and information about income (measured in different ways in different surveys)
World Bank 2013b	2012–14	Syrian crisis is estimated to increase poverty among Lebanese population by 170,000 people by 2014, with existing poor being pushed deeper into poverty

in 1997. As the Mission IRFED study was based on income, poverty estimates in 1960 and 1993 are not comparable. Nevertheless, according to the United Nations Development Programme (UNDP 2008b), poverty, measured as percentage of population with low income, has been U-shaped: falling from 50 percent in 1959–60 to 22 percent in 1973–74 and rising again to 52 percent in 1994–95. In terms of inequality, income-based Gini coefficients declined modestly from 0.5 in 1960 to 0.44 in 1997. Similarly, Gini coefficients based on expenditures also declined modestly, from 0.51 in 1951 to 0.47 in 1997 (Gaspard 2004).

In Lebanon, the majority of the poor are located in urban areas (World Bank 2011c). An estimated 88 percent of the population lives in urban areas. In a poverty-mapping exercise completed in 2004, Lebanon's Economic and Social Fund for Development found more poor people in small pockets of dense poverty in the suburbs of large towns than in all of rural Lebanon. The entire rural population of Lebanon represents a fraction of the population living in slums in the country (30 percent in 2004).

No significant progress on poverty reduction has likely been made so far in the twenty-first century.¹⁰ The main findings of the 2004–05 Multipurpose Household Survey are as follows (UNDP 2008a):

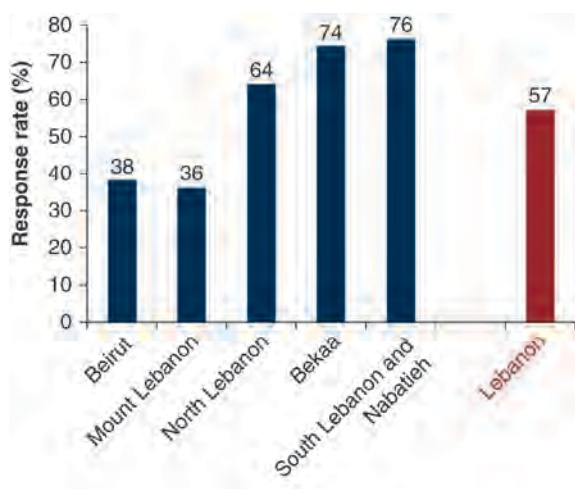
- *Extreme poverty affected 8 and 8.4 percent of the Lebanese population in 2004–05 and 2007, respectively.* This includes the percentage of households living below the extreme poverty line or unable to meet their most basic food and nonfood needs.¹¹
- *28.5 percent of the population was poor using the upper poverty line in 2004–05.*
- *Striking regional differences in consumption per capita and headcount poverty rates were evident across regions, with the North, South, and Bekaa being the poorest.* Of the poor population overall, 27.3 percent was concentrated in relatively affluent Mount Lebanon, and 38 percent was concentrated in the North; more striking, 46 percent of the

extremely poor population was located in the North.

- *Inequality within regions accounts for most of the inequality in Lebanon.* Lebanon's Gini coefficient was estimated at 0.361 in 2004–05 using spatially adjusted consumption per capita. This is on par with the average of countries in the Middle East and North Africa and much lower than inequality in countries in Latin America. Inequality was the highest in the North, which also had the lowest consumption per capita. North and Mount Lebanon had the lowest consumption growth between 1997 and 2004–05. The North region was also distinct because it had the lowest elasticity of poverty to consumption growth, which may be related to highly unequal distribution in this region.
- *Poverty is particularly acute in rural areas and agricultural households.* Compared to Lebanon's overall poverty rate of 8 percent, more than 20 percent of households engaged in agriculture fall below the poverty line. The sector's high productivity¹² and high poverty rates are the result of very small landholdings—with 90 percent of all farms between 0.1 and 4 hectares and an average farm size of less than 1.5 hectares, limiting the scope for full-time employment. Moreover, Lebanon's agriculture sector is currently experiencing downward pressure on wages as a result of the arrival of more than 1 million Syrian refugees seeking jobs in rural areas. Unlike other sectors, there is no legal restriction concerning agricultural labor and no minimum wage requirements for Syrian refugees.

A 2011–12 Household Budget Survey was conducted, but several problems were encountered, questioning the reliability and representativeness of the data (figure 2.5). The World Bank team has worked with the Central Administration of Statistics to explore ways to adjust for such high nonresponse rates. The survey results are forthcoming but were not available for this report.

**FIGURE 2.5 Household Budget Survey
Response Rates in Lebanon, by Regions,
2011–12**



Source: Central Administration of Statistics.

Insights on Poverty Based on Nontraditional Surveys (2010–14)

While the lack of reliable recent microdata prevents carrying out traditional poverty analysis, valuable information on poverty can be obtained from other surveys.¹³ For example, surveys that capture subjective well-being provide an understanding of people's own assessment of their welfare. Further analysis of the respondents' education or employment characteristics also provides useful information on what Lebanese consider to be characteristics of households that are poor and those that are not.

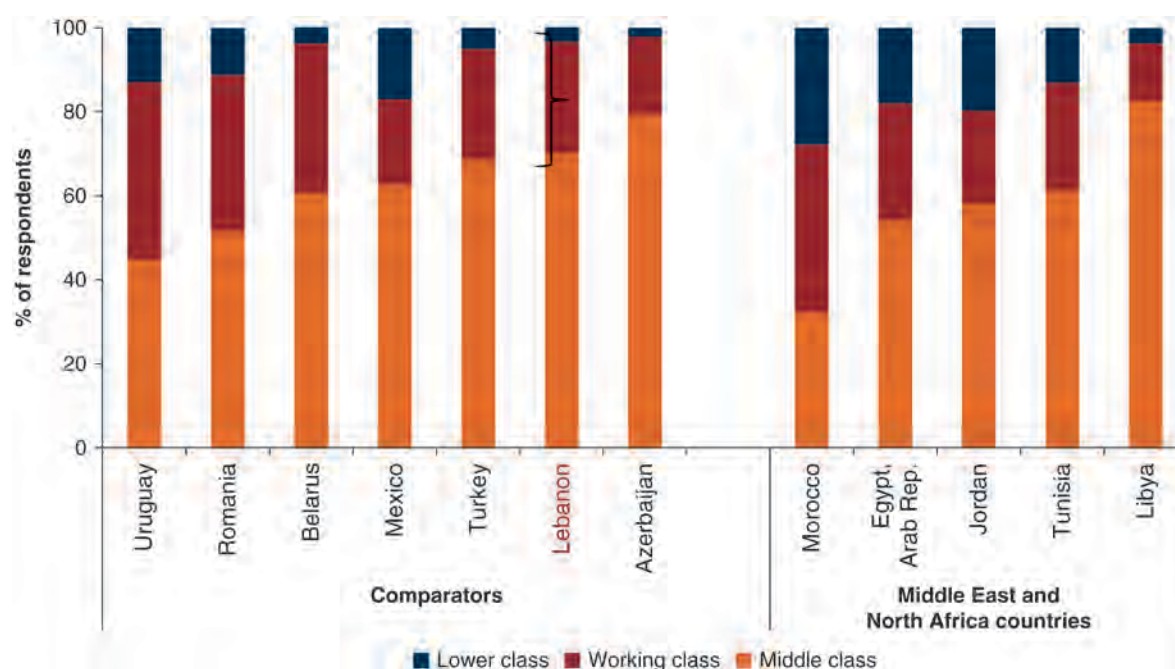
A striking and consistent result across all surveys is that, despite record GDP growth in 2007–10, poverty remained elevated in Lebanon in the 2010s. All three surveys yielded poverty estimates that are very close (measured in different ways in different surveys), namely, about 30 percent of the population. In particular, about 30 percent of respondents to the World Values Survey considered themselves as belonging to the working or lower class in 2013 (figure 2.6); about 29 percent of

respondents to the Arab Barometer Survey in 2010 considered their household to be in the low-income group and said that they had significant difficulty meeting their needs; and finally, 31.7 percent of households from a national Survey on Financial Literacy and Capabilities had income per capita lower than the poverty line, which was taken from the 2004 Multipurpose Household Survey and inflated to 2012 prices.¹⁴

Using individual demographic and socioeconomic characteristics in conjunction with welfare status provides a general picture of poverty correlates. In particular, according to the World Values Survey, being in the middle class (according to subjective perception data) in Lebanon is associated with having a tertiary education and having a full-time job or being self-employed. The lowest likelihood of being in the middle class is associated with being unemployed, being a housewife, and having no formal education. Similarly, having more education and a job has a significant negative association with being in the bottom 40 percent of population. According to the Arab Barometer Survey, the highest share of middle-income households (self-reported) was among respondents working as employers of firms and professionals such as lawyers, teachers, and doctors. The respondents who disproportionately reported being in low-income households were individuals employed as agricultural workers or as housewives or not employed.

The Survey on Literacy and Financial Capabilities found that income poverty is closely associated with demographic variables, as well as the head of household's education and labor force status. Thus poverty is more pronounced among households with many children. In particular, the poverty rate increases from 24 percent in households without children to 88 percent in households with more than four children. Being employed in the formal sector or being an employer decreases the likelihood of poverty. Finally, households with well-educated heads (tertiary education) have much lower chances of falling into poverty.

FIGURE 2.6 Self-Assessed Economic Classes in Lebanon and Comparator Countries, 2013



Source: Calculations based on World Values Survey, wave 6.

Note: Surveys were conducted in different years in different countries. "Do not know" and "no answer" were excluded from calculations. Middle class includes lower-middle class, middle class, and upper class. No definition of classes was provided to respondents. The first comparator group includes countries at similar levels of economic development—having 2010 GDP per capita in purchasing power parity terms within 10 percent of Lebanon's (Azerbaijan, Belarus, Romania, Turkey, Mexico, and Uruguay). The second includes countries in the Middle East and North Africa (Arab Republic of Egypt, Jordan, Libya, Morocco, and Tunisia).

Estimated Poverty Impact of the Syrian Crisis (2012–14)

Part of the lack of progress in reducing poverty during the 2010s is the result of the Syrian conflict, which pushed thousands of Lebanese into poverty from 2012 to 2014. In the absence of reliable and recent data with which to assess the impact of the Syrian conflict on poverty, a global computable general equilibrium model named GTAP (Global Trade Analysis Project)¹⁵ was used to simulate the impact of the Syrian conflict on poverty in Lebanon (World Bank 2013b). These models have important shortcomings for estimating poverty,¹⁶ so the specific point estimates obtained should be understood as only indicative. Shock variables included the headcount of refugees, the headcount of labor force, disposable income, and real GDP. The Syrian crisis was projected to increase poverty among the Lebanese population by 170,000 people by 2014 and to

push the existing poor deeper into poverty. The Syrian crisis has brought higher poverty as a result of higher inflation (increase in domestic income and demand), fewer employment opportunities due to lower economic activity, and lower wages (excluding the labor income of immigrants), mostly reflecting slower economic activity and a sharp increase in the labor force due to the influx of refugees.

Job Creation and the Twin Goals Growth, Jobs, and Productivity

Lebanese see job creation as a critical factor for reducing poverty and the third most important factor—especially for young people—for achieving shared prosperity. Moving out of poverty and improving the well-being of workers and their families in a sustainable way entails enhancing labor market opportunities. Lebanese stakeholders

ranked job creation as the factor that would contribute most to reducing poverty (World Bank 2014f).¹⁷ Jobs drive development and are “not a by-product of economic growth” (World Bank 2012g). They can be transformational along the following dimensions: (a) *living standards*: individuals around the world work their way out of poverty by improving their livelihoods through their ability to earn a decent and reliable income stream; (b) *productivity*: as workers improve the way they work and become more efficient, more productive jobs are created and less productive jobs are destroyed; and (c) *social cohesion*: jobs gather people from different social and ethnic backgrounds and thus improve social cohesion. The 2013 *World Development Report: Jobs* has also shown that the challenges and structural problems that impede the creation of decent jobs vary across countries (World Bank 2012g).

In Lebanon, unemployment, informality, and poverty are strongly correlated, pointing to a key role that jobs can play in reducing extreme poverty and promoting shared prosperity. As detailed above, being poor in Lebanon is associated with being unemployed or engaging in low-productivity or informal employment. It is no surprise that poverty rates are much higher among unemployed persons. However, the incidence, depth, and severity of poverty are the highest among non-salaried employees (El-Laithy, Abu-Ismaïl, and Hamdan 2008).¹⁸ Such employees constitute more than one-third of the working poor, while the self-employed make up another third. In contrast, salaried employees and employers have the lowest poverty incidence. This suggests that poverty is high among unskilled Lebanese in informal and low-productivity employment and that gaps in earnings are large between formal-skilled and informal-unskilled jobs. Expanding access to better jobs and improving productivity and earnings of the bottom 40 percent of the population could contribute significantly to poverty reduction and inclusive growth in Lebanon.

Lebanon faces a considerable employment challenge, as economic growth has not translated into sufficient job creation. Even during periods of relatively rapid economic growth, private

sector job creation has been weak due to factors such as poor governance and weak infrastructure. Between 1997 and 2009, real GDP expanded at an average rate of 4.4 percent per year, yet employment grew only 1.1 percent (World Bank 2012d). This indicates an employment growth elasticity of only 0.2, which is considerably lower than that observed in other countries in the region. Insufficient job creation is one of the main causes of persistently high unemployment rates.

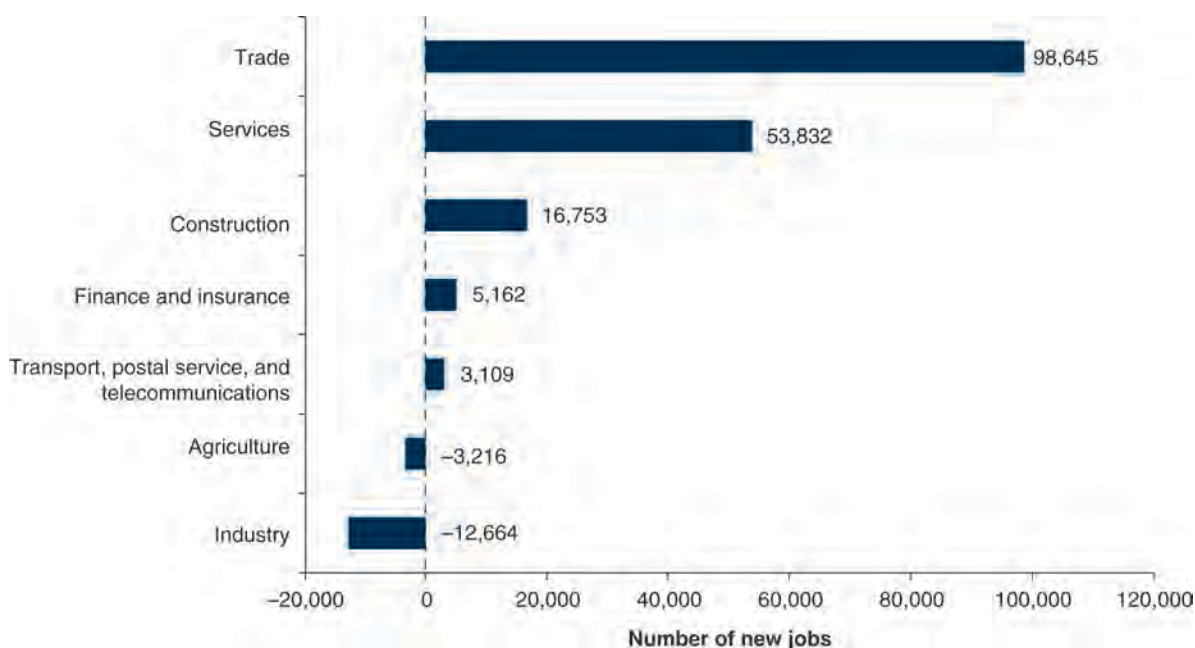
The majority of jobs created in Lebanon are in low-productivity sectors demanding low-skilled workers (figure 2.7). Between 2004 and 2009, the main contributors to net job creation were trade (61 percent) and low-productivity services (33 percent), followed by construction (10 percent). Agriculture and industry shed jobs, and higher-productivity services such as information and communication technologies (ICTs) or finance registered very little growth (only 5 percent of total net job creation).

Two-thirds of the employed are in trade and services, and half are in the informal sector (figure 2.8). One-third of wage employees and almost two-thirds of the self-employed are engaged in low-productivity services (for example, wholesale and retail trade, repair of motor vehicles, transportation, and storage). High-productivity services (for example, ICT, financial, and insurance activities) employ only 14 percent of wage employees and 3 percent of the self-employed.

Demographics, Labor Force, and Migration

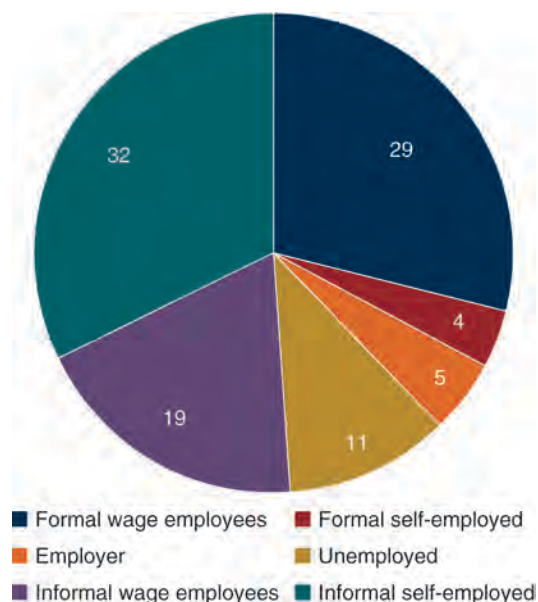
The labor force has been growing robustly, driven in part by an increase in the working-age population and in part by slowly increasing labor force participation, particularly among women.¹⁹ Lebanon continues to have low participation rates, with less than half of the working-age population participating in the labor market. The male labor force participation rate (70 percent) continues to be lower than that of other countries in the region, but largely comparable with that of countries outside the region at similar levels of

FIGURE 2.7 Net Job Creation in Lebanon, by Sector, 2004–09



Source: Central Administration of Statistics.

FIGURE 2.8 Characteristics of the Labor Force in Lebanon, 2010

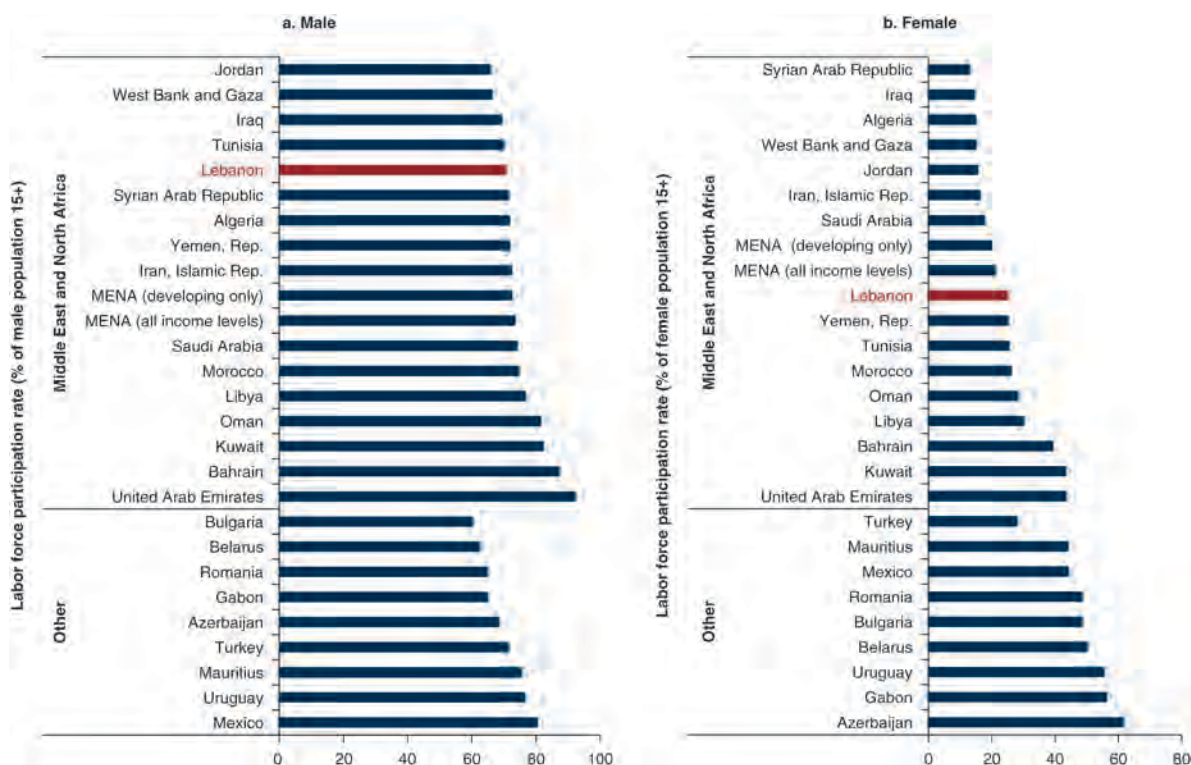


Source: 2010 Employee-Employer Survey.

development (figure 2.9, panel a). Female labor force participation, in contrast, is more in line with regional averages, but lags significantly behind comparators in other regions, with the exception of Turkey (figure 2.9, panel b). Although current participation rates are low, particularly for women, they are on an upward trend.²⁰ Not taking into account the recent influx of refugees, 23,000 individuals, on average, enter the Lebanese labor market each year. To absorb them, the economy would need to create more than six times the number of jobs it creates (on average, only 3,400 net jobs per year between 2004 and 2007).

The influx of Syrian refugees is having a profound impact on the socioeconomic situation in Lebanon (World Bank 2013c). Official refugees now constitute one-quarter of the population, exacerbating unemployment and poverty. As a result of that influx, the labor force is expected to expand by as much as 35 percent, with major changes taking place among women and youth. Because of their low level of education, most Syrian refugees will join the supply of low-skilled

FIGURE 2.9 Labor Force Participation Rates in Lebanon and Comparator Countries, by Gender, 2010



Source: World Bank 2014i; 2010 Employee-Employer Survey.
Note: Latest available year in 2000s.

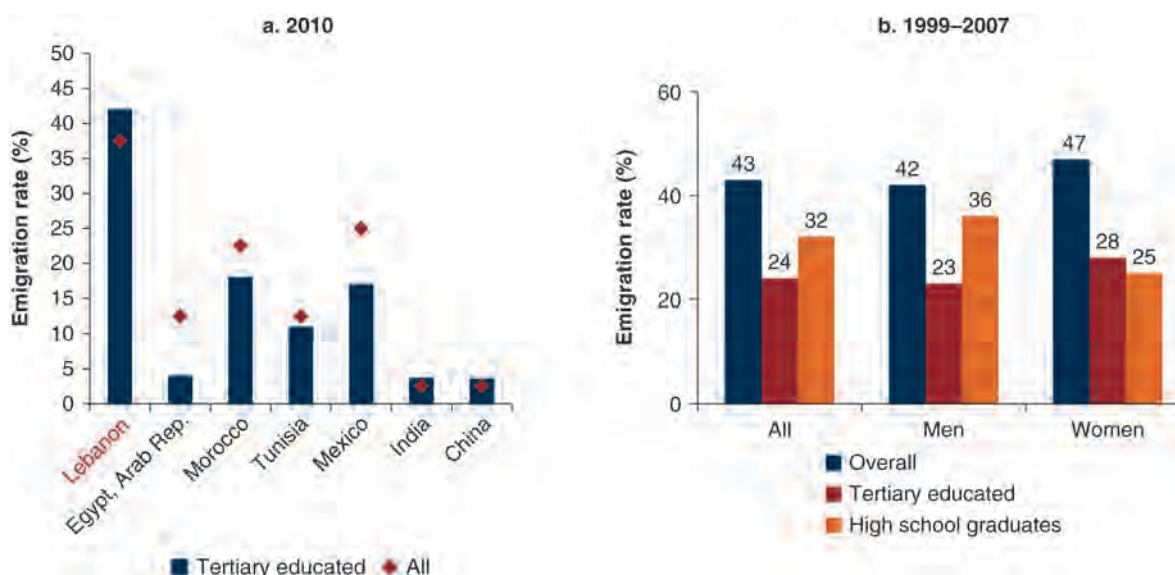
workers, and informality is likely to increase as a result. Almost half of the Syrian refugee workers are involved in agriculture or domestic services, followed by 12 percent in construction. Therefore, competition between Lebanese and Syrian workers for low-quality, low-skilled jobs will increase, likely leading to higher unemployment and depressed wages in this segment of the labor market.

Emigration is a major source of access to employment and better economic opportunities for Lebanese. About 15 percent of the Lebanese population has emigrated (as of 2010), driven mainly by political instability and the search for better economic opportunities. Comprehensive studies on the situation of Lebanese migrants are scarce; existing evidence suggests that their employment opportunities improve markedly on migration, but that some gender disparities persist. Analyzing the situation of Lebanese 18 to 35 years

of age who emigrated between 1992 and 2007, Kasparian (2009) finds that, while 61 percent of migrant men were employed in Lebanon prior to emigrating, 91 percent were employed after emigrating. For women, however, employment only increased from 32 to 36 percent, while inactivity rose 9 points to 59 percent. Lebanese migrants also appear to be well integrated into the labor market of recipient countries, even compared to migrants from other countries with historically high emigration rates and a large diaspora.

The high emigration rate of persons with a tertiary education could, in addition to the influx of Syrian unskilled labor, accentuate the scarcity of skilled labor. Presented with the lack of high-productivity wage jobs at home and given lucrative opportunities for work abroad, as many as 44 percent of the tertiary-educated Lebanese have emigrated (figure 2.10, panel a). While no quantitative impact assessment of these labor

FIGURE 2.10 Emigration Rate in Lebanon and Comparator Countries, by Educational Attainment and Gender, Various Years



Sources: World Bank 2014 (left panel); adapted from Kasparian 2009 (right panel).

outflows on the Lebanese economy exists, such large emigration shocks are likely to have sizable effects on labor supply and wages. Evidence from Mexico shows that a 10 percent increase in emigration of a given skill group raises the wages of workers in that skill group by about 4 percent (Mishra 2007). Given the differences in emigration rates across education level and gender (figure 2.10, panel b), emigration could increase the wage gap across gender and skill groups and exacerbate overall wage inequality in Lebanon. These high levels of emigration of tertiary-educated Lebanese could accentuate the scarcity of key skills and ultimately constitute a heavy drag on productivity and growth.²¹ Studies point to a significant “brain drain” due to emigration (see box 2.1).

Access to Jobs

Labor force participation rates, unemployment, and type of employment (wage or self-employment, formal or informal) vary markedly across population groups (youth, women) and regions. Disadvantaged regions tend to have lower participation rates

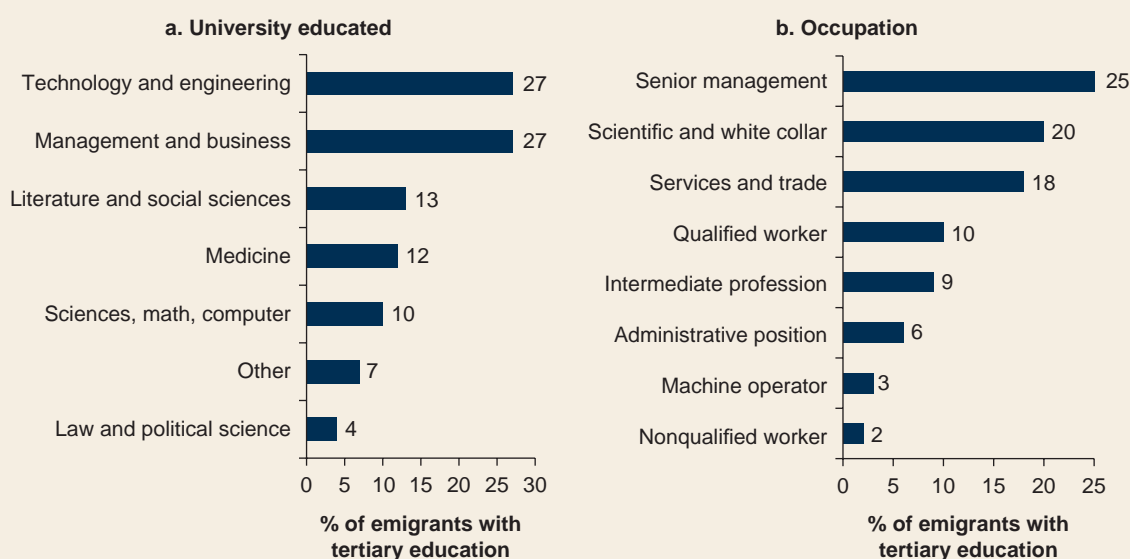
and higher unemployment, which could be due to spatial disparities in infrastructure and service delivery, identified earlier (figures 2.11 and 2.12). Participation rates are lowest in the North (38 percent) and somewhat lower in the South and Nabatieh. Unemployment is highest in South and Nabatieh. In the North the majority are self-employed, while in Beirut and Mount Lebanon, more than half of the labor force consists of wage employees.

Unemployment is high, especially among women and youth, and is often of long duration (figure 2.13). Before the Syrian crisis unfolded, around 11 percent of the labor force was unemployed. Such high rates reflected, in part, long average durations of unemployment (close to 13 months for men and 10 months for women). Unemployment is twice as high among women as among men. Youth unemployment (34 percent) is alarmingly high even by regional standards and especially compared to other countries outside the region. Current unemployment rates are likely to be significantly higher given slower economic growth and the impact of the Syrian conflict.

BOX 2.1 Educational and Occupational Profile of Lebanese Emigrants

Kasparian (2014) finds that among Lebanese emigrants who undertook university studies (25 percent of emigrants in the sample study), about 26.6 percent studied engineering and technology and 9.8 percent studied science, mathematics, and computer science. About 26.5 percent of university-educated emigrants specialized in management and business services, 13 percent in literature and social sciences, and more than 11 percent in medicine (figure B2.1.1, panel a). Many occupy middle and senior management positions critical for operational efficiency and productivity (figure B2.1.1, panel b). A quarter of emigrants hold senior management positions, 20 percent are in scientific and other white-collar professions, and 18 percent are in services, mostly trade.

FIGURE B2.1.1 Specialization and Occupation of Lebanese Emigrants with Tertiary Education



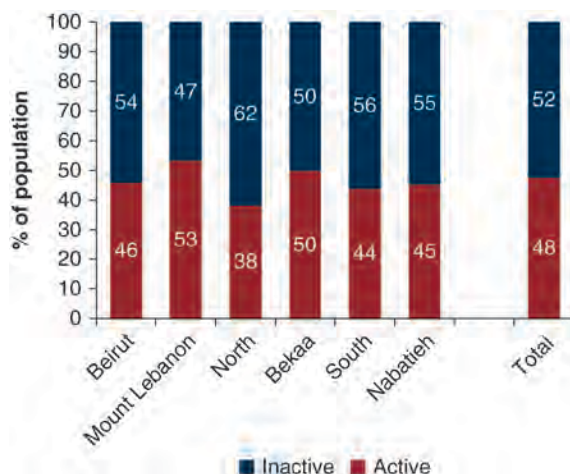
Source: Kasparian 2014.

Informality remains a salient feature of the Lebanese economy and labor markets, particularly for the poor. Half of the labor force is in the informal sector: 20 percent are in the informal wage employment, while another 30 percent are self-employed and lack access to social security (World Bank 2012d). The informality rate is significantly lower for the wealthier segment of the Lebanese population, as 15 percent of individuals in the highest quartile are informal wage employees, compared with 74 percent of individuals in the poorest quartile (Gatti et al. 2014; figure 2.14). Informality is associated with poorer working conditions²² and presents a constraint to

running a formal business.²³ Hence the quality of jobs in Lebanon overwhelmingly continues to be poor, especially for the more disadvantaged workers, and the business environment remains challenging in light of high informality. Most informal workers are involved in small retail trade, personal services, and vehicle repair services. About 66 percent of informal firms are engaged in selling food, clothes, household items, electronics, and other goods.

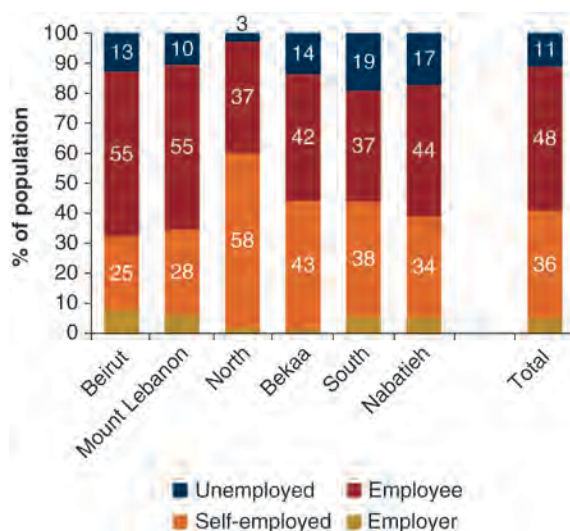
Earnings inequality is high, and labor mobility is low. Given differences in access to job opportunities and significant education and skill premiums, earnings inequality is high.²⁴

FIGURE 2.11 Labor Force Participation Rates in Lebanon, by Region, 2010



Source: Central Administration of Statistics.

FIGURE 2.12 Employment Status in Lebanon, by Region, 2010



Source: 2010 Employee-Employer Survey.

Wage disparity is significant both across and within employment status (figure 2.15). Informal employees have the lowest earnings, and their earnings are more compressed. Those in the top quintile earn, on average, about 3.3 times more than those in the bottom quintile. Formal employees earn significantly more than informal employees, and those in the top quintile have wages 3.6 times higher, on average, than those in the bottom quintile. Self-employment earnings

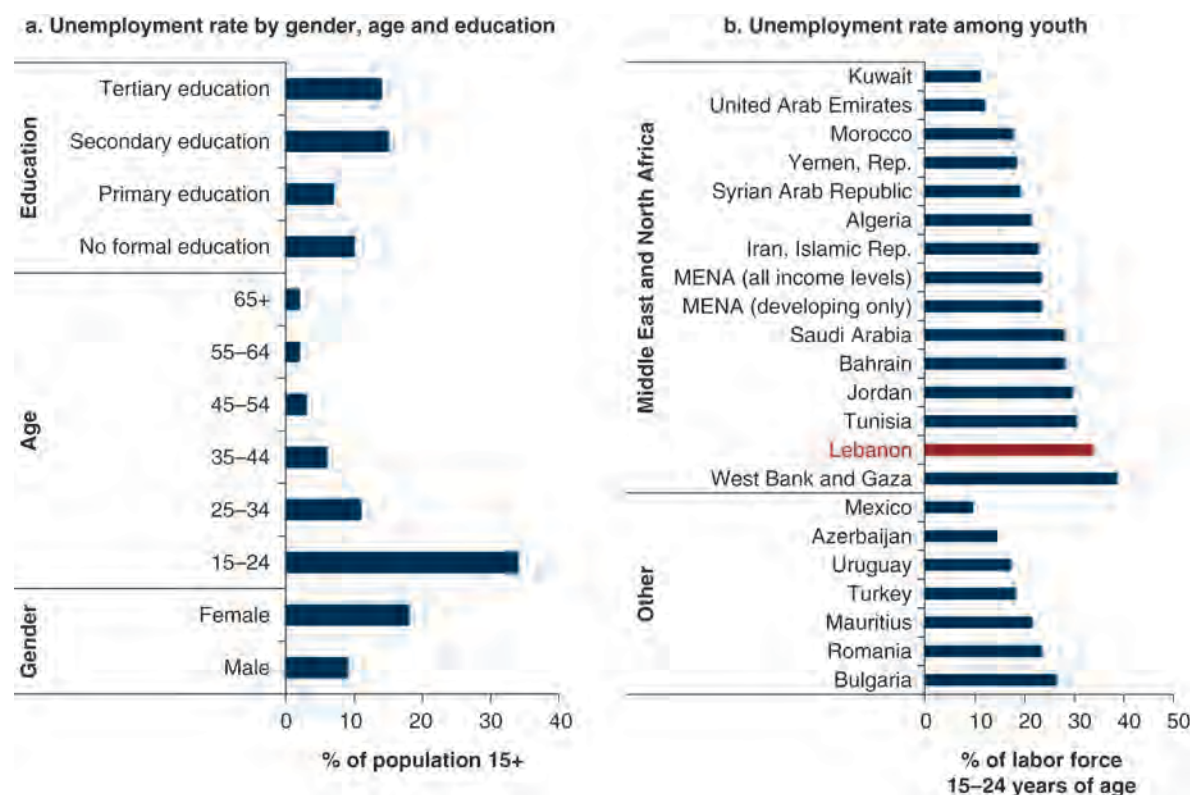
are the most varied (with a ratio of mean earnings in the top to the bottom quintile of 4.5), given the diverse nature of self-employment. In the bottom quintiles, persons who are self-employed generally earn less than formal employees, while the situation is reversed for the top two quintiles. Labor mobility is low, with transition rates from one status to another (for example, informal to formal or self-employed to wage employee) at less than 10 percent.²⁵

Education levels are strongly correlated with having better private sector jobs, but job search constraints and connections (*wasta*) may inhibit labor mobility and access (figure 2.16). Overall education levels in the labor force are low (42 percent have primary or less education), with great variation by employment status and sector of work. More than half of the self-employed have primary education or less compared to just 27 percent of wage employees. This is not surprising given that the overwhelming majority of self-employed work in low-productivity, low-paying jobs. In contrast, more than 40 percent of wage employees have tertiary education, and this share reaches almost 75 percent among wage employees working in high-productivity services in the private sector.²⁶ While there appears to be a strong correlation between educational attainment and access to high-productivity, high-wage private sector jobs, additional barriers and constraints related to job search and connections may inhibit labor mobility. For instance, in Lebanon personal contacts are the most prevalent mechanism for finding a job. Furthermore, connections also appear to play an important role in hiring, especially in the public sector.²⁷

Jobs Dynamics at the Firm Level

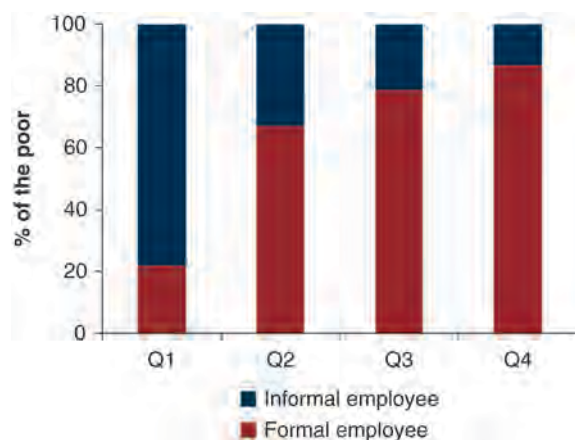
Younger firms and more productive firms are the main engines of formal job creation in Lebanon. Recent evidence on the firm-level determinants of job creation shows that in Lebanon—as in most countries in the region as well as in high-growth economies—younger, more productive firms create more jobs than older, less productive firms (World Bank 2014e). As shown in

FIGURE 2.13 Unemployment Rates in Lebanon, 2010



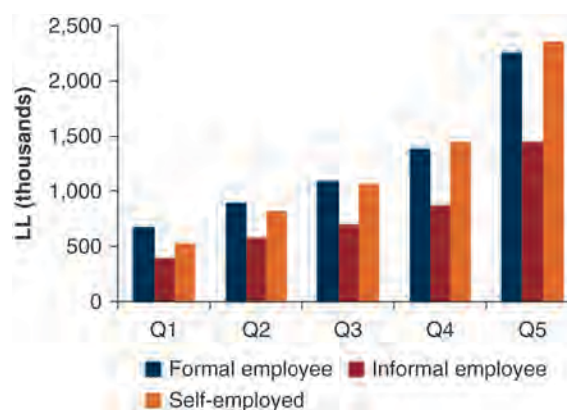
Sources: World Bank 2014i; 2010 Employee-Employer Survey.
Note: Latest available year in 2000s.

FIGURE 2.14 Informality Rate in Lebanon, by Wage Quartile, 2010



Source: 2010 Employee-Employer Survey.

FIGURE 2.15 Mean Monthly Earnings in Lebanon, by Wage Quintile and Employment Status, 2010

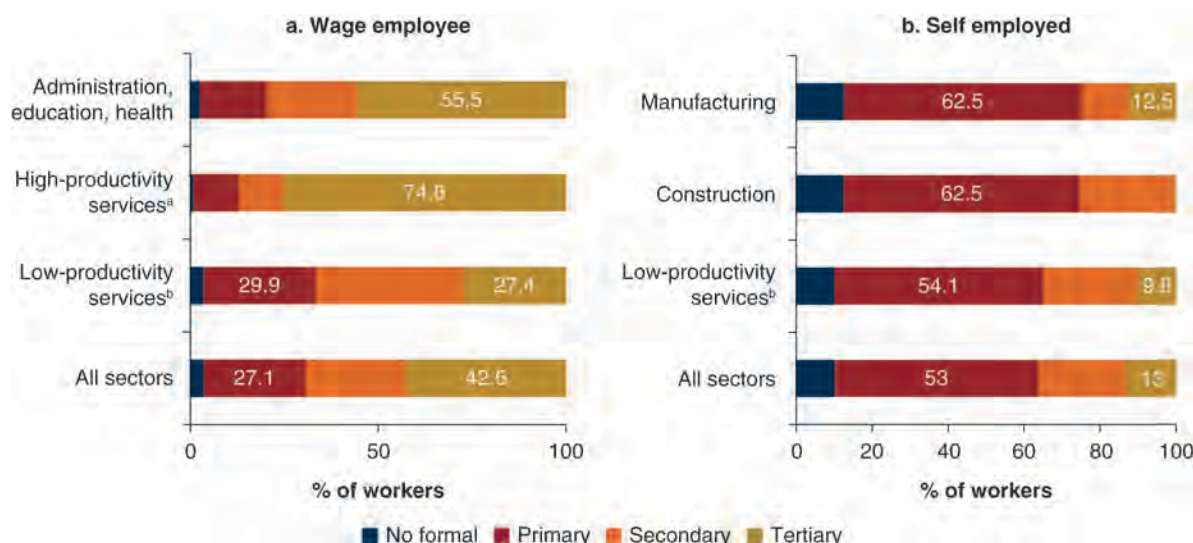


Source: 2010 Employee-Employer Survey.

figure 2.17, while older firms tend to shed workers in both Lebanon and Tunisia, net job creation is positive for firms in their start-up period (first four years). Firms with between zero and four years of activity and fewer than four workers

generated about 66,000 jobs in Lebanon between 2005 and 2010, accounting for 177 percent of aggregate net job creation. Young large firms with 200–999 employees created the second largest number of jobs (12,000).

FIGURE 2.16 Main Sector of Employment in the Private Sector in Lebanon, by Education Level and Employment Status, 2010

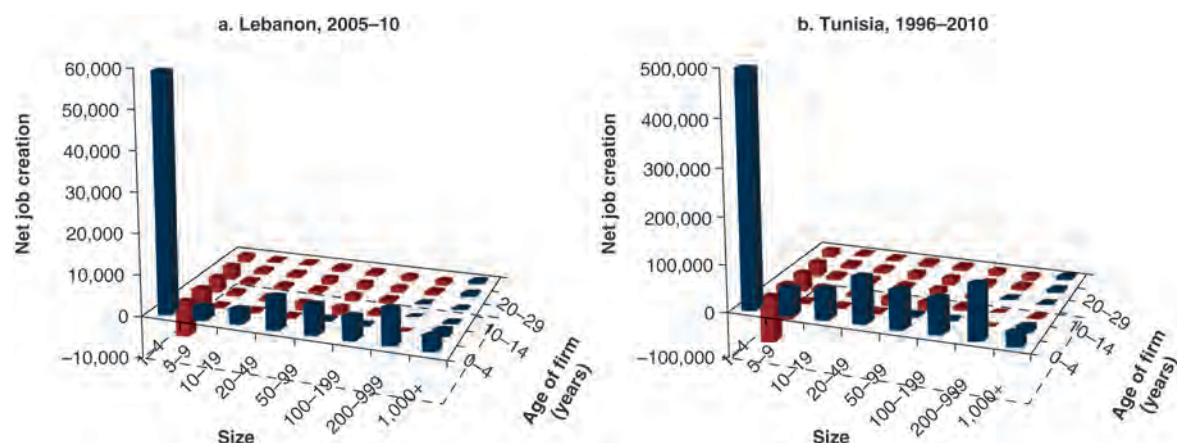


Source: 2010 Employee-Employer Survey.

a. Information and communication, financial and insurance activities, and professional, scientific, and technical activities.

b. Wholesale and retail trade, repair of motor vehicles, transportation and storage, accommodation and food service activities, and real estate activities.

FIGURE 2.17 Job Creation in Lebanon and Tunisia, by Size and Age of Firm, Various Years



Source: World Bank 2014e.

Note: Size-age categories that created jobs are in dark blue, while categories that shed jobs are in light blue.

Start-ups grow faster during their first years of operation, but they tend to underperform relative to their regional peers, pointing to the presence of substantial constraints to firm growth in Lebanon. Young firms grow and expand employment faster than older firms. In Lebanon, firms 2-4 years old expanded their employment 19 percent per year during their first two years of

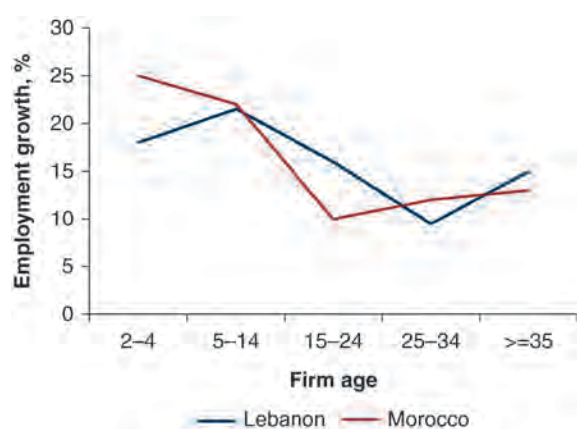
operation, while firms 25 years and older expanded their employment 12 percent (figure 2.18). Yet employment growth among young firms in Lebanon is below that of other countries in the region. In Morocco, for instance, firms 2-4 years old increase their employment 25 percent during their first two years of operation, while firms 25 years and older expand at a

rate virtually similar to that of firms in Lebanon. The loss in employment is substantial; assuming that 1,000 firms 0–2 years old start with an average of four workers and operate for two years, they would create 293 fewer jobs per year in Lebanon than in Morocco.²⁸

However, weak firm entry and productivity growth still constrain job creation. In addition to firm age, firm productivity is a key determinant of job creation (World Bank 2014f). In Lebanon a 1 percent increase in firm productivity raises job creation 3.9 percent, which is one of the highest elasticities of job creation to productivity in

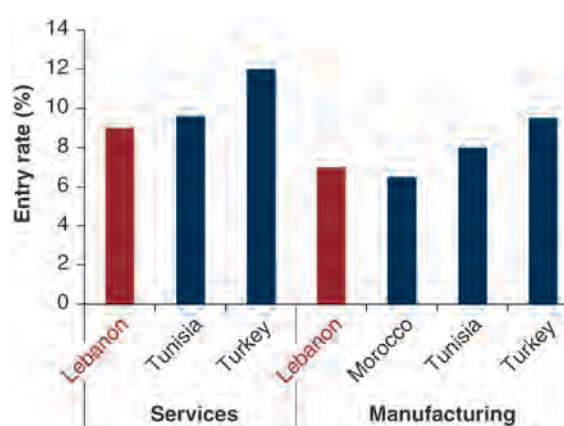
the region (table 2.2). Consistent with these findings, fast-growing firms—so-called “gazelle” firms—are more productive and younger than other firms. However, firm entry and productivity growth are too weak—partly due to barriers to entry—to unleash faster job creation in Lebanon. The firm entry rate in the manufacturing and services sectors in Lebanon is low relative to that in other countries in the region (figure 2.19). For instance, the entry rate of new services firms is only 9 percent in Lebanon compared to 9.6 percent in Tunisia and up to 12 percent in a fast-growth economy such as Turkey.

FIGURE 2.18 Growth of Firms in Lebanon and Morocco, by Age of Firm, Various Years



Source: Enterprise Survey data from the 2013 survey for Lebanon and 2007 survey for Morocco.
Note: Annual employment growth rates were calculated using firm employment level during the survey year and two years prior to the survey.

FIGURE 2.19 Firm Entry in Lebanon and Comparator Countries in the Middle East and North Africa, by Sector, Various Years



Source: Adapted from World Bank 2014e.
Note: Entry rate is the share of new firms in a given year over the number of firms in the previous year. The data cover 2005–10 in Lebanon and Turkey, 2003–06 in Morocco, and 1996–2010 in Tunisia.

TABLE 2.2 Job Creation in Lebanon and Comparator Countries in the Middle East and North Africa, by Firm Productivity

Indicator	Lebanon (all sectors)	Tunisia (all sectors)	Turkey (all sectors, 20+ workers)	Egypt, Arab Rep. (manufacturing, 10+ workers)
Labor productivity	0.039***	0.029***	0.007***	0.007
Controlling for firm size and age	Yes	Yes	Yes	Yes
Number of observations	141,061	129,516	176,665	7,925
R ²	0.40	0.34	0.03	0.10

Source: World Bank 2014f.

Note: The dependent variable is firm employment growth defined using the Davis-Haltiwanger-Schuh growth rate. Regressions are weighted by the average size of firms over the growth period. Job growth is measured annually, and productivity is measured in the beginning of the period. In Egypt, data include manufacturing and mining establishments with at least 10 employees; in Turkey, firms with at least 20 employees are considered. The estimation periods are 2005–10 in Lebanon and Turkey, and 2007–11 in Egypt. Labor productivity in Egypt is significant at the 1 percent level when the job creation rate measured over the four-year period is regressed on initial labor productivity in 2007.

*** Significant at the 1 percent level.

Constraints to Firm Entry, Growth, and Formalization

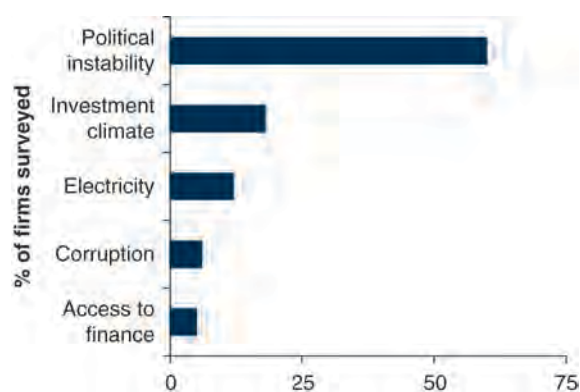
Businesses identify political instability, the investment climate, lack of reliable electricity services, and corruption as the chief obstacles to their operation and growth. Political instability ranks as by far the most severe constraint on the ability of firms to run their operations and grow, with 58 percent of firms reporting it as such (figure 2.20). The second leading obstacle is the weak “investment climate,”²⁹ with 15 percent of firms identifying it as a major or severe constraint, followed by electricity (11 percent), corruption (7 percent), and access to finance (7 percent). This ranking of major constraints remains the same across the different cuts of data (firm age, size, sector, and location), although the percentages vary, with larger shares of the youngest firms and medium-size businesses and those operating in North Lebanon and in the services sector of Greater Beirut and South Lebanon listing political insecurity as the predominant constraint. Some of these constraints are not mutually exclusive. For instance, political instability weakens institutions and could undermine transparency and accountability, fueling corruption and poor service delivery.

Many firms have to pay bribes to obtain documents such as operating licenses, construction

permits, or import licenses. Firms in Lebanon face demands for bribes or feel that a payment is needed when they engage in most operational activities, such as construction (42 percent of firms report expecting to give a bribe), obtaining an electrical connection (17 percent), or operating a license (12 percent). This stifles competition and the entry and expansion of firms. The high incidence of bribe payments and corruption is closely linked to the multitude of licenses and authorizations required as well as to unclear laws and regulations, which often lead to discretionary implementation of policy. This ultimately accentuates the barriers to business creation and growth.

Entrepreneurs in Lebanon find uncertain regulatory and policy implementation to be a significant impediment to business operations. Medium-age and medium-size firms are particularly negatively affected, as are firms located in Mount Lebanon and in retail and wholesale business activities (figure 2.21). However, this uncertainty appears to affect smaller firms and those outside the capital city to a larger degree. As a consequence, managers spend, on average, more than 12 percent of their time dealing with various government entities. The lack of clarity in laws and regulations opens the doors to discretionary implementation, fosters red tape and

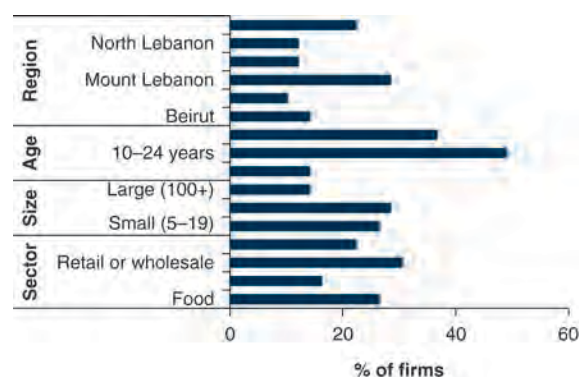
FIGURE 2.20 Obstacles to Firm Operations and Growth in Lebanon, 2013–14



Source: 2013–14 Lebanon Enterprise Survey.

Note: Figures are survey-weighted. The top five national-level obstacles shown. The investment climate indicator pools seven relevant indicators (tax rates and administration, customs and trade regulations, labor regulations, licenses and permits, courts, access to land, and informal practices).

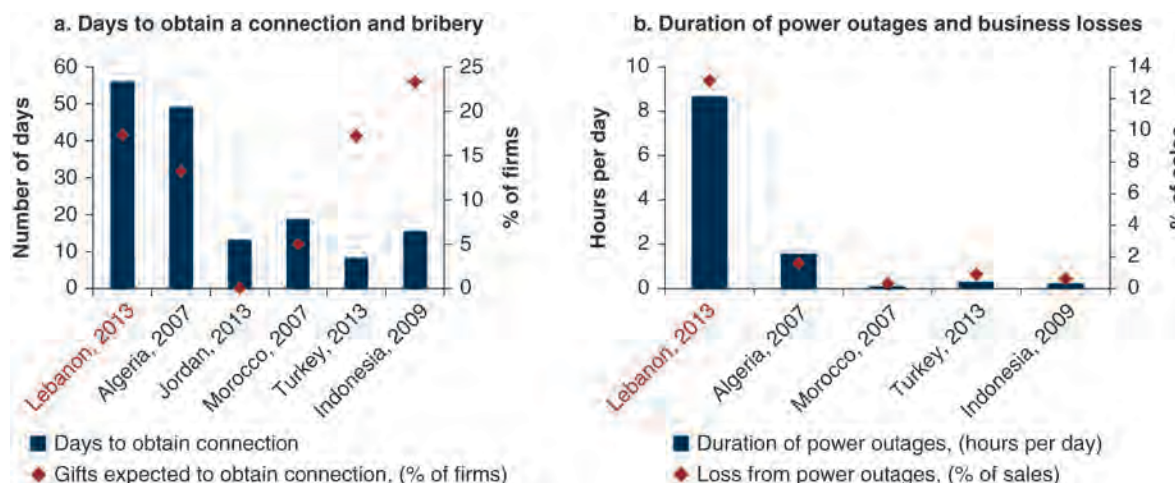
FIGURE 2.21 Consistency and Predictability of Policy Implementation as Obstacles to Firm Performance in Lebanon, by Age, Size, Sector, and Region of Firm, 2013–14



Source: 2013–14 Lebanon Enterprise Survey.

Note: Figures are survey-weighted.

FIGURE 2.22 Delivery of Electricity Services and Firm Performance in Lebanon and Comparator Countries, Various Years



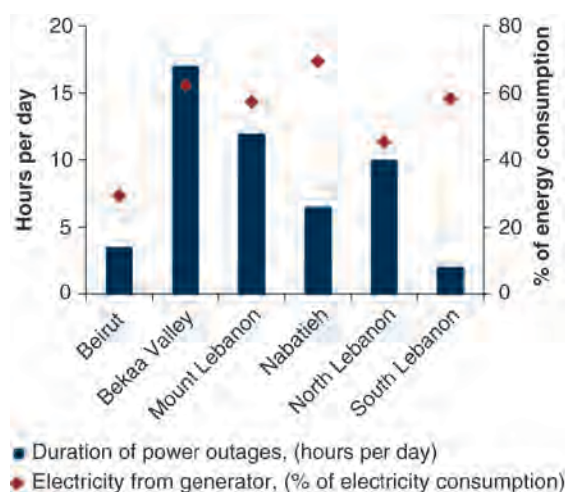
Source: 2013–14 Lebanon Enterprise Survey.

corruption, and limits the potential for firm growth and investments.

Firms have an unreliable supply of electricity, with significant regional variation, and incur large losses as a result. Firms in Lebanon have to wait 56 days after submitting an application to obtain an electricity connection, compared with 13 days in Jordan and 19 days in Morocco (figure 2.22). Once connected, firms receive very poor service. They experience more than 50 power outages per month for an average duration of 5.2 hours, which is about 8.7 hours per day. The impact on businesses is large; the average firm loses 6 percent of its sales because of power outages. Poor service delivery masks large differences in service quality across regions. Firms in Beirut and South Lebanon experience, on average, 2 to 4 hours of power outages per day compared to 11 hours per day in Mount Lebanon and up to 17 hours in Bekaa Valley (figure 2.23).³⁰

Although Lebanon performs well regionally in lending to small and medium enterprises (SMEs), the country's conservative lending culture limits access to credit, although this is partially mitigated by incentive programs of the government and the BdL. The share of SME loans as a percentage of total bank loans is around 16 percent. In the region, only Morocco

FIGURE 2.23 Delivery of Electricity Services in Lebanon, by Region, 2013–14

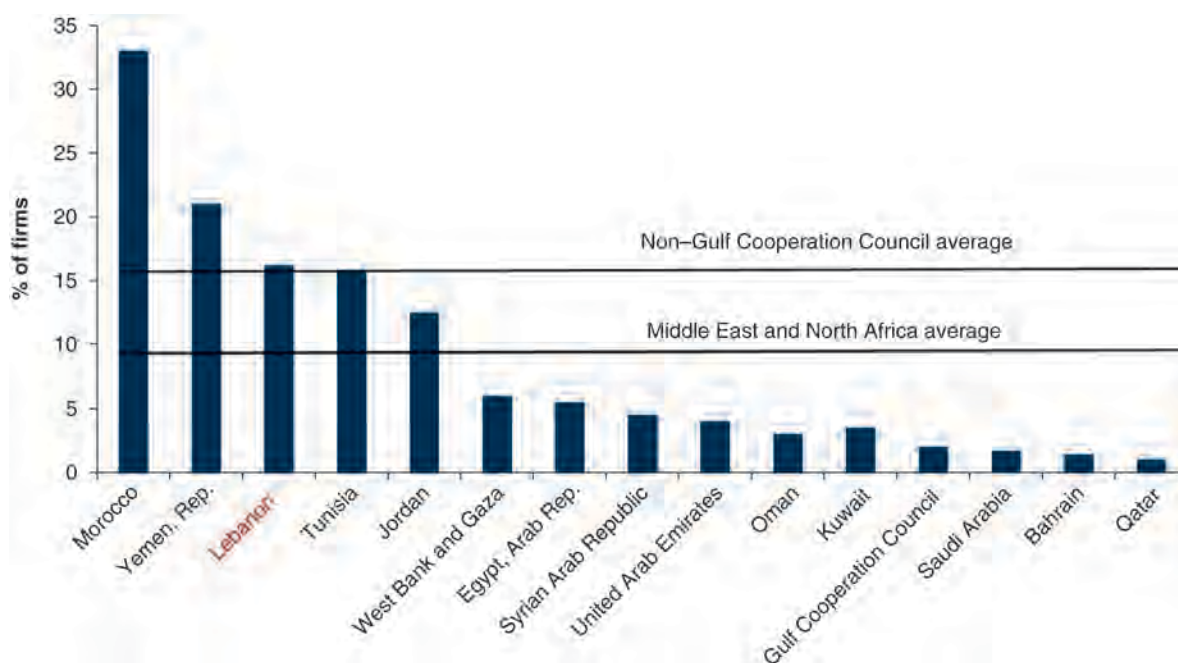


Source: 2013–14 Lebanon Enterprise Survey.

(34 percent) and the Republic of Yemen (20 percent) have higher shares of SME lending (figure 2.24). Lebanese firms depend significantly on the banking sector for their financing, as 53 percent of all firms, 50 percent of small firms, and 63 percent of medium-size firms report having received a bank loan.

Overall, domestic commercial banks provide 24 percent of firms' working capital finance and 39 percent of their investment finance.

FIGURE 2.24 Access to Finance of Firms in Lebanon and Comparator Economies, 2010



Source: World Bank and Union of Arab Banks 2010.

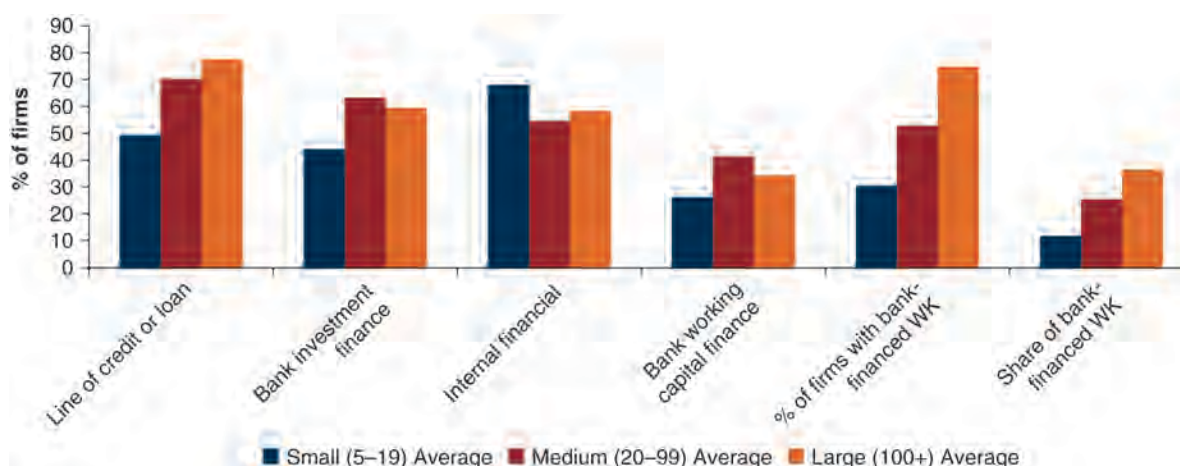
Since 2000, the government and the BdL have been subsidizing interest payments of SME borrowers, extending special guarantees to SMEs, and granting exemptions on compulsory reserves of creditors.³¹ It is unclear how much of this business would appeal to commercial banks in the absence of incentive programs. In many markets internationally, despite the absence of extensive incentive programs SME finance has proved a profitable business for banks that have developed expertise to address the specific risks associated with the sector. Notwithstanding the considerable support of government and BdL programs, access to credit remains among the top constraints to business and growth as identified by Lebanese firms. In addition, accessing credit remains a challenge because the value of required collateral is significantly high—at 166 percent of loan value, on average—and around two-thirds of enterprises report that their most recent loan required collateral (World Bank 2010c).

Notwithstanding relatively favorable access to finance, important gaps remain. Smaller firms, in particular, have difficulty obtaining business loans from banks. As a result, compared with

large firms, they tend to use fewer bank lines of credit and loans, less bank financing of investment and working capital, and more internal sources of financing (figure 2.25). Insofar as the smaller companies also tend to be younger, to have weaker collateral, and to have a short financial track record, their access to bank financing can be particularly challenging. As detailed in World Bank (2014e), younger firms are the main engines of job growth in Lebanon, so relieving their financing constraints is particularly important for achieving the twin goals of poverty reduction and shared prosperity. In that regard, particularly welcome are two recent initiatives: the launch of the BdL Circular 331 initiative designed to provide up to US\$400 million for start-up equity, and a complementary initiative by Kafalat to provide even earlier high-risk seed capital.

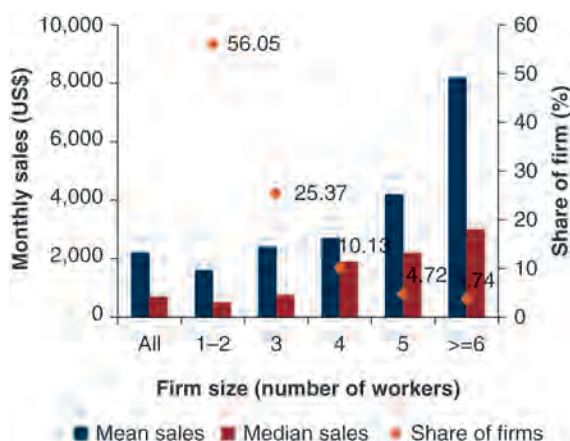
The majority of informal firms are small, Lebanese owned, and managed by persons with relatively low educational attainment. The average informal firm has US\$2,455 of sales per month. Median monthly sales are US\$995, indicating large differences across firms.³² Firms with

FIGURE 2.25 Financial Constraints for Firms in Lebanon, by Size of Firm, 2013



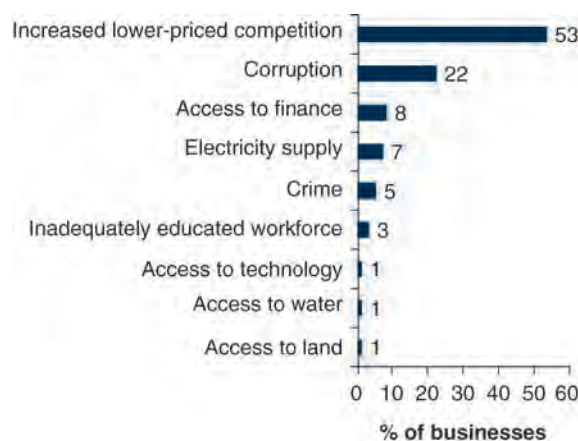
Source: 2013–14 Lebanon Enterprise Survey.

FIGURE 2.26 Size of Informal Establishments in Lebanon, by Monthly Sales and Share of Firms, 2013–14



Source: 2013–14 Lebanon Enterprise Survey on the Informal Sector.

FIGURE 2.27 Biggest Obstacles to the Operations of Informal Enterprises in Lebanon, 2013



Source: 2013–14 Lebanon Enterprise Survey on the Informal Sector.

fewer than four employees dominate the informal sector, representing more than 91 percent of all firms (figure 2.26). The majority of informal firms are managed by Lebanese (about 87 percent), followed by Syrians (8 percent) and Palestinians (4 percent). Educational attainment among owners of informal firms is relatively low: 46 percent have only a primary education and 9 percent have no education, while only 16 percent have tertiary training.

Informal firms identify lower-priced competition and corruption as the most severe constraints to their operation and growth. Of the informal firms surveyed, 53 percent report that lower-priced competitors are the biggest obstacle to their ability to run their operations and grow (figure 2.27). The second leading obstacle is corruption, with 22 percent of firms identifying it as a major or severe constraint. This is followed by access to finance (8 percent).

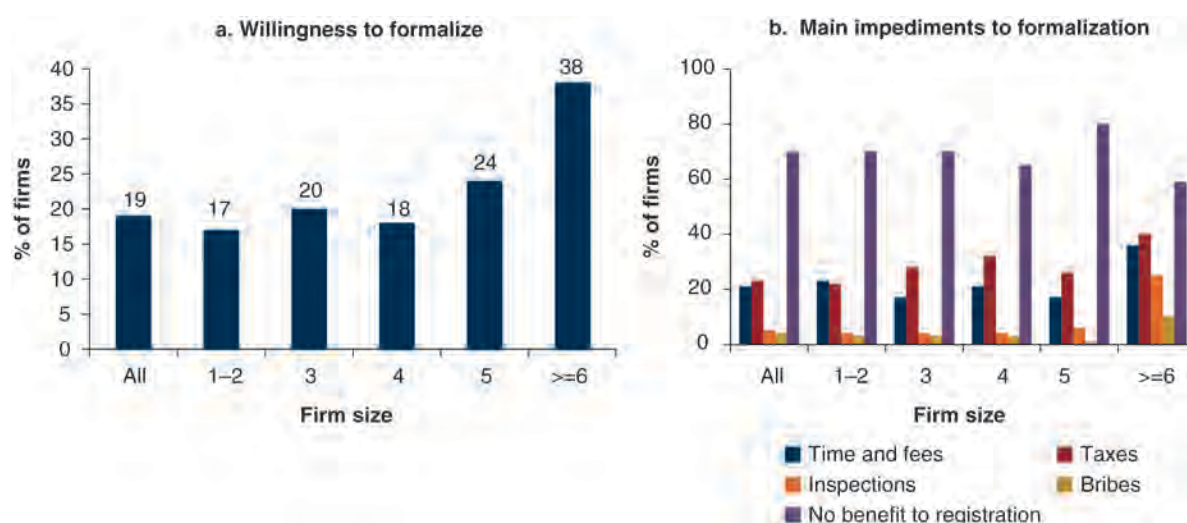
The poor supply of electricity is particularly problematic for informal firms engaged in small manufacturing activities. For instance, about 76 percent of bakeries cite lack of electricity as a major or severe constraint. Other constraints appear to affect sectors equally.

Small firms are reluctant to register and formalize their activities, largely because they see registration as having few benefits (figure 2.28, panel a). Among larger informal firms, the time, fees, taxes, and inspections that registering involves also matter for their decision to remain informal, indicating a propensity to opt out of the formal sector as a mechanism to escape policy enforcement. About 72 percent of informal owners report that they do not register their firm because they see no real benefits to registration (figure 2.28, panel b). The other main reasons given are the time and fees involved with the process (21.6 percent) and higher taxes (27.7 percent). Impediments to formalization related to time and fees, taxes, inspections, and meetings with government officials appear to be more important for larger than for smaller firms. Among firms with six workers and more, owners who do not want to register the firm cited lack of benefits to registration (59.5 percent), higher taxes (39.5 percent), the time

and fees involved (32 percent), and more inspections and meetings with government officials (26 percent). Thus informal firms in Lebanon choose to opt out of the formal economy in order to fall below the radar screen of enforcing authorities given the low opportunity cost of informality.

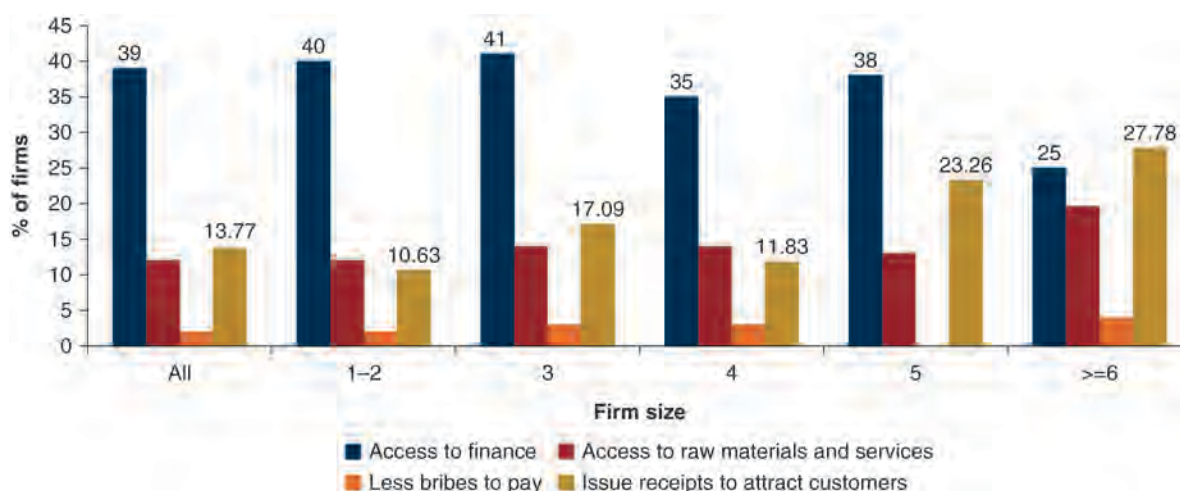
Programs to increase formalization would have more impact if they were combined with policies to improve access to finance, reduce taxes, and simplify tax procedures for small firms (figure 2.29). Informal entrepreneurs see the main benefits to formalizing as being to improve access to finance (39 percent of firms), to be able to issue receipts and attract customers (13.8 percent), and to have better access to raw materials and government services (12.8 percent). Few entrepreneurs expect formalization to reduce bribe payments. Smaller firms see larger benefits in improving access to finance. Among larger firms, formalization brings the ability to expand the client base by issuing receipts. These findings suggest that policies to increase formalization would have more impact if they were combined with programs to improve access to finance among newly formalized businesses as well as with measures to reduce taxes and simplify tax procedures for small firms.

FIGURE 2.28 Willingness to Formalize and Main Constraints to Formalization of Firms in Lebanon, by Firm Size, 2013



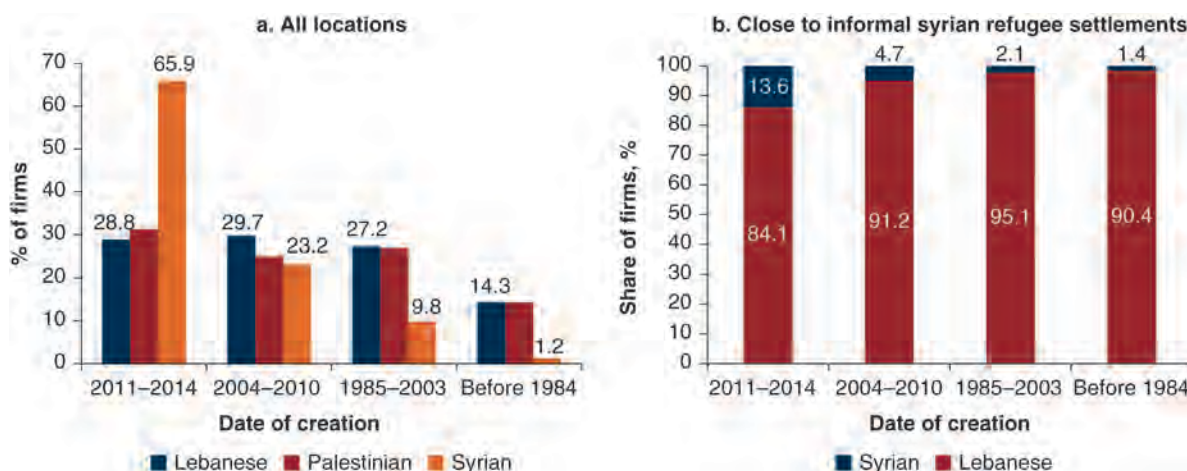
Source: 2013–14 Lebanon Enterprise Survey on the Informal Sector.

FIGURE 2.29 Perceived Benefits of Formalization in Lebanon, by Firm Size, 2013–14



Source: 2013–14 Lebanon Enterprise Survey on the Informal Sector.

FIGURE 2.30 Creation of Informal Firms in Lebanon, by Owner's Nationality, 1984–2014



Source: 2013–14 Lebanon Enterprise Survey on the Informal Sector.

The inflow of Syrian refugees has led to an increase in Syrian-owned informal firms, but there is little evidence that they have displaced Lebanese firms. Among informal businesses opened after 2011, about 66 percent are managed by Syrians and 29 percent by Lebanese (figure 2.30, panel a). However, the share of Lebanese-managed informal businesses created in 2004–10 and in 2011–14 is virtually equal. In locations close to Syrian refugee settlements, Syrians manage 13 percent of informal businesses opened between 2011 and 2014 compared to 4.7 percent of businesses opened between 2004 and 2010,

but Lebanese businesses still account for more than 84 percent of the new businesses near these Syrian settlements (figure 2.30, panel b).

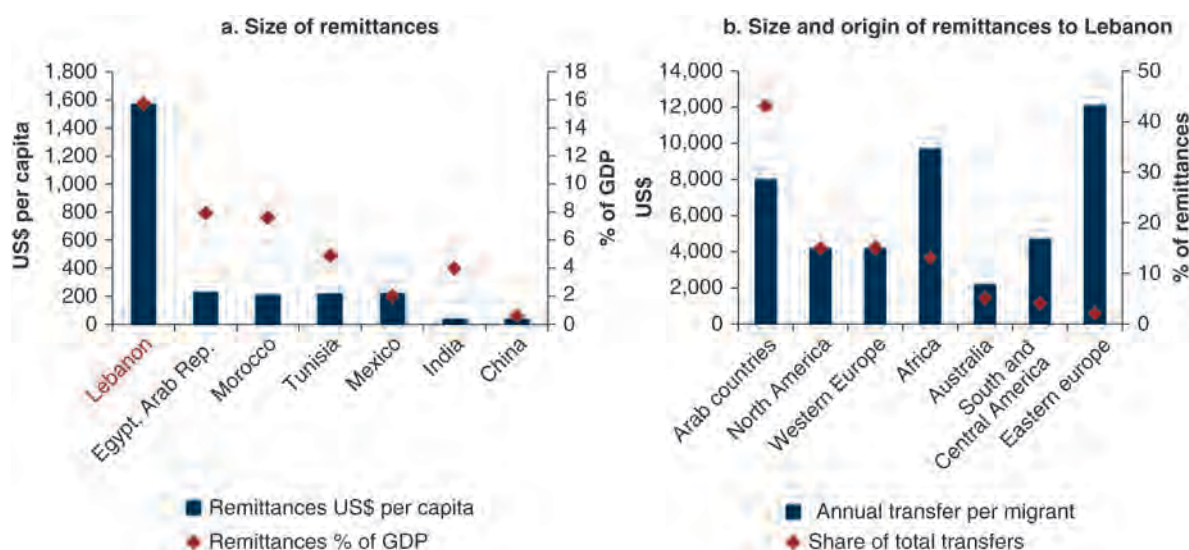
Diaspora and Remittances

Thanks to their strong economic standing abroad and deep ties at home, emigrants support relatives through large, relatively frequent, and stable remittances. Lebanon has a larger inflow of remittances than any other country of similar size (figure 2.31, panel a).³³ Remittances from emigrants residing in Arab countries play a significant role, followed by remittances from

emigrants in North America, Western Europe, and Africa (figure 2.31, panel b).³⁴ Remittances are frequent and stable, especially for emigrants who have children or parents in Lebanon. About one in every four emigrants remits regularly; about 96 percent of emigrants who are household heads and have a spouse and children in Lebanon remit regularly. About 44 percent of migrants who have parents in Lebanon remit

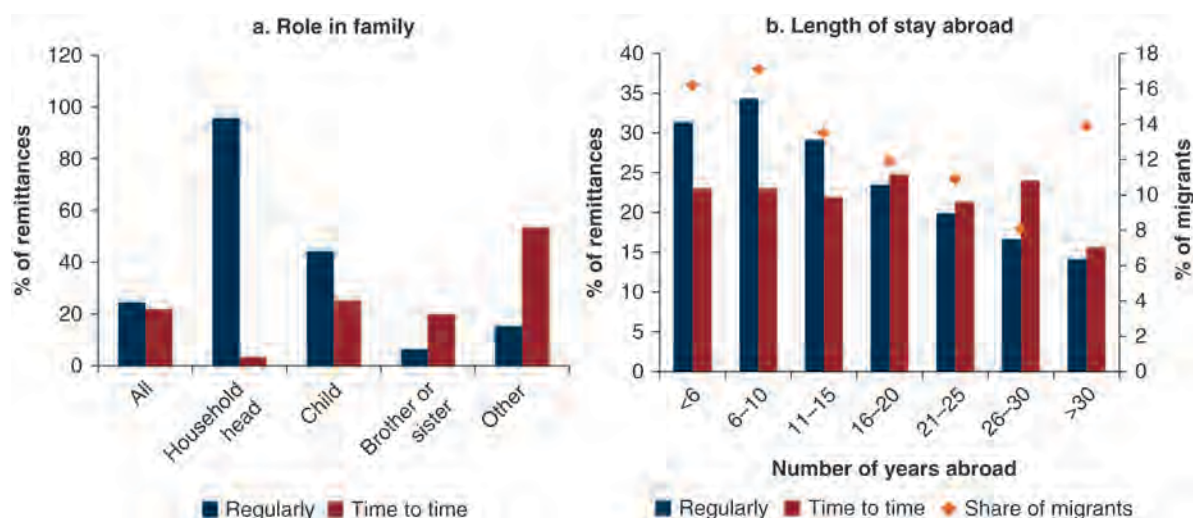
regularly. Less frequent remittances are more common among emigrants with only brothers or sisters in Lebanon or lesser blood relations (figure 2.32, panel a). While the frequency of remittances is lower for the diaspora who left Lebanon decades ago and is well established abroad, it remains substantial (Kasparian 2014). About a third of emigrants who left less than 10 years ago remit regularly compared to about

FIGURE 2.31 Remittances to Lebanon and Comparator Countries, by Size and Origin (various years)



Sources: Adapted from Kasparian 2014 (panel a); World Bank 2014I (panel b).

FIGURE 2.32 Frequency of Remittances in Lebanon, by Role in Family and Length of Stay Abroad (various years)



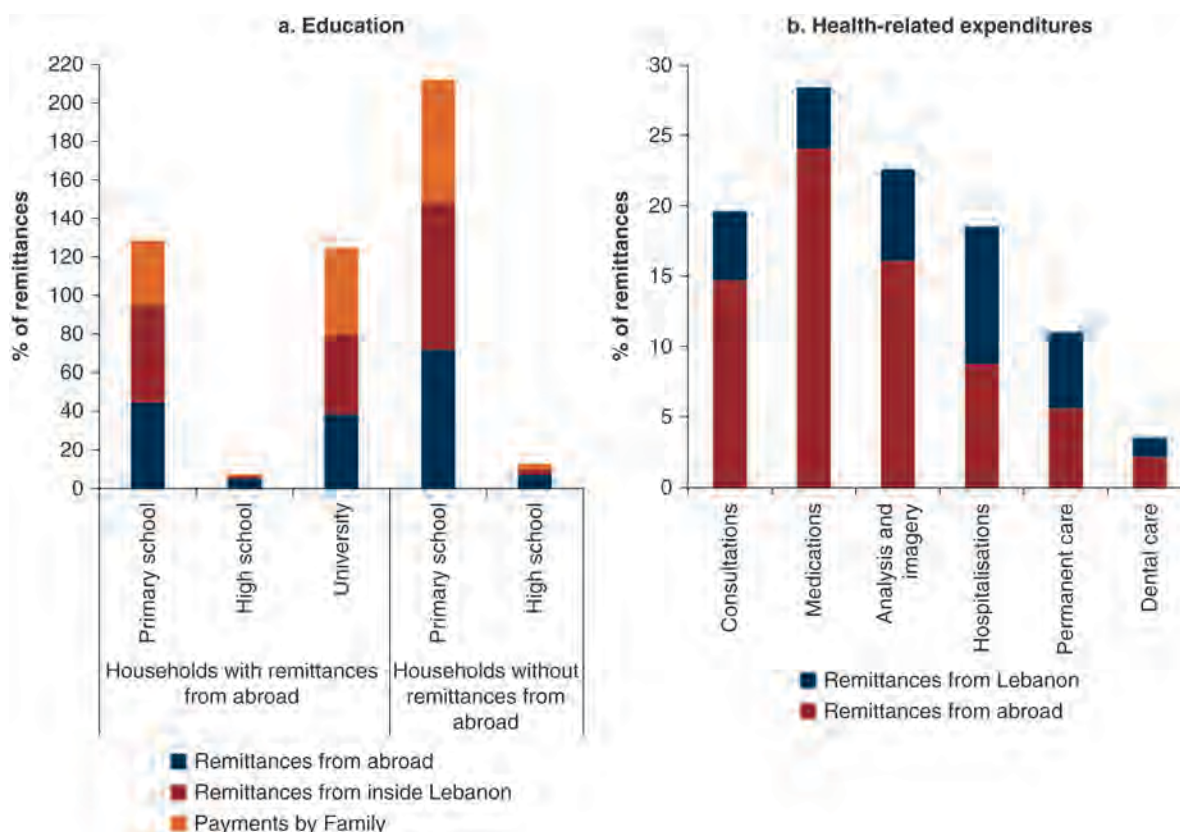
Source: Kasparian 2014.

17 percent of those who left more than 25 years ago (figure 2.32, panel b).

Remittances contribute largely to investments in the education and health of Lebanese households, thereby supporting human development and the skills of the next generation. Remittances support household investments in education, and their impact is significant at all levels, from primary school to university. About 39 percent of remittance-receiving households partially or fully rely on these transfers to finance primary school education, while 46 percent use them to finance tertiary education (figure 2.33, panel a). The contribution of remittances to health care is also significant. Among remittance-receiving households, 24 percent rely on remittances from abroad to pay for medications, while 4 percent rely on remittances from within Lebanon (figure 2.33, panel b).

While the diaspora has maintained strong ties with Lebanon, its participation in the country's political and economic life is limited. Lebanese migrants send remittances, visit the country, contribute to business creation and trade, support philanthropic activities, and help communities in times of conflict and natural disasters (Hourani 2007). For instance, at the macroeconomic level, the diaspora has contributed to meeting the government's financing needs by buying treasury bills targeted to emigrants. The Lebanese Children's Fund, first created in Cyprus in 1995, later opened several country offices to collect philanthropic donations and supported more than 24 organizations in Lebanon (Rahme 2007). Successive governments have attempted to link the diaspora with Lebanon to varying degrees by creating and expanding Lebanon's diplomatic and consular missions and permitting the creation on

FIGURE 2.33 Investments in Education and Health of Lebanese Households, by Source of Funds (various years)



Source: Kasparian 2014.

Lebanese soil of organizations related to emigrants' interests.³⁵ The large potential for investment in business by the diaspora is not fully realized because Lebanese entrepreneurs abroad find that the policy environment in Lebanon is too uncertain and corruption too rampant.

The large number of Lebanese abroad represents an important opportunity to tap into a rather well-educated, prosperous, and connected pool of people. High levels of remittances from the diaspora have kept the Lebanese economy afloat, along with the strong banking system.³⁶ Diasporas and diaspora networks abroad are especially important reservoirs of knowledge about trade and investment opportunities as well as technical and scientific expertise. About 3.4 percent of the Lebanese diaspora residing in the Organisation for Economic Co-operation and Development (OECD) countries is highly skilled. A recent World Bank consultation with the Lebanese diaspora points to a strong desire to give back and stay connected with Lebanon and abroad. Many of the interviewees referred to their background and experience growing up in a time of war and having the natural ability to adapt and take risk. They expressed willingness to give more if proper and more transparent venues were instituted. Despite the gloomy business environment in Lebanon, diaspora members tend to believe that they have an important role to play. Individual efforts, such as connecting, investing, and mentoring, can be crucial in particular sectors (high technology, ICT, solar energy) and in development projects in remote and rural areas. Diaspora members are often attached to their city of origin and are willing to improve the local infrastructure there.

The government's strategy of financing the reconstruction and recovery through borrowing rather than taxation (at least over the medium term) clearly benefited wealthier Lebanese citizens: not only did they not face a high tax burden (taxes in Lebanon are relatively low compared to comparator countries), but they also benefited from a relatively high real (after-tax) return on capital (proxied, for lack of better data, by the

after-tax real average effective interest rate on public debt). As shown in figure 2.34, this rate of return (r) on capital was significantly higher than the real GDP growth rate (g) over the postwar period (that is, over 1993–2013: $r = 7.1$ percent $>$ $g = 4.6$ percent). As Piketty (2013) notes, such a high gap (2.5 percent) between r and g generates persistent and large income inequality, as g proxies for the upper bound on real wage growth over the long term.

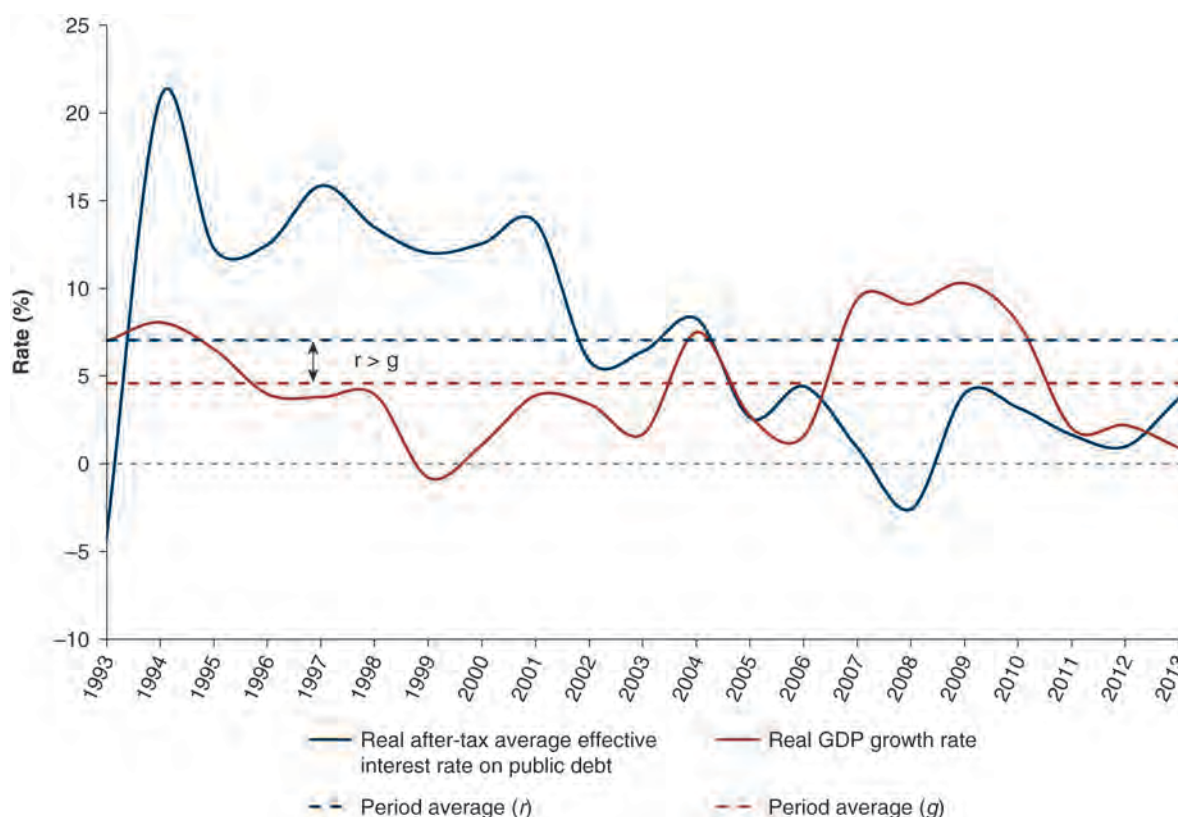
Poverty and Inequality in Access to and Quality of Public Services

Nonmonetary dimensions of poverty are high in Lebanon due to the limited availability of good-quality social and infrastructure services. Shared prosperity is difficult to achieve without a favorable environment for equitable and sustainable growth. The government plays a critical role in creating this environment by maximizing the human and productive potential of a society, regardless of exogenous circumstances such as gender, place of birth, parental wealth, religion, or ethnicity. Governments can maximize human and productive capacity by the effective provision of public goods such as education, water, roads, and electricity. This section briefly discusses inequality in access to and quality of two basic public services—water and education—in Lebanon.

Water

A recent survey of the relatively affluent *mohafaza*³⁷ of Greater Beirut and Mount Lebanon region indicates high variability in access and quality.³⁸ The survey found that public access to water is not uniform in the area and varies across residence and households by wealth status (figure 2.35). In particular, 70 percent of the population from the top 60 percent of the distribution has access to the public water network compared to 58 percent from the bottom 40 percent. There is substantial variation in

FIGURE 2.34 Gap between Return on Capital and Economic Growth in Lebanon, 1993–2013



Source: Central Administration of Statistics.

Note: The 1993–2013 average of the after-tax real average effective interest rate on public debt is 7.1 percent, while the average real GDP growth rate for the period is 4.6 percent. The income from interest in Lebanon is taxed at 5 percent (withheld at source). The 2.5 percentage point gap between r and g is large.

access to public water across municipalities as well. For example, access to the public network is almost universal in Metn and less than 10 percent in Aley. Furthermore, the quality of public water is worse for households from the bottom 40 percent than for wealthier households. For example, service water is saline for 46 percent of households from the bottom 40 percent compared to 32 percent of households from the top 60 percent (figure 2.36).

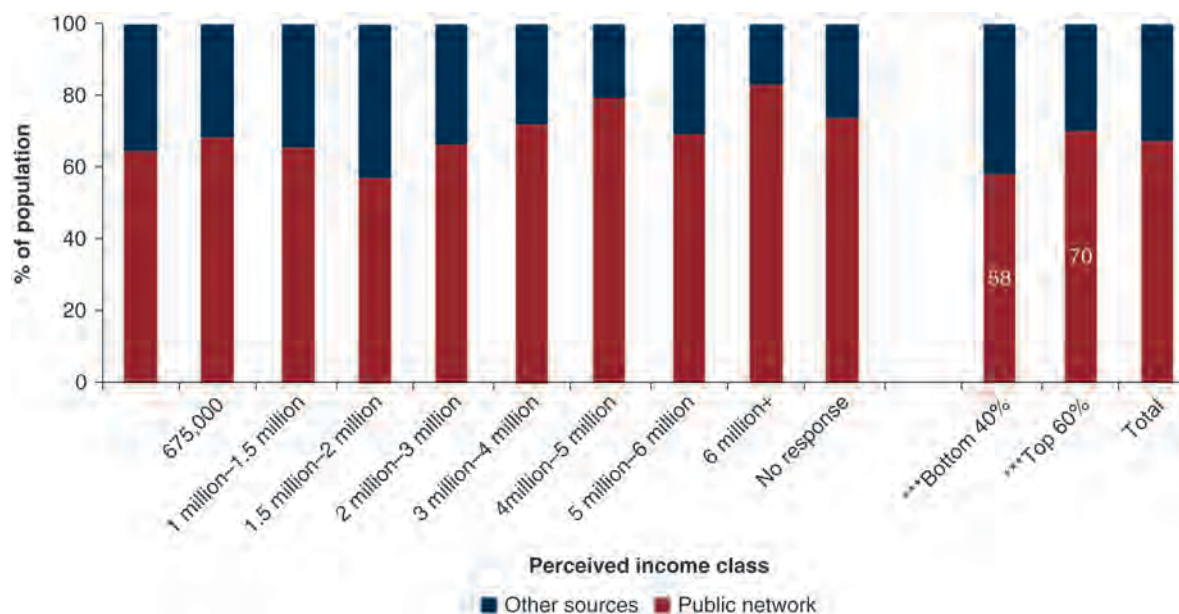
The delivery of public water is also unreliable, with the majority of subscribers experiencing frequent interruptions in supply. Average water supply in the public network is much shorter than is experienced in nonpublic sources: 6 and 13 hours per day, respectively. Only 20 percent of households connected to the public network have water available every day in

the wet season (December through May) compared to 90 percent of households using water from other sources. An estimated 82 percent of subscribers are not satisfied with the public network service.³⁹

Educational Outcomes

A significant gap exists in educational attainment between public and private education, which is reducing equality of opportunity among children (figure 2.37). Children from wealthier and middle-class households are concentrated in high-performing private schools, while disadvantaged children are concentrated in low-performing public and private schools (figure 2.38). Household characteristics, area of residence, and access to services have a large

FIGURE 2.35 Public and Private Access to Water in Mount Lebanon, by Income Classes (various years)

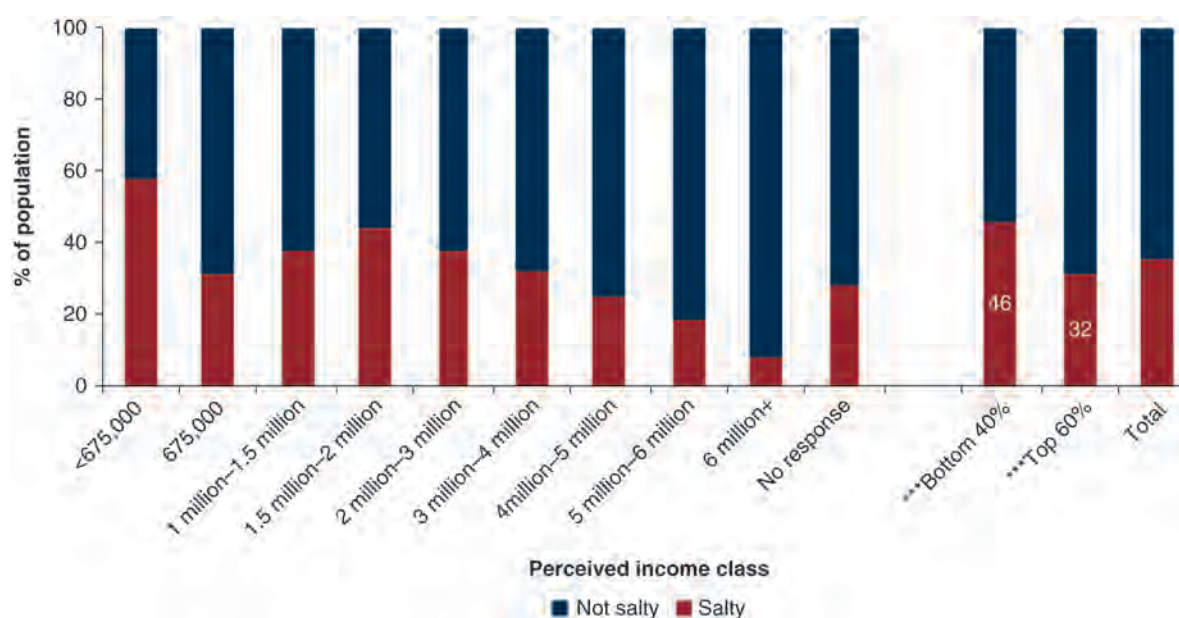


Source: World Bank 2014c.

Note: Precise income data are not available from the survey, so the upper income threshold was imputed for each household from a particular income group to calculate income per capita. As a result, income per capita reflects the upper-bound approximation.

***Average access to public network is lower among the bottom 40 percent of the population than among the top 60 at 1 percent significance level.

FIGURE 2.36 Salinity of Public Water in Lebanon, by Income Class (various years)

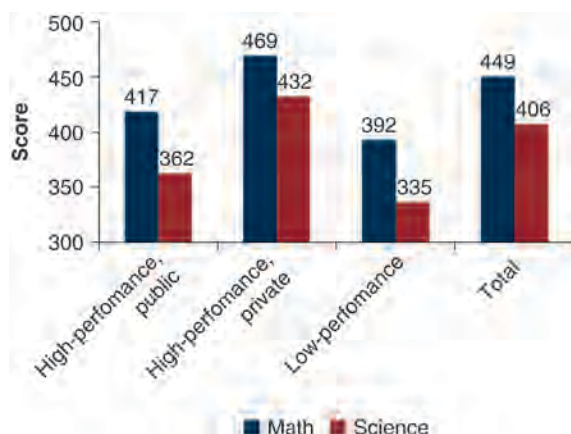


Source: World Bank 2014c.

Note: Precise income data are not available from the survey, therefore the upper income threshold was imputed for each household from a particular income group to calculate income per capita. As a result income per capita reflects the upper-bound approximation.

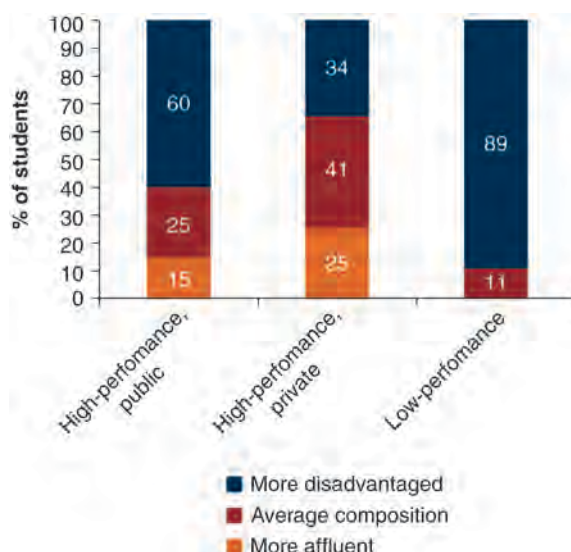
***Average access to the public network is lower among the bottom 40 percent of the population than among top 60 at 1 percent significance level.

FIGURE 2.37 Test Scores on Math and Science in Lebanon, by Type of School, 2011



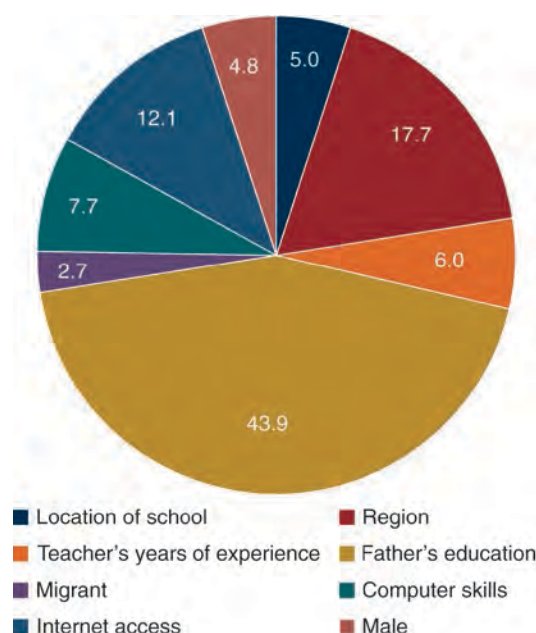
Source: 2011 Trends in International Mathematics and Science Study (TIMSS).
Note: Students' weights were used.

FIGURE 2.38 Economic Background of Students in Lebanon, by Type of School



Source: 2011 Trends in International Mathematics and Science Study (TIMSS).
Note: Students' weights were used.

FIGURE 2.39 Circumstances Contributing to Inequality of Opportunity in Math Test Scores in Lebanon, 2011



Source: 2011 Trends in International Mathematics and Science Study (TIMSS).

impact on math and science achievement. Simple cross-tabulations show a substantial variation in test scores in math and science across regions, area of residence, parents' education, access to ICT, and durables. Residing in a remote rural area is also associated with low test scores. Parents' education is a strong predictor of children's test scores as well. Living in a family where parents do not have any secondary education is associated with the lowest test score. Father's education and residence (region and location of school) are the two largest contributors to inequality of opportunity, accounting for 44 and 23 percent of total inequality, respectively (figure 2.39).

Notes

1. Appendix B provides an overview of the economy's performance prior to and during the civil war. This long-term perspective illustrates the lasting impact that the conflict had on Lebanon's core drivers of growth (human, physical, and social capital).
2. GDP figures for 2004 to 2011 are based on the Lebanese national accounts published by the Central Administration of Statistics in July 2013, while data for 2012, 2013, and 2014 are projections pending final GDP estimates from the Central Administration of Statistics. These projections

are based, in part on the Lebanon coincident and leading economic indicators developed by Matta (2014).

3. The conflict with Israel resulted in large human losses, infrastructure damage, and economic losses, with US\$2.8 billion in direct damages and US\$700 million to US\$800 million in indirect damages (World Bank 2010b).
4. Major security incidents included the Nahr-el Bared conflict in the summer of 2007 and armed clashes between opposing political factions in May 2008.
5. This group has the same GDP per capita (purchasing power parity terms) as Lebanon in 2013. It includes Azerbaijan, Belarus, Cuba, Gabon, Mauritius, Mexico, Romania, Suriname, Turkey, Uruguay, and the República Bolivariana de Venezuela.
6. National accounts data in this paragraph refer to data consistent with the July 2013 national accounts release.
7. The American University of Beirut/Byblos Bank consumer confidence index dropped 33.9 percent in 2012 and 9.9 percent in 2013, respectively. These are the latest available annual numbers.
8. Social protection consists of policies and programs designed to reduce poverty and vulnerability by promoting efficient labor markets, diminishing people's exposure to risks, and enhancing their capacity to manage economic and social risks, such as unemployment, exclusion, sickness, disability, and old age (World Bank 2001).
9. The Gini index measures the extent to which the distribution of income or consumption expenditure among individuals or households within an economy deviates from a perfectly equal distribution. A Gini index of 0 represents perfect equality, while an index of 1 implies perfect inequality.
10. After 2000, the Ministry of Social Affairs, supported by the UNDP, and in partnership with the Central Administration of Statistics, undertook the first Multipurpose Household Survey (Living Conditions and Household Budget Survey), which was conducted from February 2004 to April 2005 in about 13,000 households nationwide (CAS 2005). The sample covered the entire population, except the Palestinian population living in refugee camps. Household-specific extreme, lower, and upper poverty lines were constructed based on the costs of basic needs. Since the lower poverty line is used as eligibility criteria in the National Targeting Program, it was updated in 2013 using the consumer price index from US\$2.40 per capita per day to US\$3.84 (World Bank 2014m). Average annual per capita poverty lines in Lebanese pounds were as follows: LL 844,000 (food poverty line), LL 1,332,000 (lower poverty line), and LL 2,172,000 (upper poverty line). Any household that spent less than the upper poverty line was considered to be poor.
11. The poverty estimates for 1997 and 2007 were obtained using backward and forward simulations (UNDP 2008a).
12. High productivity among small farms is relatively common in developing and emerging markets. While small farms are more productive than large farms, they still cannot leave subsistence agriculture given their small amount of land, lack of rural advisory services, and market imperfections (among others).
13. Detailed results of the analysis along with a description of the data are provided in Vishwanath and Atamanov (2014). In the absence of recent microdata, having information from other surveys that have self-reported information on household income or people's perceptions about their well-being can be useful. In particular, three sources roughly covering the period between 2010 and 2014 have been used: the World Values Survey, the Arab Barometer Survey, and the Survey on Financial Literacy and Capabilities. All three surveys contain rich information on subjective well-being and individual or household characteristics of respondents. Some of the surveys collected self-reported income. Combining monetary information with subjective well-being helps to triangulate results using imperfect proxies for poverty in recent years.
14. The average poverty line in 2004–05 was LL 2,172,000. Cumulative inflation between 2004–05 and 2012 was 51.1 percent.
15. For the initial documentation of the GTAP model, see Hertel (1997); for more recent literature and latest version of the model, see <https://www.gtap.agecon.purdue.edu/models/current.asp>.
16. For example, a global GTAP does not have the detailed modeling of the economy needed for a precise estimation. Moreover, the World Bank study was undertaken in August 2013, and the data available at that time covered only a few months in which a large number of refugees were in Lebanon. It probably did not capture some of the channels through which the Syrian conflict would affect poverty.
17. Other key factors, in decreasing order, were economic growth, social protection, rural development, public sector governance, equality of

- opportunity, education, anticorruption, and balanced regional development.
18. Employee paid weekly, hourly, or piece-rate basis.
 19. During 2004–10, the labor force grew at an average annual rate of 2.2 percent, half of which was explained by a growing working-age population.
 20. Over the past decade, the total participation rate increased moderately, driven largely by increases in the participation of women, especially young educated women (that is, female participation rates increased from 22 in 2004 to 26 percent in 2013).
 21. While labor inflows into Lebanon (immigrant workers, refugees) could compensate for the high emigration of skilled workers, there is little reason to believe that this is the case. First, the profile of immigrant workers and refugees is similar to the profile of the Lebanese resident population (World Bank 2013c), indicating that such inflows cannot close the skilled labor-supply gap opened by emigration. Second, labor laws, in particular those geared toward managing the political and social impact of refugees from certain countries, limit the integration of refugees into the Lebanese labor market, such as in high-skill professional fields.
 22. Evidence suggests that formal workers have access to better benefits (annual, maternity, and sick leave) and better-quality jobs (higher earnings, a written contract, longer tenure).
 23. Among business owners and top managers, 53 percent identified competition with unregistered or informal firms as a major constraint in Lebanon, as opposed to 28 percent in the Middle East and North Africa region. Disaggregated further, this appears to be the biggest constraint in rural areas (specifically in North Lebanon, where informality rates are especially high (2013–14 Enterprise Survey data)).
 24. Other things being equal, having higher tertiary education increases hourly wages by 32 percent for men and 52 percent for women relative to having only primary education. Cognitive skills have a positive effect in addition to the effect of education (World Bank 2012d).
 25. On a month-to-month basis over December 2007–10 (World Bank 2012d).
 26. Beyond formal education, cognitive skills appear to have positive effects on earnings for wage employees, while noncognitive skills affect the likelihood of working in the informal sector (World Bank 2012d).
 27. See Rizk Azour (2013) for details on personnel cost in the central government of Lebanon.
 28. In this scenario, firms 2–4 years old would create 760 jobs in Lebanon and 1,000 jobs in Morocco during the first year (difference of 240 jobs). During the second year, they would create an additional 904.4 jobs in Lebanon and 1,250 in Morocco (difference of 345.6 jobs). The average difference in the number jobs created in the first two years is 292.8.
 29. “Investment climate” comprises tax rates and administration, customs and trade regulations, labor regulations, licenses and permits, access to land, courts, and informal practices.
 30. Firms adopt various costly coping strategies such as producing electricity with power generators, with more than 91 percent of firms owning or sharing a power generator. Outside Beirut, power generators provide more than 50 percent of firms’ electricity consumption. In the Bekaa Valley and Nabatieh, firms draw 62 and 69 percent, respectively, of their electricity from generators.
 31. One of the region’s most successful credit guarantee programs is Kafalat, a government- (and donor-) subsidized loan guarantee scheme aiming to improve access to finance for SMEs. Firms with a Kafalat guarantee are still required to have substantial collateral, which is an important obstacle for small and start-up firms. The main benefit of the Kafalat guarantee is to make longer-term lending more available. Small firms, in addition, pay lower interest rates, reducing their cost of financing (World Bank 2012f).
 32. One- or two-person firms—which account for 56 percent of informal firms—have average monthly sales equal to about US\$1,500. Average monthly sales reach over US\$9,000 for informal firms with six or more workers, but such firms account for less than 4 percent of informal firms.
 33. Remittances were US\$1,600 per capita or 16 percent of GDP in 2012, followed by Egypt (US\$238 per capita, 7.5 percent of GDP) and Morocco (US\$200 per capita, 6.8 percent of GDP) in the Middle East and North Africa.
 34. Kasparian (2014) finds that emigrants in Arab countries are the leading source of remittances, followed by emigrants in North America, Western Europe, and Africa.
 35. The diaspora has voiced its desire to have the right to citizenship for the descendants of Lebanese migrants and the right to vote in absentia for Lebanese residing abroad.
 36. In 2013 (latest available data), remittances constituted 6.8 percent of GDP.
 37. A *mohafaza* is an administrative unit equivalent to a governorate. Lebanon has six *mohafazas*.

38. This section discusses the results of a survey conducted by the Consultation and Research Institute to assess the impact of the Bisri Dam Project. The number of observations was 1,200 households located in Greater Beirut and Mount Lebanon. No national survey regarding access to safe water has been conducted recently in Lebanon.
39. As a result, 43 percent of connected households are willing to choose a hypothetical plan with the best water service and the highest water fee (continuous connect time and high water quality).

Chapter 3

Lebanon's Challenges and Opportunities

Overarching Challenges

The confessional system of governance—in its current incarnation—and the dynamics of national and regional conflicts constitute overarching constraints that have engendered deep structural inequalities and deficiencies, and have inhibited economic growth and inclusive development. These constraints are at the core of Lebanon's current fragility and vulnerability to destabilizing national and regional shocks. They affect growth and development across all sectors and must be taken into account when analyzing sector-specific challenges and priorities. This chapter describes the main manifestations of these twin constraints.

Lebanon's Confessional Governance and Elite Capture

Lebanon's economic growth and development pathway since independence cannot be considered apart from the country's (evolving) confessional system of governance. This is due to the role of confessionalism not only in providing the basis for Lebanon's political system, but also in determining economic and relationships and forms of organization. In this respect, the confessional system has exerted a constitutive—and not exogenous—influence on economic growth and development trajectories. Confessionalism, as an overarching constraint, manifests itself in several ways.

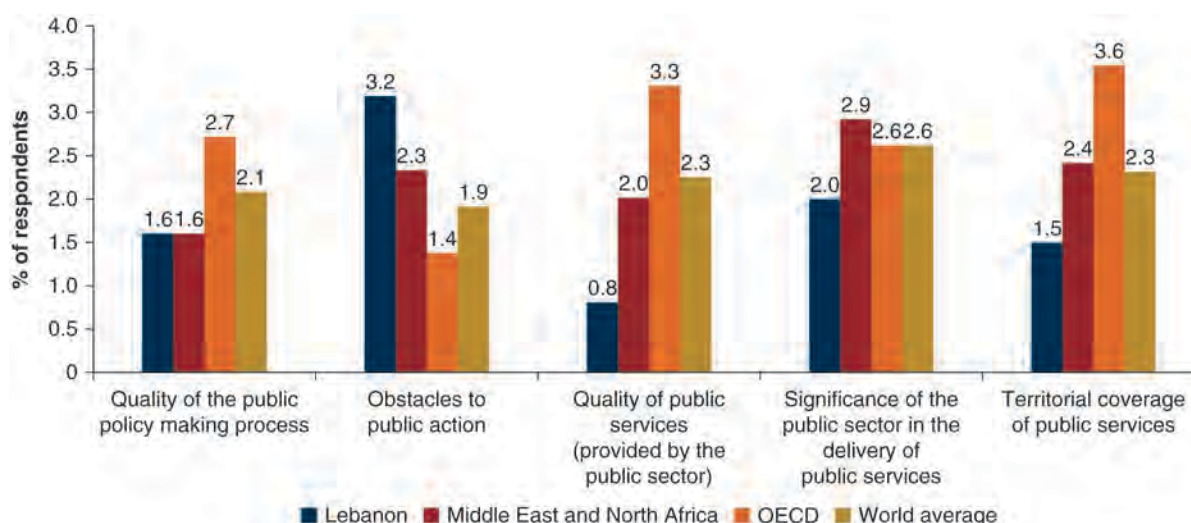
First, the inability of political actors to reach a consensus on national priorities severely constrains the ability of government to develop and implement long-term, visionary development policies. Continuing tensions between domestic

political actors, often manifested in confessional terms, have repeatedly created deadlock within the legislative and executive branches of government. As a result, key development plans and policies have not been ratified or implemented. This constraint is rooted in the nature of the confessional system itself (specifically in the partial implementation of the Taef Accord).

Second, the confessionally-driven staffing of public institutions at the expense of merit-based criteria impedes the state's ability to deliver quality public services efficiently and to generate inclusive and sustainable growth (figure 3.1). The need to maintain a sectarian balance of power within institutions, reflected in both staffing and responsibilities for resource allocation, means that sectarian interests are prioritized over the equitable and adequate provision of services, transparency, and accountability. This problem has worsened markedly in Lebanon in the past decade (figure 3.2) to the extent that the country is now the worst performer among countries in the Middle East and North Africa with regard to political interference in hiring decisions (figure 3.3).

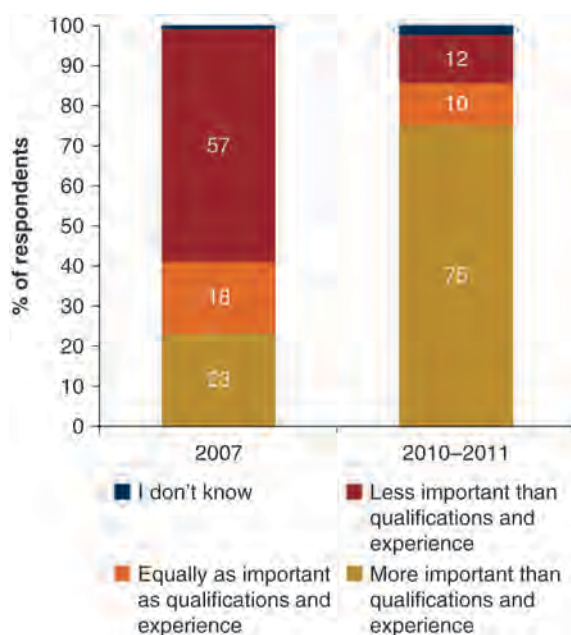
Third, the confessional system has become the dominant system for structuring socioeconomic relations. As described in chapter 1, the Lebanese state emerged from the civil war in weakened form, with its sovereign role and capabilities displaced by sectarian organizations and interests, which in certain cases assumed *de facto* responsibilities for territorial administration and governance. In this context, individual social and economic rights and opportunities came to be defined through sectarian affiliations and patronage or clientelistic relationships with

FIGURE 3.1 Policy Making and Delivery of Services in Lebanon and Comparator Regions, 2012



Source: 2012 Institutional Profiles Database.

FIGURE 3.2 Perception of Political Interference in Public Employment in Lebanon, 2007 and 2010–11



Source: Arab Barometer Surveys (2007, 2010–11).

Note: Responses to the question, How important is the applicant's political orientation to obtaining government employment?

sectarian leadership. This gave sectarian actors and organizations considerable authority and, in some cases, political autonomy. It also meant that sectarian affiliations became key organizing principles in the provision of public services and

financial allocations, perpetuating regional income disparities and uneven access to and quality of public services.

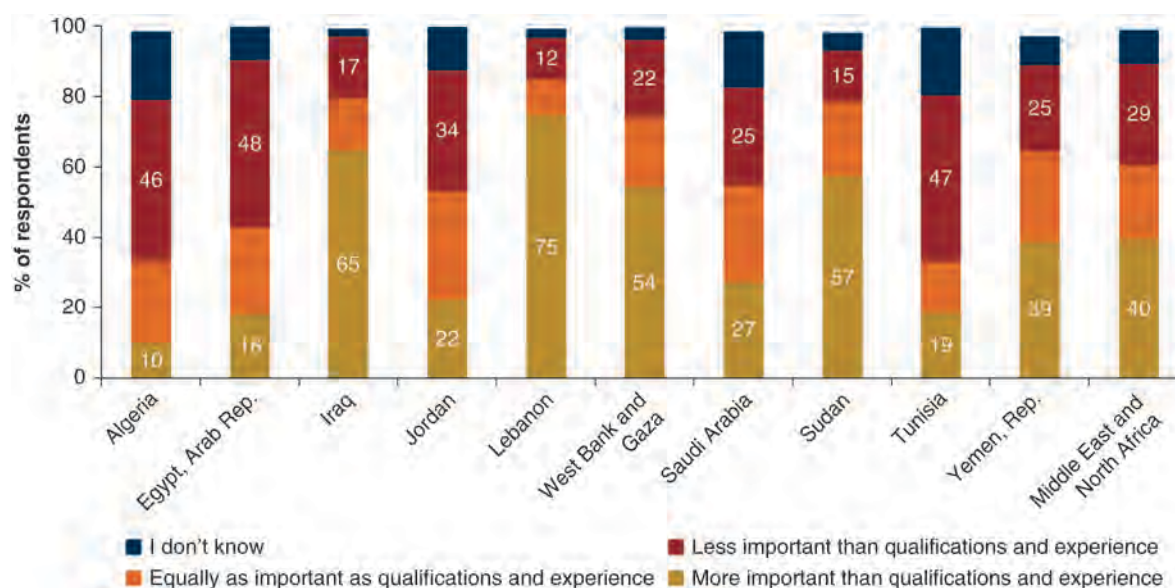
Fourth, electoral accountability is weak. The 1960 parliamentary elections law and the role it gave to confessions result in elections where political party platforms have limited economic and social content, and are focused, instead, on defending the confession's access to public resources. When faced with limited prospects for improving the quality of public services and institutions, and the impact these have on growth, many Lebanese opt to emigrate.

Fragility, Conflict, and Violence

For most of its history, Lebanon's internal stability and political, social, and economic dynamics have been directly affected by regional conflicts. Two dimensions are particularly salient for the purposes of this Systematic Country Diagnostic (SCD) because of the constraints they impose on governance and on economic and social stability.

First are regional alliances and the weakening of state authority, governance, and institutional capacity. A key feature of politics in Lebanon is the establishment of alliances between domestic political actors (confessional groupings or sects)

FIGURE 3.3 Perception of Political Interference in Public Employment in Lebanon and Comparator Economies, 2010–11



Source: 2010–11 Arab Barometer Survey.

Note: Responses to the question, How important is the applicant's political orientation to obtaining government employment?

and regional actors, usually in some form of clientalistic relationship (Hourani 2013). At present, Lebanese groups have aligned with opposing sides of the conflict in the Syrian Arab Republic—March 8 is aligned with the Syrian regime, and March 14 is aligned with the Syrian opposition. This alignment is threatening to undermine the delicate confessional balance, with growing potential for destabilization and conflict. This is directly affecting governance and state institutional capacity, paralyzing an already problematic decision-making apparatus, and undermining the ability of state institutions to contain increasing insecurity and violence (Barnes-Dacey 2014).

Second is the influx of refugees and the consequent economic and social destabilization. As of January 2015, more than 1.1 million Syrian refugees have officially sought refuge in Lebanon, creating severe pressures and competition over social services and jobs. In addition to the fiscal burden and limited absorptive capacities of government services and communities (World Bank 2013c), there is growing concern that deepening vulnerability and rising tensions could lead to a

breakdown in relations between host and refugee communities and upset the delicate confessional balance within society, further polarizing sectarian tensions at the political level.

Nested Challenges and Constraints

These overarching constraints have been the root cause and also exacerbated Lebanon's long-standing and well-identified development and private sector challenges. Two studies have analyzed Lebanon's growth constraints and drivers. The first study, by Berthelemy, Dessus, and Nahas (2007), using the growth diagnostic methodology of Hausmann, Rodrik, and Velasco (2008), identifies binding (nested) constraints to growth in Lebanon. Key among these are the country's fiscal imbalances and the resulting macroeconomic risks. The risk of crisis affects the nature and of quality private sector investment. The inefficiency of public spending and services also has a major impact on economic activity, as it poorly complements private investment (weak

infrastructure, especially electricity) and widens the inequality gap and regional disparities.

The second study, by the World Bank (2012e), focuses on Lebanon's drivers of long-term sustainable growth. It identifies the key constraints as (a) macroeconomic volatility, in particular the risk of continued fiscal imbalances and severe macroeconomic shocks that these imbalances may create; (b) infrastructure gaps, especially in electricity, water, transport, sanitation, and telecommunications; and (c) deficiency in banking sector intermediation due to fiscal dominance in which highly productive industries and innovative activities do not seem to benefit from financial inflows, which are used mainly for short-term deposits in banks or real estate acquisitions. Furthermore, despite Lebanon's strong banking sector, access to finance for micro, small, and medium enterprises remains a constraint.¹

The rest of this section reviews in some detail the key nested constraints that Lebanon is facing. These are the overall macroeconomic environment, infrastructure gaps, weak institutions and governance, uneven human capital, the business climate, access to finance, and environmental degradation.

Macroeconomic Vulnerability

The macroeconomic environment is vulnerable as a result of precarious public finances and Lebanon's exposure to regional instability and conflict. According to the World Economic Forum's global competitiveness index, the weakness of the macroeconomic environment is Lebanon's biggest constraint both in absolute terms and also compared to countries in the Middle East and North Africa region, comparator countries in terms of purchasing power parity, or comparator countries in terms of stage of development. Lebanon's macroeconomic environment is ranked as the second worst in the world according to the global competitiveness index ranking of 144 countries. This weakness arises, to a large extent, because of the country's structurally weak public finances. The predominance of confessional interests in government

institutions and the challenges this poses to effective decision making have prevented the establishment of appropriate checks and balances, and sound coordination of economic and fiscal policies (Makdisi 2007).

Moreover, Lebanon's location at the intersection of several conflicts in the region has been a source of constant macroeconomic shocks, including the significant fiscal impact of the influx of Syrian refugees (World Bank 2013c), as well as security-related shocks, which have led to major declines in key sectors, especially tourism and trade (Bertelsmann Stiftung BTI 2014).

Until a few years ago, Lebanon had the highest ratio of debt to GDP in the world. A period of strong growth from 2007 to 2010 reduced this ratio markedly, due mostly to a cyclical improvement but also to some rationalization of expenditures. The underlying structural fiscal deficit has, however, not been fundamentally addressed; on the contrary, it has widened in part due to the introduction of permanent revenue-eroding measures (for example, the value added tax exemption on diesel). With growth tumbling since 2011 and a large fiscal burden associated with the Syrian crisis (a combination of lower revenue and higher expenditures related primarily to the cost of providing public services to refugees), the debt-to-GDP ratio is rising again, resulting in a marked deterioration of the country's macroeconomic environment. Based on current policies and projections, Lebanon's debt dynamics are not sustainable (IMF 2014).

Determined under a confessionally-oriented regime, fiscal policy is not transparent, lacks basic accountability, is prone to being captured by vested interests, and therefore is inefficient and unproductive. The budget process is in disarray. There have been no approved budgets since 2005 due to political polarization in parliament and a dispute regarding extra-budgetary expenditures.² The last officially closed fiscal accounts are for 2003. Spending has been conducted largely through enabling legislation, treasury advances, and ad hoc measures. Even prior to 2005, fiscal policy was not transparent due to basic impediments such as having different

budget classifications for the approved budget law and the executed budget. Lack of proper oversight, including over extra-budgetary entities that receive significant government funding and are only answerable to certain confessions or politicians, entrenches a culture of non-transparency and capture of fiscal policy for confessional purposes. This lack of transparency and accountability creates room for fiscal leakages, inefficiencies, and corruption. Furthermore, key documents on the government's national budget and financial activities are either not published or not produced at all. This limited access to information inhibits potential third-party accountability mechanisms (for example, voting power of informed citizens, civil society organizations, media), making the management of public resources an ad hoc, discretionary endeavor. The constraints have been exacerbated by increasing polarization linked to the conflicts in Syria and Iraq, leading to paralysis in both policy development and implementation (Bertelsmann Stiftung BTI 2014).

The public financial management system suffers from several constraints that hinder its proper functioning, weaken its transparency, and result in the inefficient use of public resources. Despite the implementation of some reforms,³ Lebanon's public financial management system is outdated, imposing considerable inefficiencies within the budget cycle and reflecting a fragmentation in the budget and treasury functions. The wage bill and an unsustainable pension for civil servants⁴ are sources of public spending inefficiency. The wages and salaries scale for the civil service are not transparent, revealing large gaps and distortions within the public service itself, and large benefit packages distort the general equilibrium of the labor market.

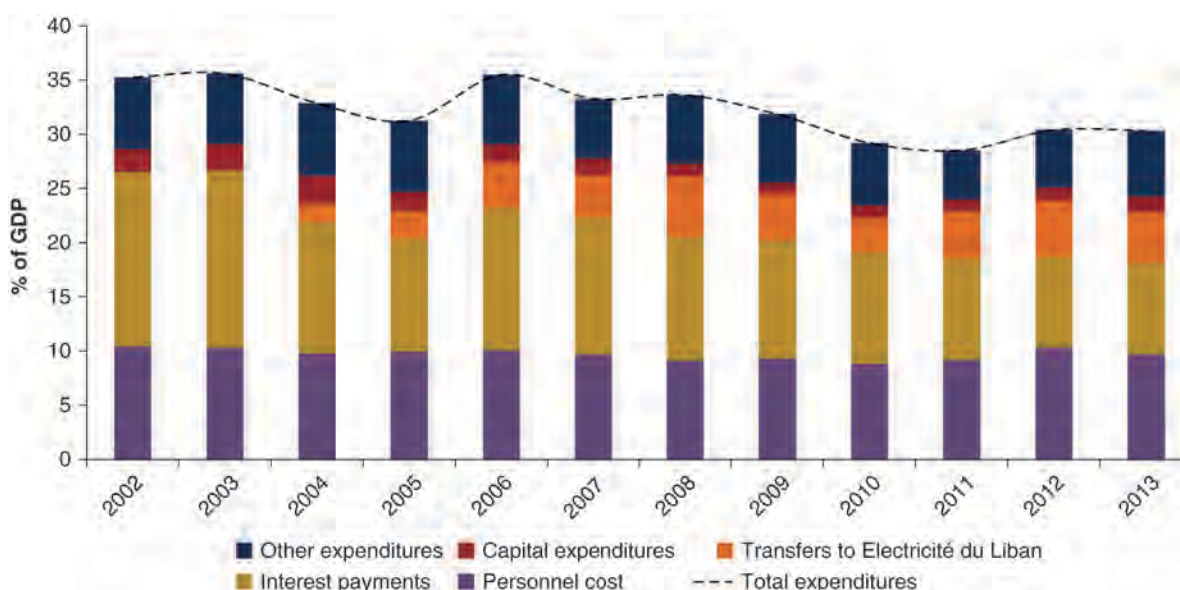
On the human resources level, the implementation of competency-based meritocratic recruitment could be enhanced. Moreover, a significant gap in capacity exists in the civil service, with vacancies reaching 41 percent for leading positions and 70 percent across the civil service (Moubayed Bissat 2013). Additionally, the absence of policy orientation concerning civil

service reform, coupled with deficiencies in human resource management and training, hinders the formation of human capital, mobility of the workforce, and management of diversity. Such challenges further strain the state's "capacity to govern" at a time when the threat of rising violence and conflict in neighboring countries is exacerbating an already weak environment regarding the implementation of rules and guidelines. Trust in government has been eroding, with increasing corruption, vested interests, and confusing policy choices (Arab Barometer Surveys). Finally, accountability is hindered by the scant availability of data and information, which reduces transparency and participation.

Lebanon's expenditures are characterized by large budget rigidities that limit fiscal space and flexibility to react to shocks. These expenditures are concentrated on personnel costs, debt servicing, and transfers to the state-run electricity company, Electricité du Liban (EdL), which together accounted for 81.6 percent of total spending, on average, during 2006–13 (figure 3.4). The wage bill (as a share of GDP) for public sector employees is not excessive when compared to the bill in a group of comparator countries, although benefits are generous, especially pensions (which is, however, heterogeneous among public sector employees with some, such as the army and judges, having a very generous scheme compared to others)—(figure 3.5). The issue is more about the quality of public services that these public sector employees are able to deliver. Reflecting the large public debt, interest payments have been sizable, accounting for one-third of total expenditures and about 60 percent of total revenue and grants.

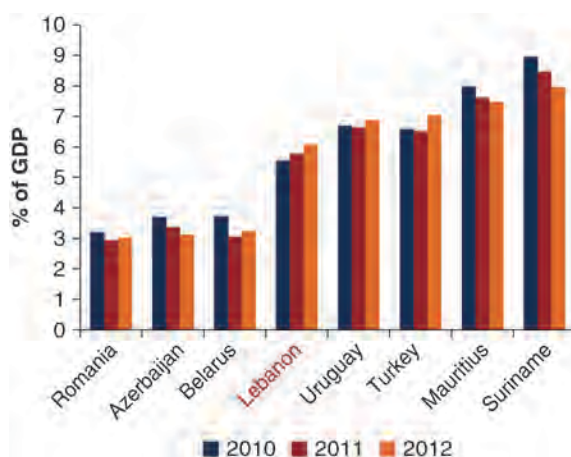
Unproductive spending and fiscal leakages are significant and widespread; they crowd out effective social safety net programs and hinder the provision of better services for the population. The energy sector is a major drag on public finances. Between 2006 and 2014, the government transferred an average of 4.3 percent of GDP to EdL each year. EdL's production is both inefficient and insufficient, with a generating capacity of 2,019 mega-watts, compared to a

FIGURE 3.4 Central Government Spending in Lebanon, 2002–13



Source: Ministry of Finance data.

FIGURE 3.5 Cost of Public Sector Employees as a Share of GDP in Lebanon and Select Countries, 2010–12



Source: Ministry of Finance data.

peak demand of 3,195 mega-watts. Systematic and long blackouts are a daily occurrence, causing the extensive use of backup private generators at a cost that is three times the level of EdL tariffs (IMF 2014). Moreover, whereas only about half of total electricity production costs are recoverable, electricity tariffs have remained unchanged

since 1996, when the price of oil was US\$23 per barrel (World Bank 2008a).

EdL is not the only source of leakage. Leakages also occur on both the expenditure and revenue sides, such as spending on civil service and military pensions or tax exemptions (World Bank 2005c). Corruption is perceived as endemic. Given these large, inefficient, and in the short term nondiscretionary items, the budget in Lebanon has limited resources left to pursue meaningful antipoverty programs, social safety nets, and investment in basic infrastructure.

Low capital expenditures have reduced potential economic growth (Berthelemy, Dessus, and Nahas 2007). The lack of fiscal space combined with the failure to approve a budget since 2005 have resulted in a sharp fall in public spending on capital projects, which have averaged around 1.5 percent of GDP since the beginning of the millennium. This is significantly below the spending in comparator countries. As a result, the country's infrastructure network has deteriorated, particularly transportation, water supply, and electricity—services important for the population's well-being. Further, low public investment in these sectors has caused capacity to lag behind

demand, leading to a reduction in potential economic growth and an overall deterioration in living conditions.

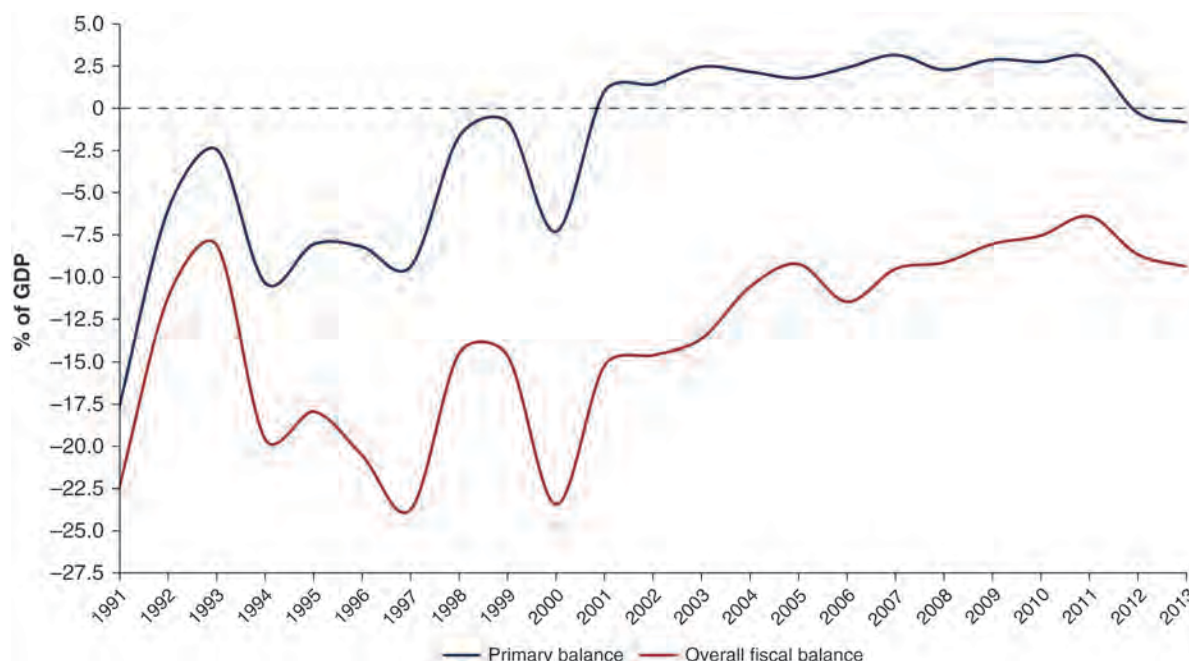
The debt-financed postwar reconstruction, coupled with inefficient and unproductive spending, has resulted in over-indebtedness. In contrast to the pre-civil war period, when the public sector was a net saver, Lebanon's public finances in the postwar period have been structurally and persistently weak—during 1993–2013, the overall fiscal deficits averaged 12.4 percent of GDP (figure 3.6). These deficits have been driven by low growth, high borrowing costs (compared to the economy's growth rate), and weak efficiency of public spending, partly due to an inability to rein in waste and corruption (World Bank 2005c).

As a result of these high and persistent deficits, Lebanon's public debt peaked at 185.2 percent of GDP in 2006, the world's highest debt-to-GDP ratio at the time (figure 3.7). Between 2006 and 2010, high and sustained GDP growth significantly improved Lebanon's fiscal balances and lowered the debt ratio by about 40 percentage points.

The underlying structural fiscal balance, however, did not improve. As a result, once growth tapered off, debt dynamics stopped improving. With the added fiscal impact from the Syrian crisis—estimated at an additional spending of US\$1.1 billion for the period 2012–14 (World Bank 2013b)—the debt ratio started rising in 2013 and is projected to continue rising over the medium term given current policy and regional turmoil and factoring in the expected rise in global interest rates.

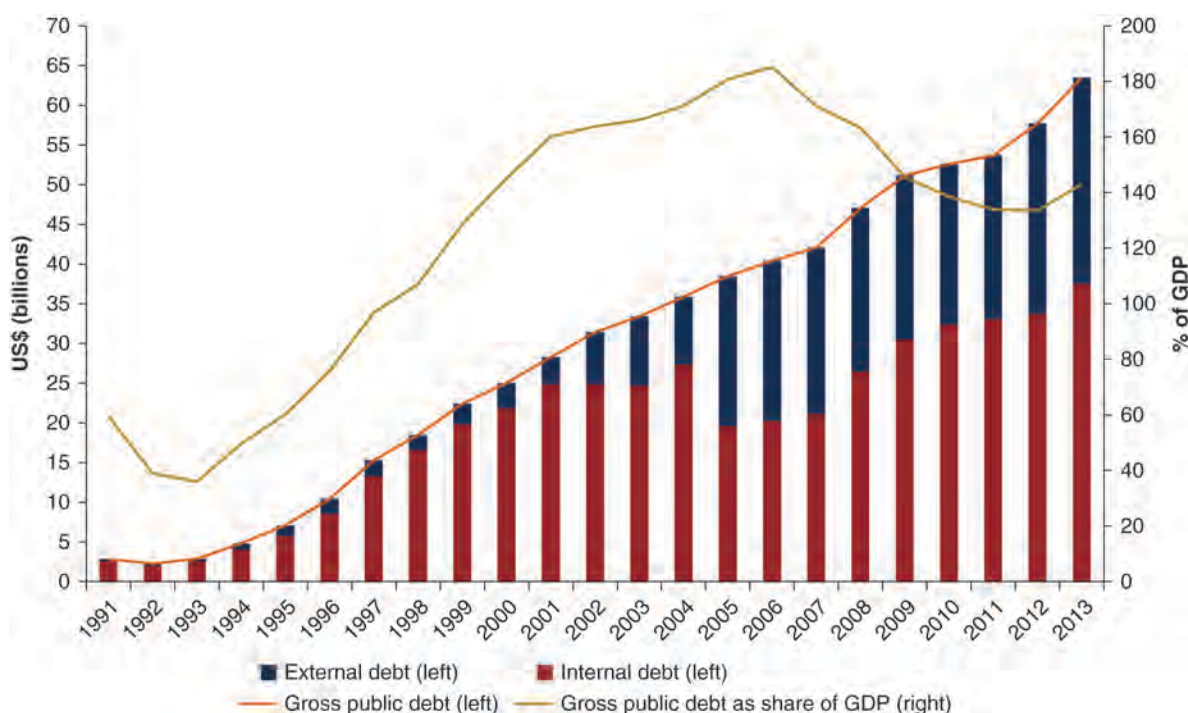
The domestic banking system, relying on funds from the diaspora and the Gulf, has been willing to finance the large buildup in public debt, but at the expense of the private sector and a large exposure to the sovereign. At the end of the civil war, the lack of foreign aid necessitated the mobilization of private funds to finance the country's large reconstruction needs. This resurrected the country's prewar banking culture, which successfully reconnected with the large expatriate community, enlarged by the war. The successful introduction of a fixed exchange rate regime (fixed to the U.S. dollar) to anchor

FIGURE 3.6 Fiscal and Primary Balance as a Share of GDP in Lebanon, 1991–2013



Source: Ministry of Finance data.

FIGURE 3.7 Gross Public Debt in Lebanon, 1991–2013



Source: Ministry of Finance data.

expectations and stop a currency crisis that erupted in 1992 has resulted in a very stable nominal exchange rate, with the pound-dollar peg unchanged since 1997. Both peg and high interest rates on government debt have enabled the banking system to attract foreign deposits profitably by offering high interest rates on pound and dollar deposits and then use them to finance the government.

Given the scale of the public debt, the banking sector has reached a size seen in only a few countries in the world. At the same time, if financial inclusion is to be improved, returns from lending to the private sector have to be better than the low risk, low cost, and high margins that banks are realizing by lending to the sovereign. Although this is less an issue for connected firms, it is an important concern for the rest of the private sector and especially for small and medium enterprises (as discussed later in this chapter, access to finance is the sixth most problematic factor to doing business).

To maintain the peg, the central bank, the Banque du Liban (BdL), is trapped in a

Stackelberg follower role⁵ vis-à-vis the fiscal authority; it is the residual buyer of sovereign debt, while ensuring that banks offer attractive dollar spreads to finance the current account. Under severe fiscal dominance and a banking sector balance sheet that is more than three times GDP, the BdL ensures that banks keep attracting foreign deposits and that the public sector's gross financing needs are met. For the former, the BdL has introduced certificates of deposit or various subsidized refinancing schemes. For the latter, it is the residual buyer of government debt in the primary or secondary markets. The resulting banking-sovereign feedback loop undermines the BdL's independence, which could ultimately prevent it from achieving its monetary policy objectives. However, the BdL will not be able to stop being a Stackelberg follower vis-à-vis the fiscal authority until the size of the public debt and the public sector's gross financing needs shrink sufficiently that they do not endanger macro stability.

While commercial banking has flourished, this sector has limited capacity to address a range of

outstanding financing needs. Gaps persist in the financing needs of micro and small and medium enterprises (SMEs) as well as in the availability of longer-term financing for infrastructure and public-private partnership projects (World Bank 2013j). Some of these gaps could be addressed by the further development of non-bank financial institutions (NBFIs), such as those offering leasing, factoring, microfinance, and capital market solutions. While NBFIs could play a larger role in the provision of more inclusive financial services, they are constrained, in part, by the lack of an adequate legal and regulatory environment. For instance, in the microfinance sector, some progress has been made, but a significant amount of demand has not been met, which is attributable, in part, to the burden of a regulatory framework not tailored to this specific sector.

Helping to address a critical gap, the BdL recently launched an innovative incentive program (Circular 331) that encourages banks to invest in early-stage equities. This effort should boost the supply of capital, particularly for start-up companies and potentially higher-growth businesses that offer the greatest short- to medium-term potential for job creation. Likewise, longer-term financing mechanisms also need work to build institutional capacity and establish appropriate regulatory environments before they can play a role in funding large-scale infrastructure and public-private partnership projects. Strengthening financial infrastructure related to collateral registries, settlement and custody systems, and credit information, among others, would improve risk management and promote inclusiveness.

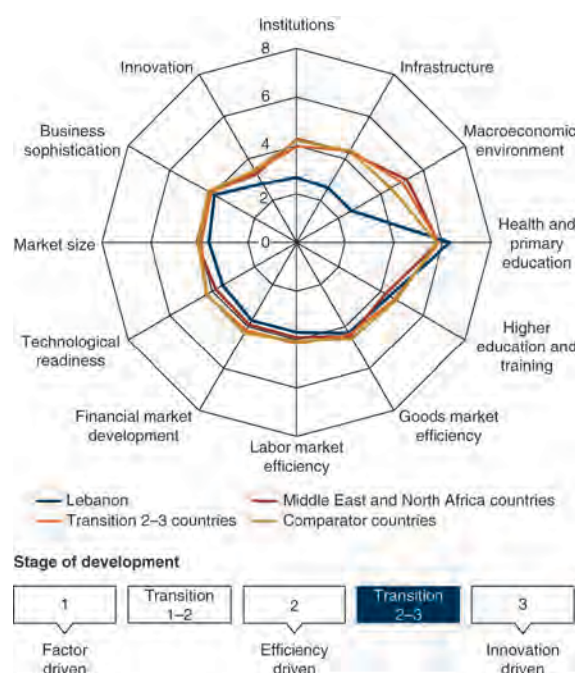
Infrastructure Gaps

Lebanon's weak infrastructure base has curtailed economic development and lowered the population's well-being. The weakest sectors are telecommunications, electricity, water, sanitation, and transportation, sectors that are essential not only for achieving growth in productivity and aggregate income, but also for ensuring a basic standard of living for people.

Furthermore, better infrastructure can have a positive impact on income inequality because it allows low-income groups to access better and more productive opportunities, increasing the returns on their assets. It also enhances health and education outcomes, improving human capital.

Lebanon's infrastructure is deficient compared to that of similar countries and acts as an impediment to private sector expansion and job growth. According to the WEF's competitiveness index, infrastructure is Lebanon's second weakest comparative constraint, and is materially below various sets of comparator countries (figure 3.8). Among the nine sub-indicators for infrastructure in the World Economic Forum's global competitiveness index, two of Lebanon's are in the bottom 10 percent of world ranking (out of 144 countries) and four are in the bottom 25 percent (table 3.1). Specifically, Lebanon ranks 143 for quality of electricity supply (second worst in the world), 120 for quality of roads, and 114 for mobile phone subscriptions per 100 population.

FIGURE 3.8 Global Competitiveness Index in Lebanon and Comparator Countries, by Component, 2014–15



Source: World Economic Forum.

TABLE 3.1 Global Competitiveness Index in Lebanon, 2011–15

	Rank (out of 144)	Score (1–7)
GCI 2014–2015	113	3.7
GCI 2013–2014 (out of 148)	103	3.9
GCI 2012–2013 (out of 144)	91	3.9
GCI 2011–2012 (out of 142)	89	3.9
Basic Requirements (37.7%)	127	3.5
Institutions	139	2.7
Infrastructure	122	2.6
Macroeconomic environment	143	2.6
Health and primary education	30	6.3
Efficiency Enhancers (50.0%)	85	3.9
Higher education and training	67	4.4
Goods market efficiency	71	4.3
Labor market efficiency	123	3.7
Financial market development	102	3.7
Technological readiness	86	3.5
Market size	76	3.6
Innovation and sophistication factors (12.3%)	101	3.3
Business sophistication	75	3.9
Innovation	119	2.8

Source: World Economic Forum.

Investments in infrastructure can lead to significant job creation. According to the World Bank, every US\$1 billion invested in infrastructure has the potential to generate, on average, around 110,000 infrastructure-related jobs in oil-importing countries in the Middle East and North Africa (Freund and Ianchovichina 2012). According to data from the World Bank Enterprise Survey, electricity is the second biggest obstacle to private sector firms in Lebanon, after political instability.

Broadband Networks. Lebanon’s weak broadband networks and services also constrain growth and private sector activity. Recent studies estimate that a 10 percent increase in broadband penetration increases economic growth between 0.24 to 1.50 percentage points and employment around 10 percent (Beardsley et al. 2010; Czernich et al. 2009; Katz 2010; Qiang, Rossotto, and Kimura 2009). The jobs created would be both

skilled and unskilled. Direct jobs relate predominantly to civil works and broadband infrastructure, which employ mainly unskilled workers. Indirect and induced jobs can be both unskilled and skilled, but most are high skill. The potential to develop new services in intermediary sectors, such as e-banking or e-health, and new industries, such as export-oriented information technology-enabled services, opens the door to multiple private sector-led job opportunities. The rise of mobile applications businesses and the fragmentation and delocalization of global employment through crowdsourcing are opening multiple opportunities for persons connected through broadband to these new platforms. If Lebanese workers and the economy are not connected to these new opportunities, Lebanon will likely face severe constraints in the future, especially as it aspires to move to high-income status. Box 3.1 provides more details on recent reforms in the sector and its outstanding constraints.

Electricity. The electricity sector is a striking example of an underperforming sector that negatively affects Lebanon’s macroeconomic situation, economic growth, and households. First, fiscal transfers to the vertically integrated public utility, Electricité du Liban, account for a large part of the country’s public debt. Second, electricity is a binding constraint on Lebanon’s competitiveness and ease of doing business. And third, many consumers are willing to pay significantly more for good-quality electricity service and own private generators to ensure that they do.

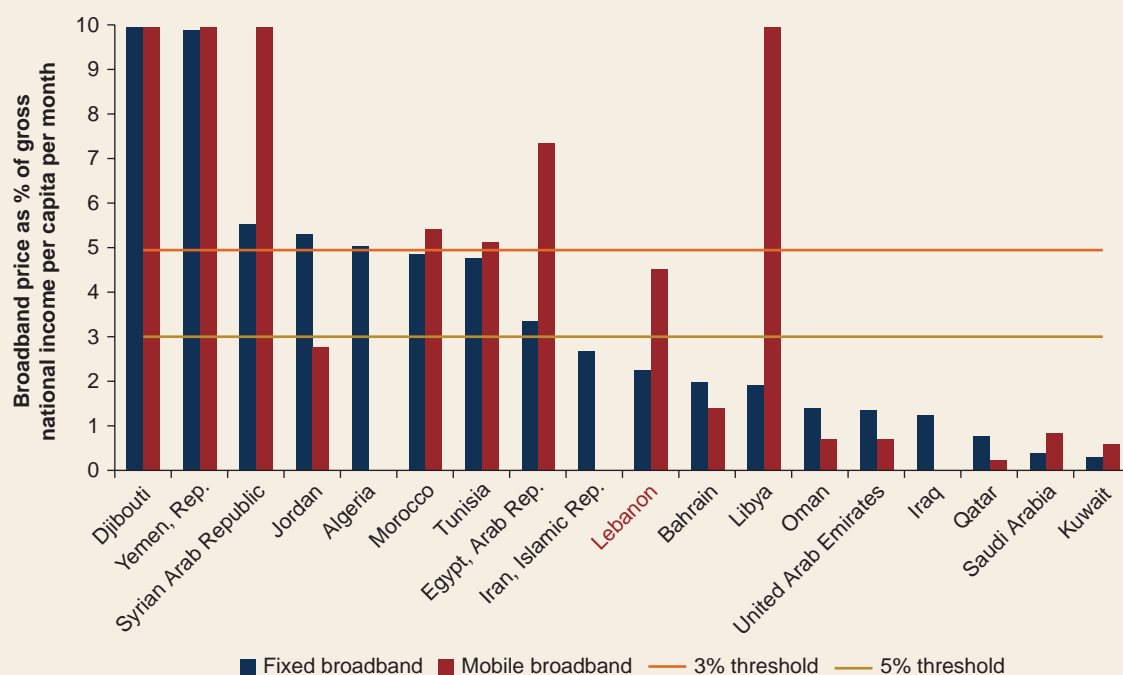
The burden on consumers is inequitable: poor regions go without public electricity for 12–13 hours every day, while richer ones, such as Beirut, are subject to 3 hours of daily blackouts. Political and confessional cleavages have blocked reforms that have been on the table for more than 30 years. This has allowed EdL to keep underperforming, with high noncommercial losses, and low billing and collection rates. This is partly due to its inability to recover costs given a freeze on tariffs, which has been in place for more than 20 years. Box 3.2 presents more details on the situation of the electricity sector.

BOX 3.1 Performance of the Information and Communication Technology Sector in Lebanon

Since 2011, the government has taken a more active role in strengthening the supportive infrastructure of the information and communication technology (ICT) sector, but has not tackled the main issues in the sector, including lack of competition, and insufficient private participation. The insufficient focus on policy and regulatory reform has been only partially compensated by government investments in telecommunications infrastructure. These investments have extended the coverage of mobile and broadband services and lowered prices. In 2014 mobile penetration reached almost 100 percent of the population, and mobile broadband reached almost 50 percent (mostly through 3G service). Prices for fixed broadband have fallen significantly, and today they are in line with the regional average of US\$22 per month (price data from December 2012; see Gelvanovska, Rogy, and Rossotto 2014). However, fixed broadband has limited coverage, and mobile broadband costs US\$55 per month, on average, which is above the regional monthly average of US\$44, making mobile broadband unaffordable for many (figure B3.1.1). The quality of connections and access to high speeds are problematic, particularly for businesses. Ultra-Fast Broadband (for example connections above 20 Mbps) is not common in Lebanon. Coupled with uncertain electricity, access to quality broadband remains a key infrastructure concern for entrepreneurs.

Government actions have extended coverage and lowered prices. However, the sector relies on government action and investment to improve coverage and services to meet the growing demand. Without the introduction of private sector-led investment and competition, the sector will not be able to continue upgrading infrastructure, extending coverage, and reducing prices. In the long term, this inability is likely to stifle the productivity of firms and the economy. High broadband costs and low quality will also have an impact on technology entrepreneurship, an area that has the potential to create new business opportunities and jobs for youth.

FIGURE B3.1.1 Fixed and Mobile Broadband Prices in Lebanon and Countries in the Middle East and North Africa Region, 2012



Source: Gelvanovska, Rogy, and Rossotto 2014.

Note: For West Bank and Gaza, data are not available; values for Djibouti, fixed broadband: 22.1 percent; for Libya, mobile: 32.4 percent and fixed broadband: 77.2 percent; for the Republic of Yemen: 10.0 percent; for Syria, mobile broadband: 13.8 percent.

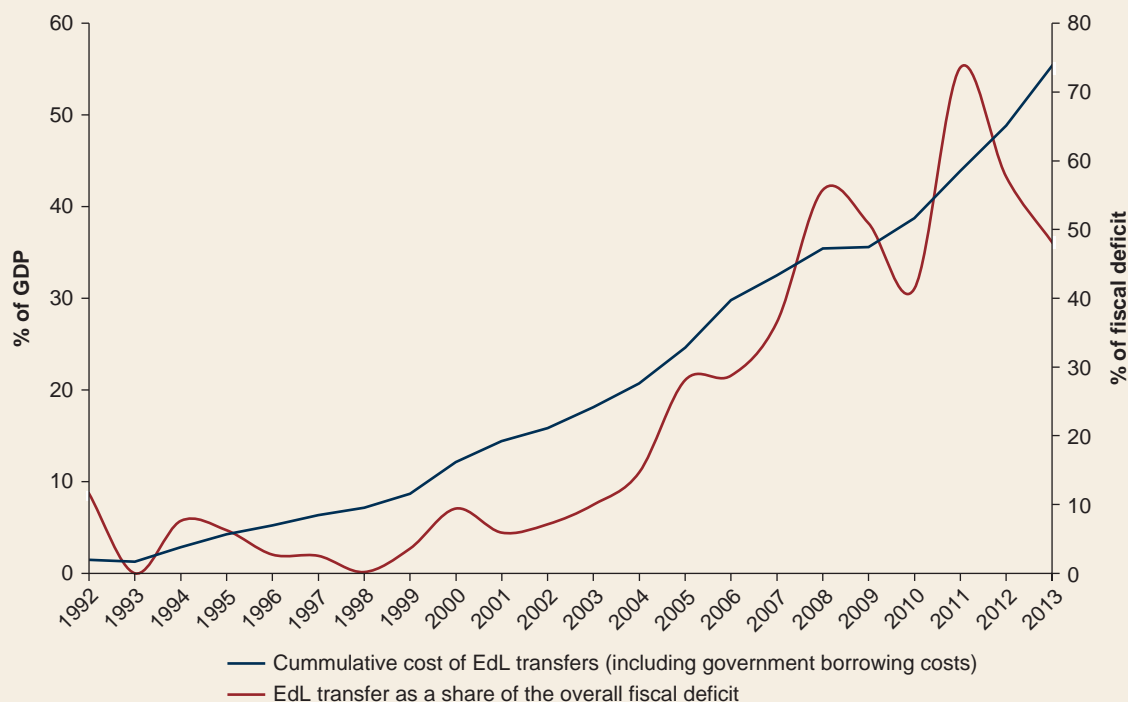
BOX 3.2 EdL: The Poster Child of Confessionally Induced Waste in Public Spending That Plagues Public Finances, Businesses, and Households since 1981

The staggering recurrent transfers to Electricité du Liban, the national electricity company, illustrate the perennial structural issues that escalate over time as political consensus for reform is lacking. EdL dominates electricity supply in Lebanon. The company is a vertically integrated utility. By itself the company is a major source of macroeconomic vulnerability for the country given the large drain on public finances it has generated over time, and that it continues to impose. However, given the sector's highly politicized/confessionalized nature, reforms have not materialized.^a

The EdL's drag on public finances is staggering. The company accounts for about 40 percent of Lebanon's public debt and is escalating rapidly (figure B3.2.1). Transfers to the EdL averaged 2.3 percent of GDP from 1992 to 2013 and 4.4 percent from 2006 to 2013, or 55 percent of the country's fiscal deficit (figure B3.2.1). Since 2012, transfers to the EdL have exceeded US\$2 billion per year. As the overall fiscal balance has been in deficit since 1992, transfers to the EdL have been effectively paid through borrowing. Using the rolling average effective interest rate on public debt since 1992 to price that borrowing cost, one finds that the cumulative cost of EdL transfers from 1992 to 2013 is a staggering 55.4 percent of 2013 GDP. With Lebanon's public debt-to-GDP ratio at 143.1 percent, almost 40 percent of Lebanon's total public debt can be attributed to EdL. Alternatively, Lebanon's debt-to-GDP ratio would have been 87.8 percent instead of 143.1 percent if EdL had not been loss making.

EdL's financial losses, their sources, and their solutions have long been known (for example World Bank 1983), but have not been addressed. They became substantial in 1981, as the number of illegal connections and unbilled consumers rose. With normal power line losses at about 12 percent, only about 54 percent of the energy generated and purchased by EdL was billed to consumers. These losses arose

FIGURE B3.2.1 Cumulative Cost of Transfers to EdL, 1992–2013



Source: Ministry of Finance data.

BOX 3.2 EdL: The Poster Child of Confessionally Induced Waste in Public Spending That Plagues Public Finances, Businesses, and Households since 1981 *(continued)*

despite a government subsidy on the ex-refinery price paid by EdL that, in 1982, was equivalent to 29 and 20 percent of fuel oil and gas oil refinery prices, respectively.

At that time, the World Bank (1983) recommended that the government (a) urgently discuss the problem of illegal connections and excessively overdue accounts with EdL, (b) set up practical measures to help EdL to restore normal conditions in the sale of electricity, and (c) discuss with EdL its operating costs and financial requirements, and the extent of tariff increase necessary to enable EdL to pay for its current oil purchases, meet its debt service, and break even on its operating account.

Despite EdL's large and subsidized budget, the power supply remains inconsistent for 92 percent of households, who need to be linked to private generators. The revenues of private generators are estimated at US\$1.7 billion or 4 percent of GDP (Roberts 2013). The poor quality of service delivered can be attributed to corruption, mismanagement, and the confessional system, in which sectarian leaders protect segments of the supporting infrastructure (workers, service providers).

Aside from significant but longstanding operational inefficiencies, the government's tariff policy has further compounded EdL's losses and its reliance on budgetary transfers. A large portion of budgetary transfers to EdL can be attributed to a nominal freeze in place since 1996 which caps EdL's tariffs at a level derived from an average oil price of US\$23 per barrel—far below cost recovery levels. Also contributing to low revenue are very high production costs, including the cost to operate and maintain power plants due to insufficient regular maintenance, aging assets, and high technical losses.

The failures of the electricity sector also widen inequality in the country (World Bank 2009c): (a) consumers who are not billed are cross-subsidized by taxpayers and EdL customers who pay their bills; (b) consumers who suffer from electricity blackouts must use higher-cost alternatives (private generators for the rich, candles for the poor); and (c) electricity rationing favors the rich at the expense of the poor. Poor regions go without public electricity for 12–13 hours every day, while richer ones such as Beirut are subject to 3 hours of daily blackouts. Despite this major constraint on daily life and livelihood, Government is more apt to equalize the benefits that each confessional group receives than to encourage needs-based service delivery that favors the poor.^a For example, in the early 1990s, seven sites were identified as suitable for a thermal power plant because each community insisted “on having its own power plant, ... and subsequently the government launched the construction of two hardly justifiable plants in Tyre and Baalbeck” (Nahas 2008).

Consumers are willing to pay significantly more to have high-quality electricity supply. More than half of respondents to a Social and Impact Assessment Survey said that they would be willing to pay double their current budget in return for 24-hour service (World Bank 2009c). According to this same study, the share of electricity expenditures (EdL and private sector) in household budgets is relatively low, even for the lowest income quintiles. Even relatively high tariff increases across the board would not lead household expenditures to exceed international norms for any quintile. The impact on the poor and less well-off consumers would, however, need to be assessed carefully and compensated if needed.

The poor quality of electricity supply hurts economic activity. Development and cost-efficient investment in energy systems is correlated with GDP growth. When electricity supply is frequently interrupted or prohibitively expensive, economic growth slows down or even contracts. Electricity ranks as a key binding constraint to doing business in Lebanon. Lebanon has the second worst quality of electricity supply in the world (2014–15 World Economic Forum's Global Competitiveness Index). Similarly, according to the World Bank's 2013/14 Enterprise Survey, 55.1 percent of Lebanese firms identify electricity as a major constraint to their business operations and competitiveness.

a. For example, in 2012, attempts by EdL to outsource its distribution retail services to private service providers met with strong and sometimes violent resistance from a highly factionalized workforce. The divisions within EdL's workforce are a direct result of Lebanon's confessional approach to governance and public employment, and highlight the constraints on rational management decision making within a confessional system.

Transportation. Lebanon's poor transport infrastructure and cumbersome procedures hinder trade and competitiveness. The World Bank's logistics performance index, which benchmarks countries' performance on trade logistics, reveals that import and export costs in Lebanon are relatively high. While Lebanon's cost of domestic exports via its ports and airport is relatively low compared to the regional average and that of upper-middle-income countries, mostly due to short distances within Lebanon, the cost is significantly higher for both land-based exports and exports via its ports and airport to the region. This places Lebanon at a large disadvantage as a trade hub for the region, a role it played successfully in the past.

The major impediments to logistics in Lebanon are weak infrastructure and cumbersome procedures. This is in contrast to the important role that transportation plays in the economy: the transport and telecommunication service sector employs about 7 percent of Lebanon's working population (mostly in transport). From the perspective of job creation, the sector is particularly important to the poor both because service providers and employees tend to come from less well-off households (for example, truck drivers, taxi drivers, and microbus owners and drivers) and because the labor-intensive construction of transport infrastructure employs primarily poor and unskilled labor.

Poor transportation impedes private sector development and access to markets in lagging regions. This results in high monetary and non-monetary costs for both households and businesses. Lebanon ranks 120 out of 144 countries on road quality. Lebanon's road network, while substantial at 22,000 square kilometers, is in poor overall condition.⁶ Traffic congestion is rife in the Greater Beirut area, as the transport system is underdeveloped compared to that in most cities in the region. Further, the road network has not expanded significantly since the 1960s, all north-south traffic has to pass through Beirut's central streets, there is no mass transit system in Beirut, and there are no reliable public transport systems.⁷ Compounding the lack of

reliable public transportation is the relatively high cost of vehicle ownership: import dues on vehicles can exceed 50 percent of a vehicle's value, higher than in most countries, while gasoline is (correctly) not subsidized, as it is in most other countries in the region. All of these result in lower well-being and less connectivity, while they push up accident rates and economic and financial costs, with detrimental impacts on economic growth and inclusion.

Spending on transportation represents about 15 percent of household expenditure, which is disproportionately high compared with shares in other countries, while waste and inefficiencies related to urban congestion cost the economy no less than 4–5 percent of national GDP a year (Ministry of Environment 2011). These high costs are significant: as a trade and service-oriented economy, Lebanon depends heavily on its transport system for moving people (tourism and airlines) and goods (trade and transit business).

High transport costs disproportionately affect the poor. The inefficient and costly transport sector is creating increased disparities between Beirut and the regions. Economic activity is centered in Beirut, and poor transportation is contributing to that, as industries and services are induced to relocate to Beirut to be closer to demand and population. Poor road quality is a trademark of underdeveloped regions in Lebanon, due to their relatively weak political leverage. The rural poor cannot afford housing in Beirut, and the commute to Beirut is both expensive and time-consuming, despite the short distances. The lack of a reliable public transport system requires the urban poor to travel on outdated, overcrowded, and unsafe buses and microvans. While it is difficult to quantify the cost of deteriorating roads, particularly rural roads, on the economy and lower-income groups due to the lack of data, there is widespread evidence in other countries that rural road rehabilitation programs dramatically improve rural incomes.⁸

Lebanon's very poor record of road safety represents another major drain on the economy. Weak road safety management, including

poor-quality road infrastructure, together with bad behavior and lack of enforcement, has had a detrimental effect on road safety in Lebanon. In 2012, traffic police reported 595 fatalities, while the Red Cross registered 6,700 injuries. These figures are widely considered to be underreported, and the World Health Organization estimates the number of fatalities at 950 (WHO 2013). According to the World Bank (2013i), the economic cost of traffic fatalities and injuries in Lebanon is equivalent to 5.5 percent of national GDP, higher than in most other countries in the region.

Water and Wastewater. Water supply services are below the levels expected in a middle-income country, with significant ramifications for the poor in particular.² Despite relatively high water endowment per capita, Lebanon uses more than 66 percent of its water resources in a largely unsustainable manner. Agriculture consumes more than 60 percent of available water and employs 20 percent of the labor force, many of whom are poor, but only contributes an average of 6 percent per year to GDP. Seasonal mismatch between water supply (peaking in the rainy winters) and water demand (peaking in the hot, dry summers) is exacerbated by the very low water storage capacity,¹⁰ deficient water supply networks, and fast-rising demand from municipal and industrial sectors. A poorly sequenced investment program and absence of a viable business model for wastewater mean that 92 percent of Lebanon's sewage runs untreated into watercourses and the sea. Responsibility for irrigation has not been transferred to regional water establishments as planned, and proposals to decentralize management to water user associations and increase cost recovery have not been implemented. More than half of the irrigation schemes lack adequate operation and maintenance. Returns to water are low, and the country is missing opportunities to increase production and trade in high-value crops.

Land and Housing. Dysfunctional land and housing sectors disproportionately affect the poor.

Housing affordability is an issue of particular concern for low- and middle-income groups in Lebanon. The ratio of house price to income is 9, almost double the typical ratio in an Organisation for Economic Co-operation and Development (OECD) country, which is less than 5 (UN-Habitat 2011; World Bank 2011c). The average cost per square meter for an apartment in Beirut was about US\$4,200–US\$6,800 in 2011, approximately two to four times the cost of an apartment in the capital cities of other Mashreq and Maghreb countries. Socioeconomic segregation is substantial, and mixed-income housing is minimal.

Dysfunctional land markets and land policies affect the poor directly and through the constraints they impose on firms. Key challenges include ineffective means for servicing land, and insufficient and ineffective land taxation. The new (and controversial) rent law passed in April 2014 to remove old rents is likely to affect about 200,000 apartments, mainly in Beirut. Such legislation runs the risks of (a) displacing low- and middle-income groups, who will find it difficult to obtain affordable housing, a problem that is compounded by the presence of 1.1 million displaced Syrians; (b) inducing major demographic changes in different parts of Lebanon and in the socioeconomic profile of Beirut, leading to increased gentrification; and (c) destroying Lebanon's cultural heritage, as lucrative high-density buildings are constructed in the core of historic districts.

Weak and Deteriorating Institutions and Governance

Poor governance and weak institutions exacerbate the challenges posed by Lebanon's confessional system.¹¹ Institutions in Lebanon are characterized both by inefficiency and corruption and by a governance trap in which political stability is maintained through subordination of national prerogatives to consensus among sectarian interests at the cost of strong institutions focused on the public good. In this configuration, Banque du Liban stands out as an effective

and respected institution, because its considerable powers are legally ring-fenced, keeping it financially independent of the government.

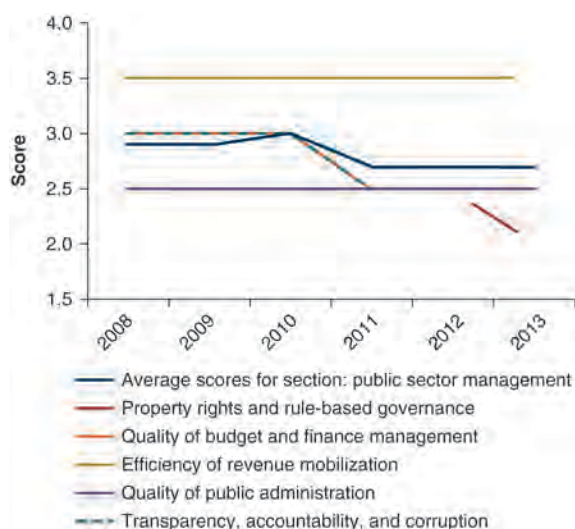
Governance. Lebanon scores poorly on many aggregate indicators of governance, and its performance is not only below the regional average, but also has declined significantly over the past decade, as figure 3.9 shows. According to the global competitiveness index, institutions are the third weakest comparative constraint of the country, and although the gap between Lebanon and comparator countries is not as large as with infrastructure and the macroeconomic environment, it is nonetheless substantial. Lebanon's institutions rank 139 out of 144 countries. In 15 of 21 institutional subindicators, Lebanon ranks among the 10 percent worst countries in the world (71 percent). Of 144 countries, Lebanon's worst rankings are for public trust in politicians (144), wastefulness of government spending (143), favoritism in decisions of government officials (142), irregular payment of bribes (142), business cost of terrorism (140), efficiency of legal framework in challenging regulations (139), intellectual property protection (139), judicial

independence (138), transparency of government policy making (138), and diversion of public funds (137). These weaknesses are also reflected in polls of Lebanese citizens. In a 2013 Gallup World Poll, Lebanese reported low confidence in (a) their national government (37 percent) and the judiciary, (b) the honesty of elections (15 percent), and (c) the honesty of government—that is, lack of corruption (4 percent).

Aggregate indicators of governance, however, hide significant heterogeneity in institutional performance. Public services do not reach all citizens in the same way and with the same quality, as both the Enterprise Survey of the Informal Sector and the Institutional Profile Database report. These differences are significant across cities and between urban and rural areas (figure 3.10). The quality of public policy making and of service delivery, which was weak to start with, has deteriorated markedly since 2006 (figure 3.11).

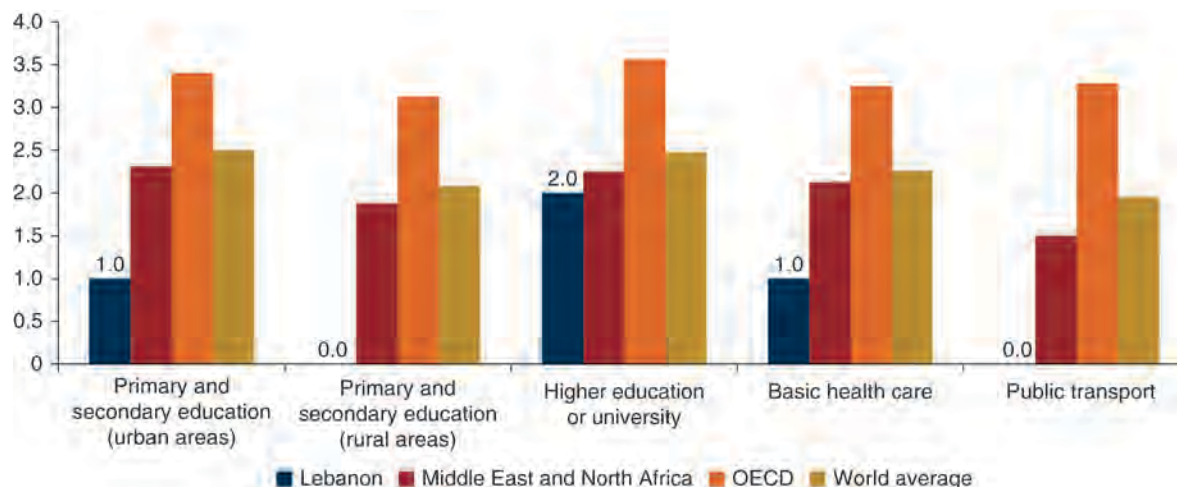
Judicial System. The judicial system is slow, costly, and corrupt, which increases transaction costs for enterprises. Contract enforcement is slow and costly, with high costs associated with legal fees. Lebanon has the slowest contract enforcement in the Middle East and North Africa region, taking more than 700 days, on average, to enforce a standard contract. Predictability of rules and regulations is generally deficient, partly as judges lack access to legal information and training, so that dispute resolution tends to be inconsistent (World Bank 2005b). Despite some reforms, corruption remains a serious problem in the judicial sector, particularly with court administration staff. The fairness and independence of the judiciary have been called into question as a result of the extension of the confessional system to judicial appointments. Predictability also suffers from the poor quality of legislative drafting and review, which is at least partly due to the lack of resources available to the legislative drafting unit of the Ministry of Justice. Judges, lawyers, and government officials have noted that improperly drafted legislation too often

FIGURE 3.9 Quality of Lebanese Public Finance Institutions, 2008–13



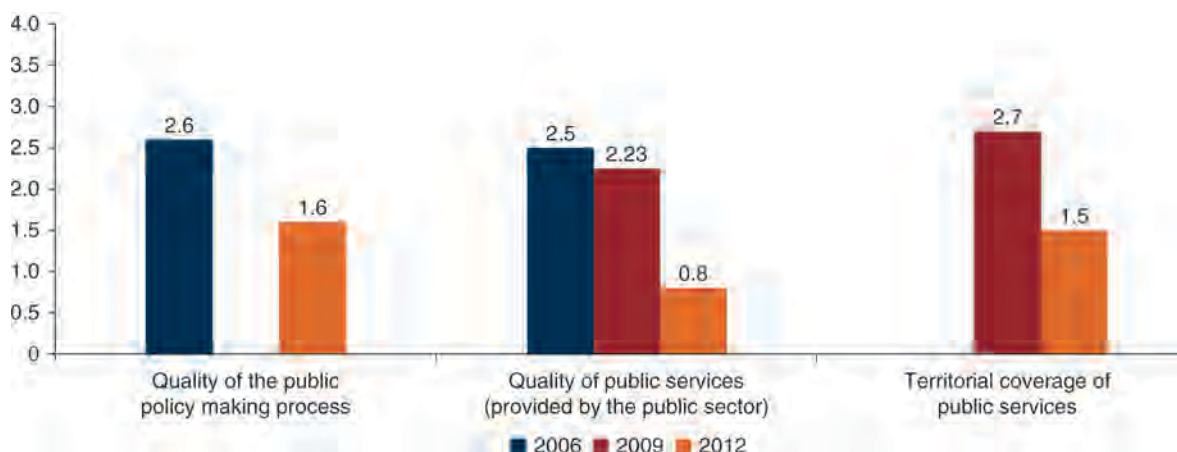
Source: 2008–13 World Bank country policy and institutional assessment.

FIGURE 3.10 Quality and Spatial Inequality in Delivery of Public Services in Lebanon and Comparator Regions, 2012



Source: 2012 Institutional Profiles Database.

FIGURE 3.11 Quality of Public Policy Making and Service Delivery in Lebanon, 2006–2012



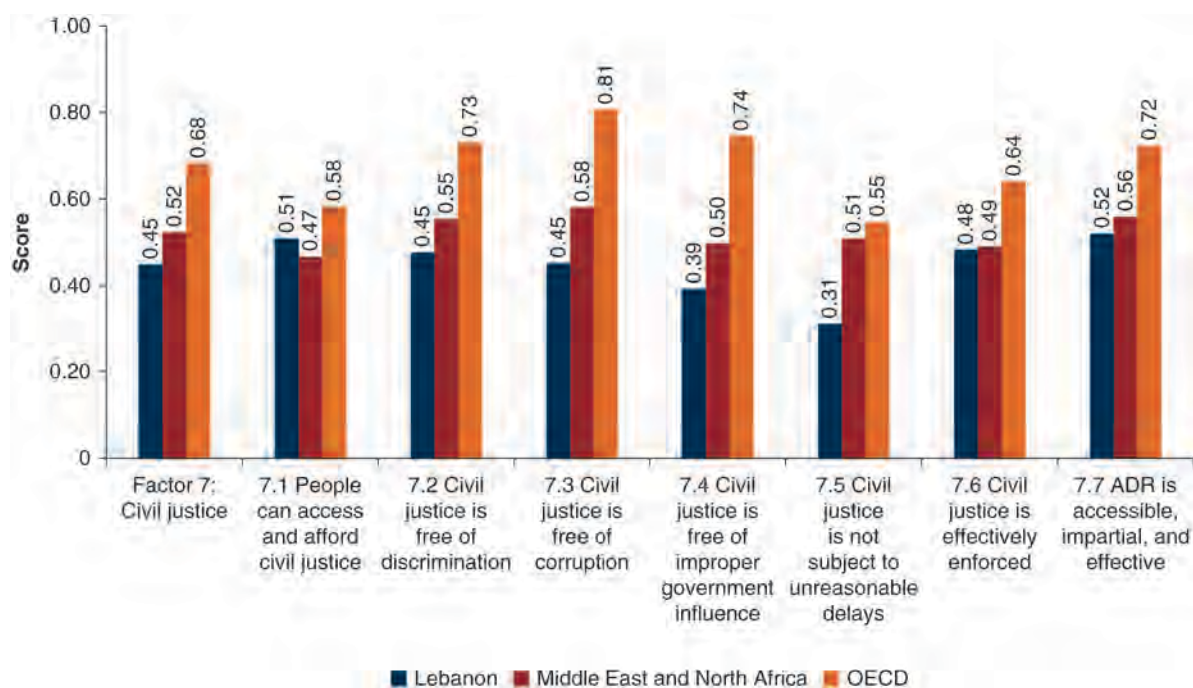
Source: 2012 Institutional Profiles Database.

results in uncertainty as to whether new laws supplement, amend, or replace existing laws, prompting the need for frequent amendments and obscuring the meaning of the law for the public. This increases the transaction costs of businesses. Enforcement of judicial decisions can also be problematic (figures 3.12 and 3.13).

A significant gap exists between the *de jure* dimensions of governance and the *de facto* implementation of laws and regulations, leading to a culture of weak accountability and impunity.

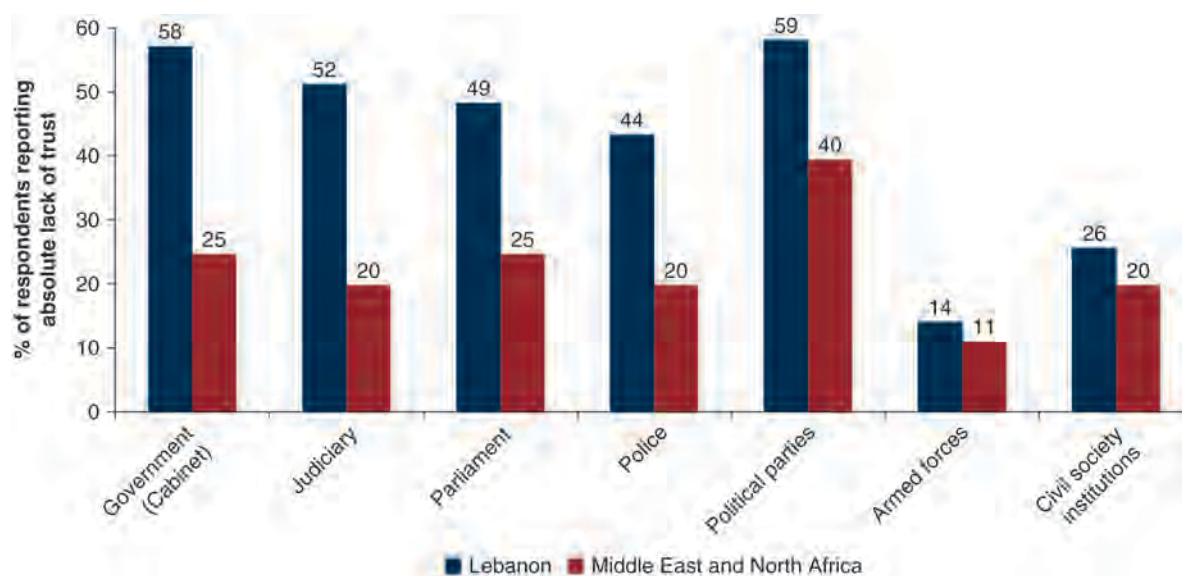
Long and repeated periods of caretaker governments have eroded accountability. A large and growing number of senior positions in the administration remain vacant due to deadlock on hiring based on confession, exacerbating unclear lines of accountability. Regulations governing income and asset disclosure are weak, as are conflict of interest regulations. Lebanon has no proper freedom of information framework, including relevant legislation and regulations.¹² Information on public affairs,

FIGURE 3.12 Perception of Civil Justice in Lebanon and Comparator Regions, 2014



Source: World Justice Project.

FIGURE 3.13 Trust in Key Public Institutions in Lebanon and the Middle East and North Africa Region, 2010–11



Source: 2010–11 Arab Barometer Surveys.

including budgetary information, is difficult to obtain. Boundaries between the public and private sector persona of policy makers are ill-defined. Most high-ranking politicians and policy makers are connected to major financial and real estate interests, either directly or through their close relatives. Monopolies linked to politicians hinder competition and create obstacles for the entry of new firms.

Civil Service. The management of civil servants is profoundly tainted by favoritism and nepotism. Political orientation rather than experience and skills appear to be the key factor influencing decisions regarding the hiring of civil servants. These factors play a more significant role in Lebanon than in any other country in the region, and their importance has increased markedly over the past few years. These public sector jobs are sought after because they offer income security and benefits for those who are able to obtain them.

Local governments have historically been disempowered, and there has been limited upward and downward accountability of them. Lebanese local governments have limited mandate and financing. This is reflected in the low share of public expenditure executed by local governments—for example, 6 percent in 2007 relative to an average of 20 percent in countries with unitary governments around the world (World Bank 2007a). Furthermore, central government transfers to local governments are irregular and often delayed, constraining the ability of local governments to invest in and sustain good-quality services and infrastructure. Mechanisms for upward and downward accountability are limited. There is limited measurement and transparency regarding the performance of local governments.

Public Procurement System. The public procurement system is weak, resulting in poor accountability and widespread rent-seeking (World Bank 2005a). Lebanon has systematically been ranked on the lower spectrum of Transparency International's surveys regarding governance, ranking 136 out of 175 countries

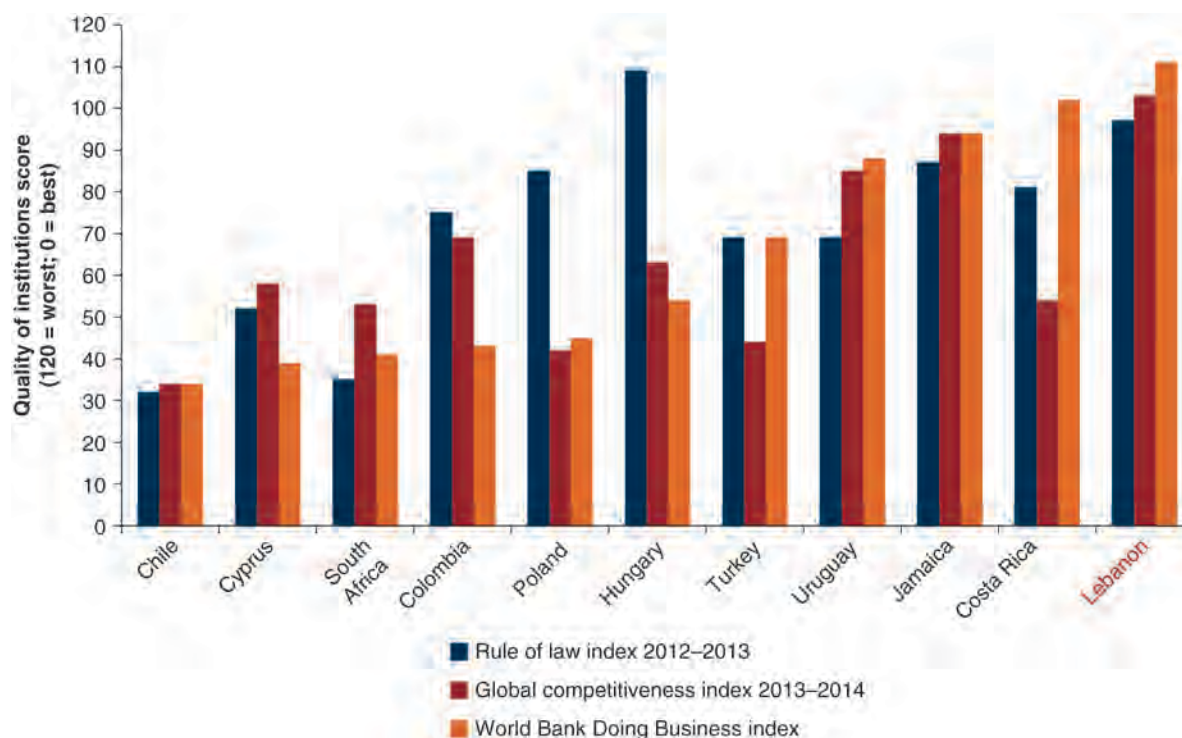
in 2014 (figures 3.14 and 3.15). Improved public governance implies improved public accountability and quality of administration as well as efforts to address bribery and corruption. A major area for improvement is the need to establish government procurement policies that are transparent and open to a wide range of bidders, including SMEs. For example, a modern public procurement law, including the possibility of e-procurement, would reduce the cost of delivering goods and services and combat corruption and bribery that are rampant in the private and public sectors. Systematic corruption has added materially to the cost of public procurement.

Control of corruption in public procurement is weak. At 22 percent in 2010 according to Transparency International, Lebanon ranks 15 out of 18 countries in the Middle East and North Africa region (ahead of Iraq, Libya, the Republic of Yemen, and Syria). Further the quality of goods and services fails to meet the required standards. Major public procurement impediments include (a) lack of a comprehensive public procurement law; (b) a weak control environment that does not enforce the implementation of rules and guidelines; (c) lack of private sector international competition; (d) weak human resource capacity and training, coupled with the perception that procurement is not a profession; (e) lack of a mechanism for lodging complaints regarding institutional procurement; and (f) lack of procurement performance information or data.

Uneven Human Capital and Skills Mismatch

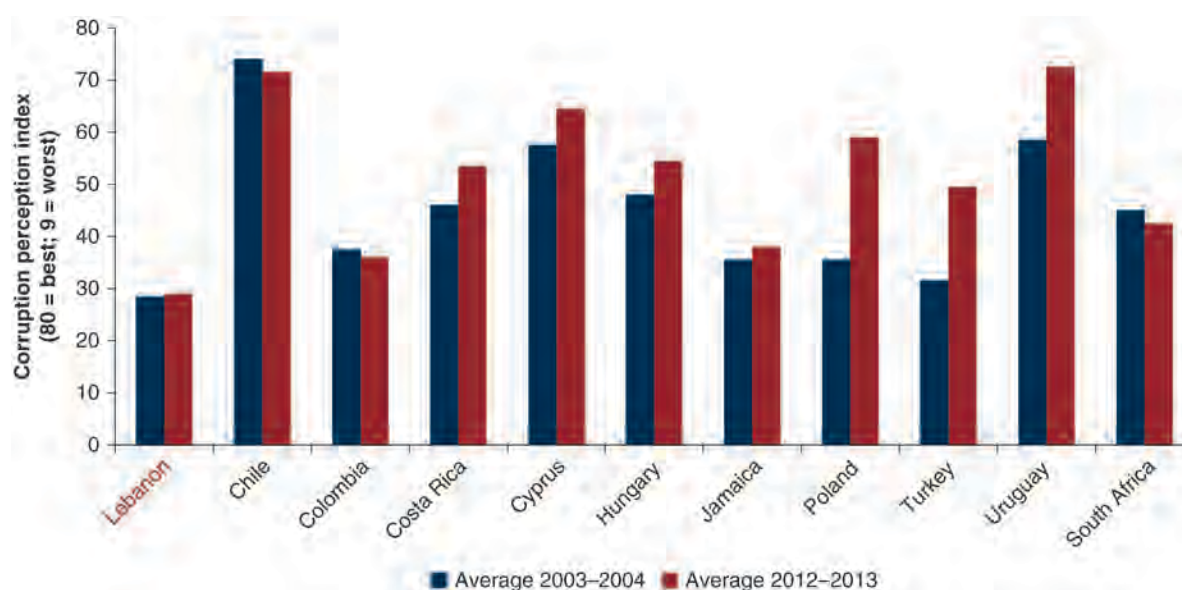
As revealed by the World Bank's inequality-adjusted 2013 human development index, Lebanon performs relatively well in terms of human capital, but faces large inequality of opportunities and outcomes among its citizens.¹³ Opportunities are more a function of confessional polity and *wasta* (influence, often accompanied by economic payment) than meritocracy. Nearly 80 percent of the respondents to the 2013 Arab Barometer Survey agreed that obtaining

FIGURE 3.14 Ranking on Quality of Institutions in Lebanon and Comparator Countries, Various Years



Source: World Bank and World Economic Forum.

FIGURE 3.15 Ranking on Corruption in Lebanon and Comparative Countries, 2003–04 and 2012–13



Source: Transparency International.

employment through connections is extremely widespread, compared to the regional average of 60 percent. More than 70 percent of respondents cited the applicant's tribe or political orientation as more important than personal qualifications in obtaining employment in the public sector, compared with 40 percent across the region. Both figures are the highest percentages in the region.

The structural inequalities created by the confessional system of government are also evident in the social services. Although social spending in Lebanon has been historically high (with more than 70 percent coming from the private sector), investment expenditure has not matched the geographic distribution of poverty (table 3.2), and the privatization of service delivery has resulted in exorbitant costs, which have disproportionately affected the poor (Sen and Mehio-Sibai 2004). The substitution of welfare support and direct delivery of social services by confessional organizations, while largely beneficial for the most vulnerable populations,¹⁴ have further weakened the ability of the state to deliver, regulate, and improve the quality of social services.

Inequality in Lebanon is particularly stark in income and in education, but is less pronounced in health (with losses of 30.0, 24.1, and 6.7 percent, respectively, compared to the non-inequality-adjusted human development index). In part this arises from the weakness of the state in delivering high-quality public services—a

difficulty that is compounded in poorer regions of the country (figures 3.16 and 3.17). With low rates of return on skilled human capital at home, Lebanon is facing severe difficulties in attracting and retaining talent (according to the World Economic Forum's human capital index, Lebanon scored 99 and 97, respectively, out of 122 countries, and 43.9 percent of tertiary-educated persons emigrate from Lebanon). These factors are affecting the country's development prospects, as skilled labor is difficult to find, and many Lebanese do not reach their full human potential.

A particular challenge is to reduce the skills mismatch with private sector needs as postsecondary schools need to address skills for ICT, tourism, health care, and construction. This mismatch is also undermining Lebanon's poverty reduction and social and economic inclusion efforts, as social-economic mobility is difficult for individuals born to low-skilled parents.

The Syrian crisis and the associated influx of refugees has severely stressed access to and quality of public services in Lebanon, especially related to human capital (World Bank 2013c). The government's cost to meet additional demands for health, education, and social safety nets in 2012–14 is estimated at US\$308 million to US\$340 million (excluding demand that is being met through international humanitarian assistance). In the health sector, the influx of refugees has significantly increased demand for

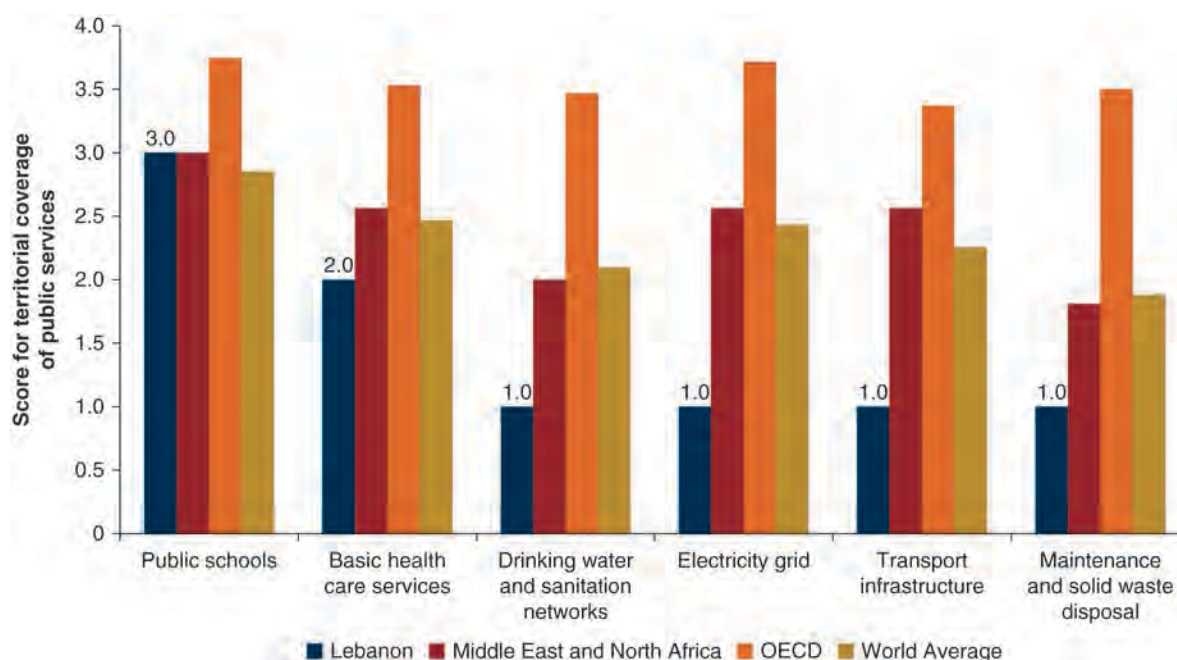
TABLE 3.2 Public Expenditure, Poverty, and Basic Needs in Lebanon, by Region, Various Years

% unless otherwise noted

Mohafaza	Total public investment expenditure, 1995–2005 (US\$, millions)	Poverty incidence, 2004	Allocation of public investment expenditure	Distribution of low satisfaction of basic needs, 1995	Distribution of poverty, 2004
Beirut	734	5.85	16	8	2
Mount Lebanon	1,111	19.56	25	30	27
North Lebanon	1,415	52.57	32	26	38
Bekaa	247	29.36	6	15	13
South Lebanon	918	42.21	21	10	16
Nabatieh	42	52.57	1	11	4
Total	4,467	28.55	100	100	100

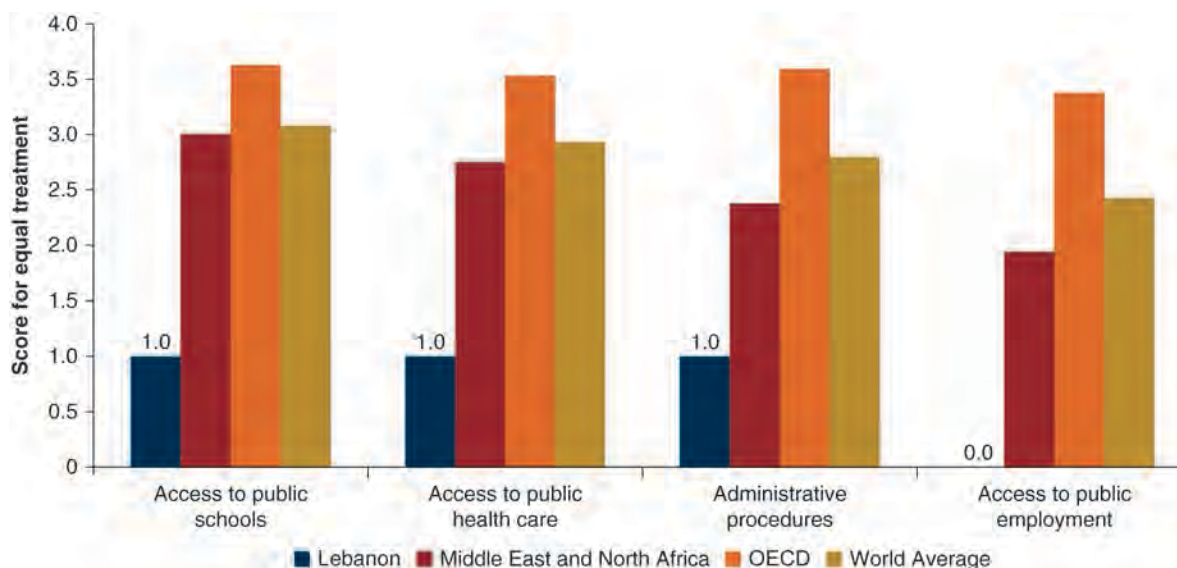
Source: UNDP 2009.

FIGURE 3.16 Geographic Coverage of Public Services in Lebanon, 2012



Source: 2012 Institutional Profiles Database.

FIGURE 3.17 Equal Access to Public Services in Lebanon, 2012



Source: 2012 Institutional Profiles Database.

health care services, creating shortages of health workers and placing financial pressure on hospitals, which the government has been unable to meet. Health care costs have risen sharply, resulting in significant welfare impacts on host

communities, who are less able to afford quality health care services. In the education sector, the influx of refugees has also resulted in mounting fiscal costs, diminished quality of public education, and greater need for informal, out of

school education. If not managed, the extra burden on the education system could lower the performance of Lebanese students. In both the health and education sectors, the crowding out of Lebanese host communities due to the large number of refugees is increasingly becoming a source of tension and undermining social cohesion and stability.

Education. Education in Lebanon is characterized by multiple adjacent systems, including public and private systems, functioning independently from each other. Public schools educate only about 31 percent of students, even though they are free and alternative options are expensive for the most part.¹⁵ The remaining students are in private schools (53 percent), in free private (and state-subsidized) schools, which are often confessionally-based (13 percent), or in schools for Palestinian students (3 percent). This revealed preference for nonpublic schools reflects the poor quality of public education¹⁶ and has large negative implications for the poor and their struggle to escape from poverty. Indeed, based on the 2004 Household Survey, poverty and education are highly correlated in Lebanon: the poor often attend lower-quality public schools, while the wealthy attend higher-quality private schools (UNDP 2008). The higher quality associated with private schools means that public school students are likely to learn less and face more difficult job prospects on graduation. This sets up intergenerational transmission of both lower learning levels and lower income. The education system in Lebanon, because of its strong stratified nature—along income and confessional lines—does not perform its civic mission of being the “glue” that binds citizens to the state.

Relative to other countries in the region, Lebanon’s adjusted primary net enrollment rates are slightly above average at 96 percent. However, secondary net enrollment lags behind at 67 percent, compared with the regional average of 72 percent. When compared with countries at similar levels of development, Lebanon’s secondary net enrollment rate is significantly lower than the average of 81 percent.

Health. Lebanon has relatively good health status, but, as with education, inequality regarding access to and quality of health services is high in terms of geography, income, and gender. For example, some regions (Bekaa and North Lebanon) have pockets of low socioeconomic and associated health status. Health inputs exhibit similarly stark geographic inequality.¹⁷ Service delivery is complex, with both public and private institutions as providers. The system is also inefficient and expensive, as public resources are allocated predominantly to curative care and pharmaceuticals, while primary care and generics receive limited resources (IGSPS 2012).

With only 50.1 percent of the population having health insurance, out-of-pocket expenditures are the largest source of health financing and are shared inequitably across households (World Bank 2013g).¹⁸ The obligation to pay directly for services is subjecting a large proportion of the population to financial hardship and even impoverishment. Data also suggest that catastrophic health expenditures vary significantly across regions. In the Nabatieh region, about 35 percent of households incur catastrophic health expenditures, while the national average is 7 percent.

The health system reflects the broader economic and political situation of the country in that different health payers and providers (Ministry of Public Health, the social security fund, and the various specialty fund holders) fall under different ministries or management responsibilities, making any attempts at national, comprehensive health sector reform very challenging. To improve Lebanon’s health system, increased accountability in the quality and delivery of public services and further strengthening of the regulatory system are critical. Among the main obstacles facing the sector and its ability to expand coverage are inadequate public spending on health and skewed spending on curative care compared to prevention and primary health care.

Social Safety Net. Lebanon’s social safety net system ranks among the weakest in the world (117 out of 122 according to the 2013 human capital index). Similar to the Middle East and

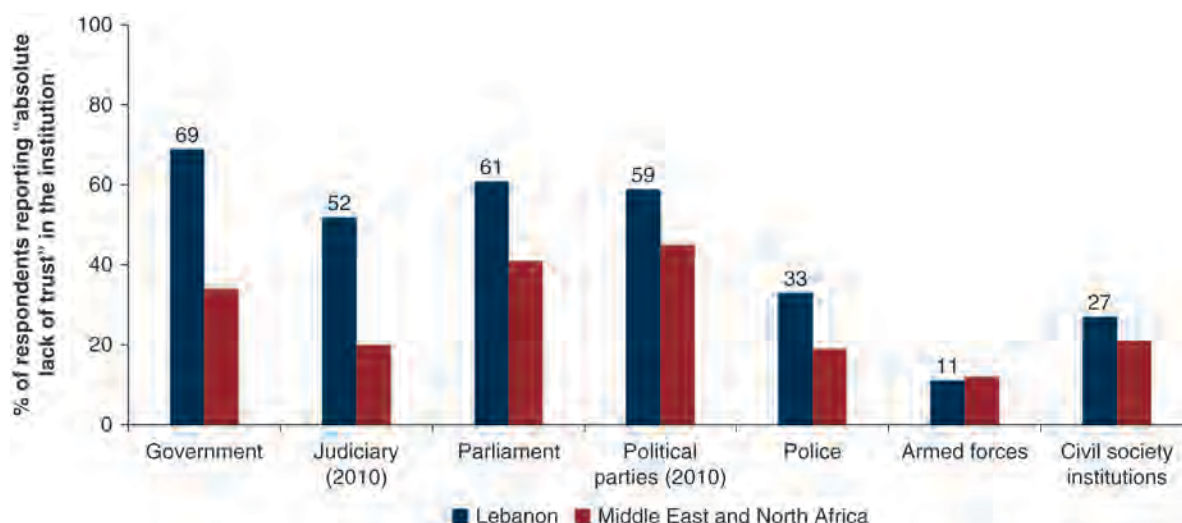
North Africa region, Lebanon suffers from key factors that hamper the effectiveness of social safety nets. First, it offers a multitude of small, fragmented, and poorly targeted programs that do not have a significant impact on poverty or address inequality because of their low coverage, high leakage, and limited benefit levels. Weak capacity of public institutions, coupled with lack of reliable and consistent data, also hampers program effectiveness. Second, the system relies primarily on inefficient and pro-rich universal subsidies, which crowd out more effective interventions. Fragmented and relying overwhelmingly on categorical and geographic targeting, Lebanon's social safety net spending without price subsidies did not exceed 1 percent of GDP in 2013,¹⁹ while price subsidies (diesel, bread, and domestic production of tobacco) accounted for a negligible 0.03 percent of GDP (World Bank 2013h).

The 1 percent of GDP spent on social safety nets in 2013 did not contribute to reducing poverty or addressing inequalities and proved to be weak in protecting vulnerable Lebanese. If electricity subsidies and, in particular, the transfers to Electricité du Liban are included, spending on social safety nets rises dramatically, reaching more than 5.6 percent of GDP. The electricity

subsidy is perceived as a social safety net for the poor, with a progressive tariff fixed in 1996. As electricity subsidies suffer from high leakage and offer small benefits to the poor, the program's efficiency as a social safety net is weak and should be replaced with better-targeted and more efficient programs (World Bank 2009c). The government's inability to provide adequate social safety nets diminishes citizen trust in the state (figure 3.18), while the absence of feedback mechanisms creates a disconnect between the government and the needs of citizens (figure 3.19).

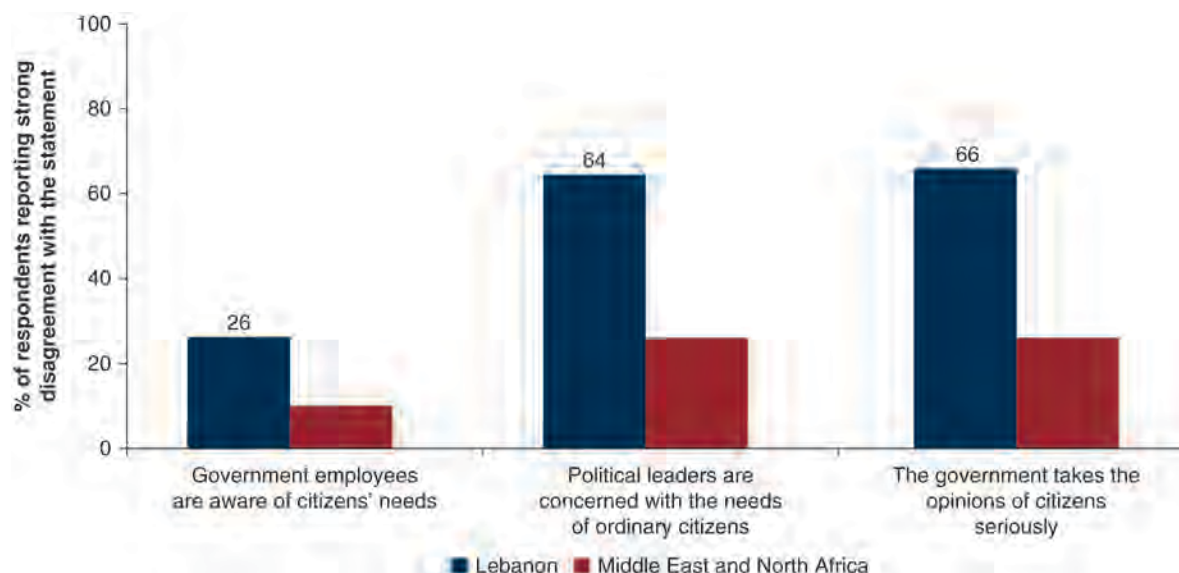
Gender Inequality. Gender inequality in Lebanon is particularly stark once political empowerment is taken into account.²⁰ According to World Economic Forum (2014), Lebanon is the world's eighth worse country in terms of gender equality, ranking 134 out of 142 countries²¹ surveyed, with a gender gap score of 0.592.²² This low score is driven mostly by the country's poor performance with regard to political empowerment (the global gender gap index measures the relative gap between women and men across four key areas: health and survival, educational attainment, economic participation, and political empowerment). According to this index, Lebanon ranks third to last in the region, where

FIGURE 3.18 Trust in Institutions in Lebanon and the Middle East and North Africa, 2013



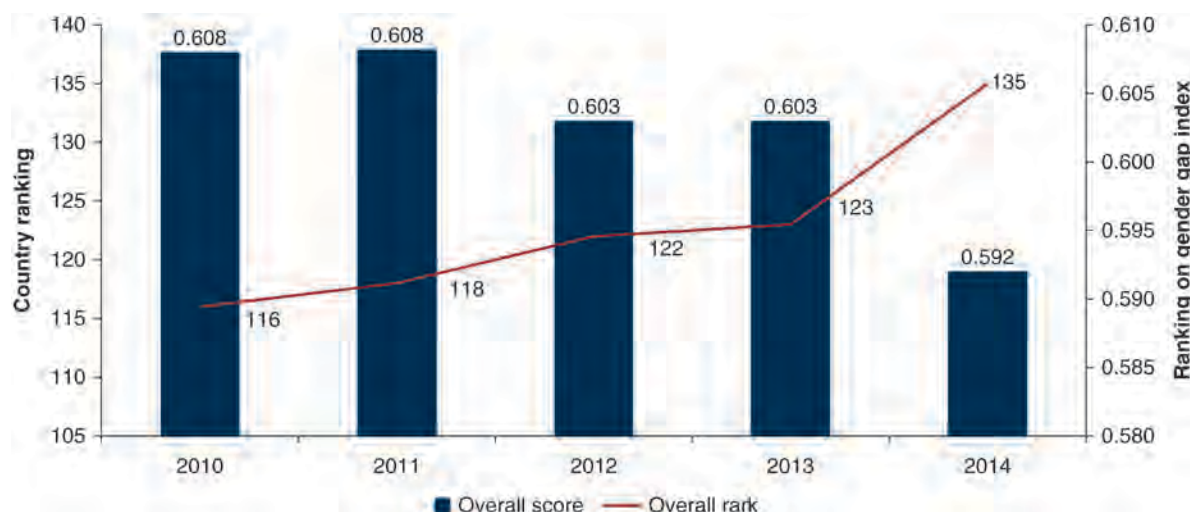
Source: 2013 Arab Barometer Survey.

FIGURE 3.19 Awareness of Citizens' Needs in Lebanon and the Middle East and North Africa, 2013



Source: 2013 Arab Barometer Survey.

FIGURE 3.20 Gender Inequality in Lebanon, 2010–14



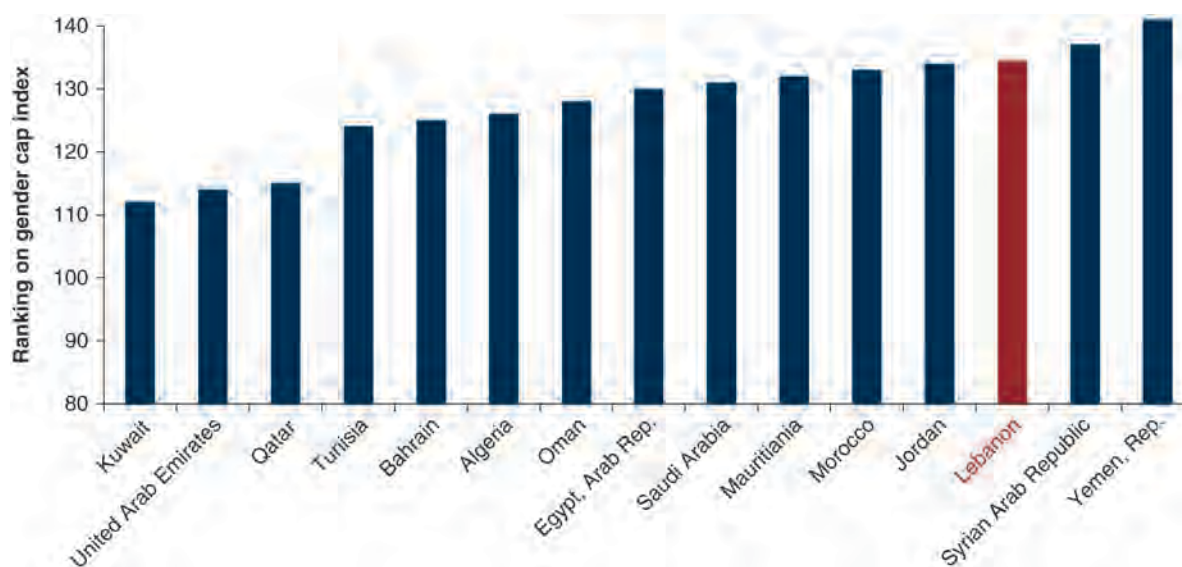
Source: World Economic Forum 2014.

only war-ridden Syria and the Republic of Yemen have a worse gender gap ranking of 139 and 142, respectively (figures 3.20 and 3.21). Notwithstanding the weak ranking, Lebanon's absolute scores are very similar to those of other countries in the region (the difference between Lebanon's score in 2013 and the fifth highest

score in the region does not exceed 0.01 point). Lebanon's global index ranking and relative gender gap score have fallen since 2010, primarily as a result of consistently close to zero scores in political empowerment (Figure 3.20).

Lebanon's gender inequality is among the lowest in the region with regard to economic

FIGURE 3.21 Gender Inequality in Lebanon and Comparative Countries, 2014



Source: World Economic Forum 2014.

participation and political empowerment, but it is noticeably higher in the areas of educational attainment and health. Lebanon's political empowerment index is second to last in the world (last in the Middle East and North Africa region), with a score of 0.01. The low score is due to the historically small number of women elected to parliament or appointed as ministers, with only three women elected to parliament in 2008 and no woman appointed in the previous council of ministers in 2014. However, this particular score does not correctly portray the role of women in political life. While countries like Kuwait and Saudi Arabia may receive a higher political empowerment score for recently appointing more women as ministers in a particular year, women in Lebanon have taken part in political life since 1952.²³

With regard to economic participation, Lebanon ranked 133 out of 142 countries, due to relatively low levels of female participation in the workforce (female to male ratio of 0.34) and low estimated earned income for women (female to male ratio of 0.27). The female labor participation rate in Lebanon is on par with that of other countries in the region and has been rising steadily, albeit from a low level.

In educational attainment, Lebanon has closed the gender gap in secondary and tertiary education, with a ratio of female to male enrollment exceeding 1.00; however, in primary education female enrollment is relatively low at 90 percent, while male enrollment exceeds 97 percent. Consequently, Lebanon ranks 106 out of 142 with regard to educational attainment.

Finally, Lebanon's health and survival ranking is the highest of the four key areas (62 out of 142); sex rate at birth and healthy life expectancy are almost equal between men and women.

Challenging Business Climate and Access to Finance

The Lebanese economy is constrained by significant structural rigidities. While political uncertainty dominates the investment decisions of businesses, according to newly available investment climate assessment data from the World Bank, issues related to the investment climate rank as the second most important constraint to business. While Lebanon's private sector has traditionally demonstrated considerable resilience—adapting in a challenging and volatile investment climate—the proximity of conflict in neighboring Syria,

increasing domestic political instability, and an uncertain geopolitical environment have considerably increased perceived risk exposure. This has led entrepreneurs and companies to prefer short-term and liquid investments, to the detriment of economic growth.²⁴ These factors, together with “traditional” investment climate constraints, intervene at all stages of a firm’s life cycle.

Establishing and Closing a Business.

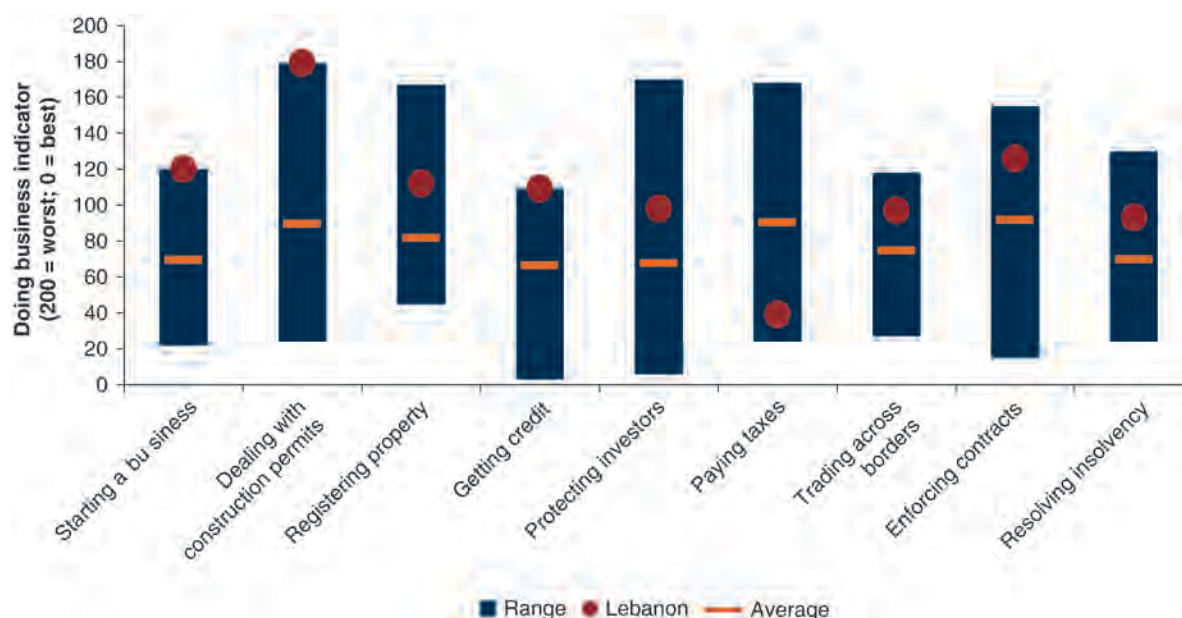
Establishing and closing a business are challenging and expensive tasks. Lebanon ranks 104 out of 189 economies on the ease of starting a business (World Bank 2015). The high minimum capital required to start a business and the fixed mandatory cost imposed by lawyers for creating a new company, even a small one, impose significant barriers to entry for small entrepreneurs. Exit (insolvency and liquidation) is costly, nontransparent, and slow. The cost and time to close a business are significant deterrents to entrepreneurial risk taking. These are a

constraint in many countries in the Middle East and North Africa, and Lebanon has better Doing Business measures than its regional neighbors. However, Lebanon’s systems for dealing with “out of court” debt restructuring, insolvency, and bankruptcy are outdated and suppress business development (World Bank 2012a). Lebanon ranks 136 on the Doing Business indicator for resolving insolvency (figures 3.22 and 3.23).

Running a Business. Running a business is also challenging. Among the key constraining factors are

- *Contestability of markets is weak*, given significant barriers to entry, especially legal and administrative measures, widespread pricing policies, and restrictive practices. There is no competition law. As a result, half of Lebanon’s domestic markets are considered oligopolistic to monopolistic, and a third of them have a dominant firm with a market share greater than 40 percent (Ministry of Economy and

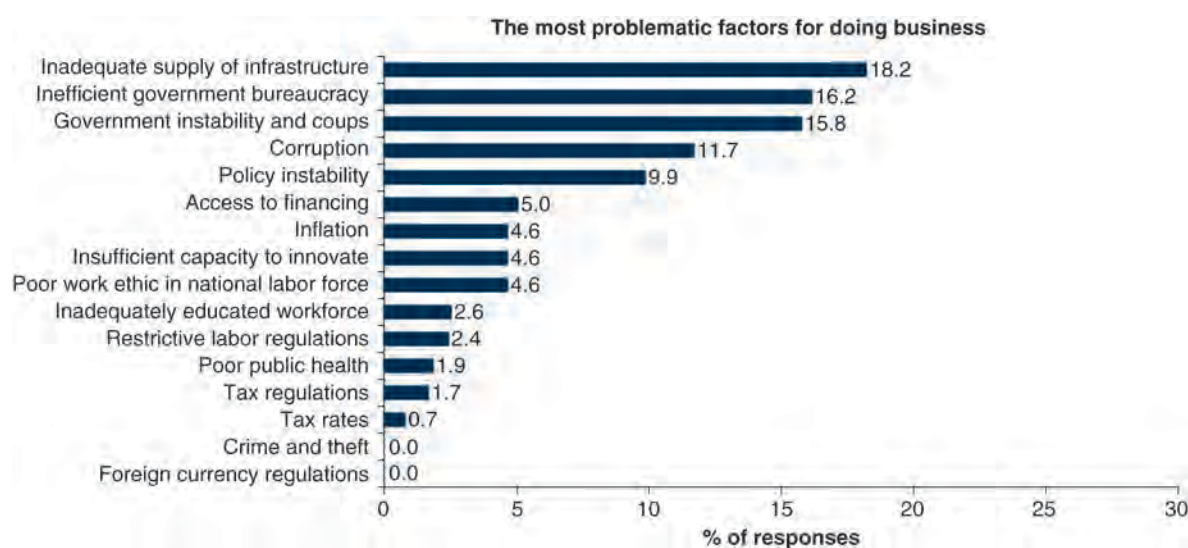
FIGURE 3.22 Indicators of Doing Business in Lebanon and Comparator Countries, 2013



Source: World Bank 2014b.

Note: The average is for a group of countries with GDP per capita in purchasing power parity terms within 10 percent of Lebanon’s in 2013. The comparator countries are Azerbaijan, Belarus, Cuba, Gabon, Mauritius, Mexico, Romania, Suriname, Turkey, Uruguay, and the República Bolivariana de Venezuela.

FIGURE 3.23 Key Constraints to Doing Business in Lebanon, 2013



Source: World Economic Forum.

Note: From the list of factors above, respondents were asked to select the five most problematic for doing business in their country and to rank them between 1 (most problematic) and 5. The bars in the figure show the responses weighted according to their rankings.

Trade 2003). In particular, import monopolies are captured by a limited number of exclusive agents stemming from a pricing and monopolies law of 1967, and they wield considerable political influence. This concentration of power makes it difficult to see any reforms in this area in the near future. The legislative framework places few restrictions on conflicts of interest for the head of state, ministers, and members of parliament, limiting efforts to prevent and combat corruption. Business and political figures are often one in the same. Such elite capture and widespread lack of competition in the economy have a large negative impact on economic efficiency (and ultimately on growth and jobs) as well as on consumer welfare, which is particularly detrimental to poor households and households in the bottom 40 percent.

- *Corporate governance is inadequate.* In 2006 the Lebanese Transparency Association spearheaded the country's first corporate governance code focused mainly on Lebanese joint stock companies. This code could serve as a model for other types of businesses and non-profit organizations, both in Lebanon and throughout the Middle East. To date, only part

of this code has been implemented by the private sector. Banks, however, have been active and responsive under the supervision of the Banque du Liban, which issued circulars in 2011 requiring all banks to adopt a code of corporate governance meant to improve transparency and facilitate the monitoring of banks by different stakeholders (World Bank 2013d). Improved corporate governance practices would improve accountability, transparency, and decision making as well as help firms to attract external capital.

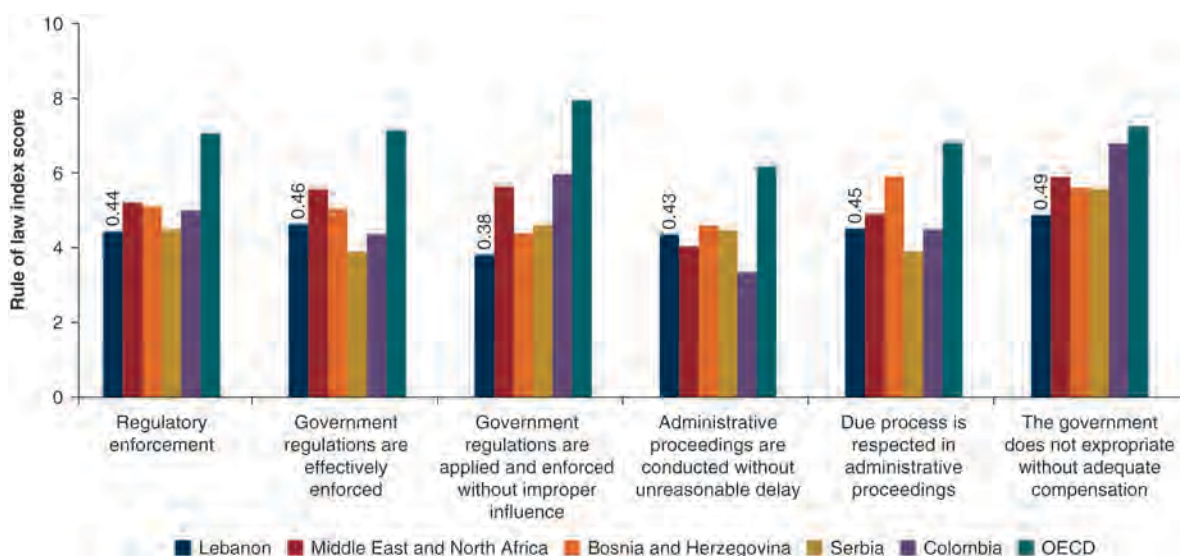
- *Tax administration and business regulations are nontransparent, outdated, complex, and unevenly applied.* In dealing with construction permits, Lebanon ranks 164 out of 189 economies, according to the World Bank's 2015 Doing Business indicators, with the process taking a minimum of 244 days to complete. Variation among firms in obtaining a permit is reported to be high and linked to how connected the firm's owner is. This is a cross-cutting challenge that affects investors operating a business in various sectors of the country. It is also an area where there is high incidence of corruption with municipal authorities. Contract enforcement remains problematic as even though

acceptable laws are in place, their enforcement is slow, unpredictable, and costly to businesses. Lebanon consistently scores lower than the regional average for regulatory enforcement and lower than the regional average, the OECD, and other comparator countries such as Bosnia and Herzegovina, Serbia, and Colombia on indicators of improper influence in enforcement and expropriation (figure 3.24). The difficulty that lenders encounter in trying to foreclose assets negatively affects private sector lending. Enterprise Survey data for 2013–14 reveal that corruption continues to be a serious obstacle to business operations, ranking fourth after political instability, the investment climate, and power supply (access to finance ranks fifth). This finding is consistent across firm size, age, sector, and location. Enterprise Survey data also show that weaknesses in the investment climate are not just de jure but also de facto. Despite positive improvements in the number of days to clear exports and imports, delays in obtaining electrical and water connections, operating licensing, and construction permits are significant. Moreover, there is significant variability in the time taken, most starkly in the case of construction permits.

- *Access to skilled labor is a serious challenge*, as detailed in chapter 2.
- *A large informal sector* (estimated at 30 percent of GDP in 2011) and is even larger in rural areas. This suggests that the formal sector has been captured by vested interests in urban centers and that the informal sector is constraining competition in rural areas (figure 3.25). The informal sector has likely expanded significantly due to the influx of more than 1.4 million Syrian refugees. As evident in other fragile and conflict-affected situations, the large influx of refugees could crowd out both the formal economy (undermining competitiveness and the capacity of the state) and the informal sector (where the majority of Lebanese poor earn their living) and, worse, give rise to further political destabilization through the progressive criminalization of the informal sector through uncontrolled rent seeking, exploitation, and domination of trade networks (Rossis 2011).

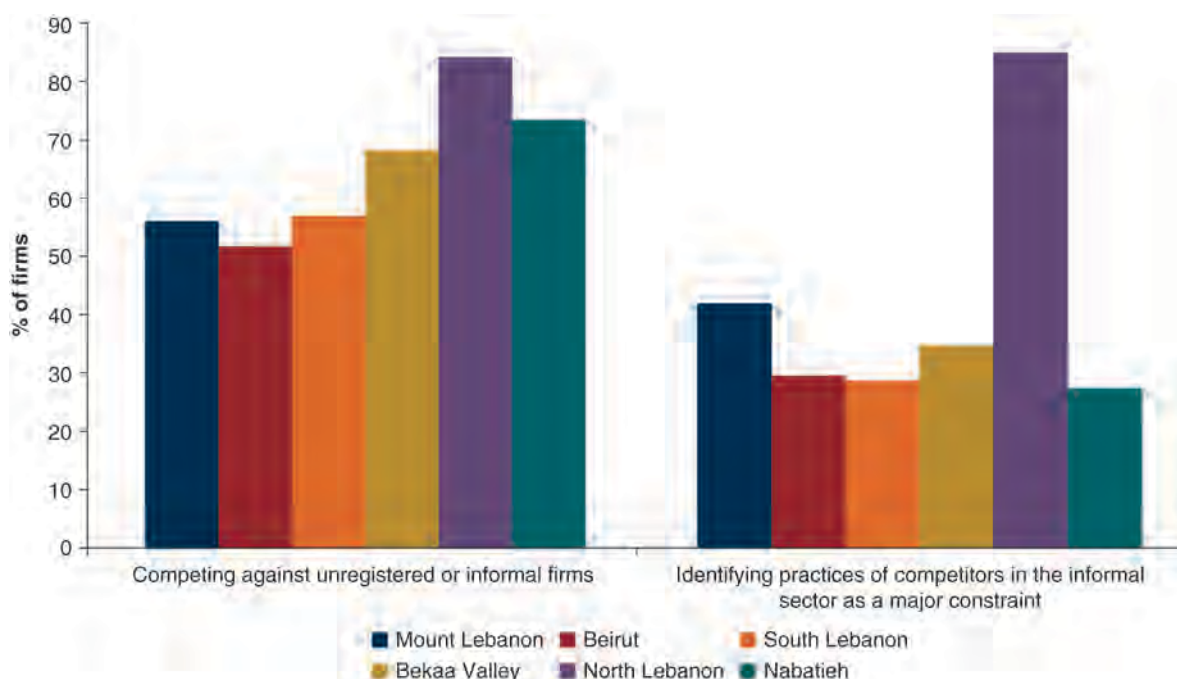
The informal sector has been severely affected by the presence of and competition from Syrian refugees. According to evidence from the 2014 Informal Enterprise Survey,²⁵ in areas with a

FIGURE 3.24 Regulatory Enforcement in Lebanon, 2014



Source: World Justice Project.

FIGURE 3.25 Quality of Business Environment in Lebanon, by Region, 2013



Source: 2013–14 Enterprise Survey.

concentration of Syrian refugees, the majority of businesses rank competition from lower-priced competitors as the principal constraint to their operations, followed by corruption.

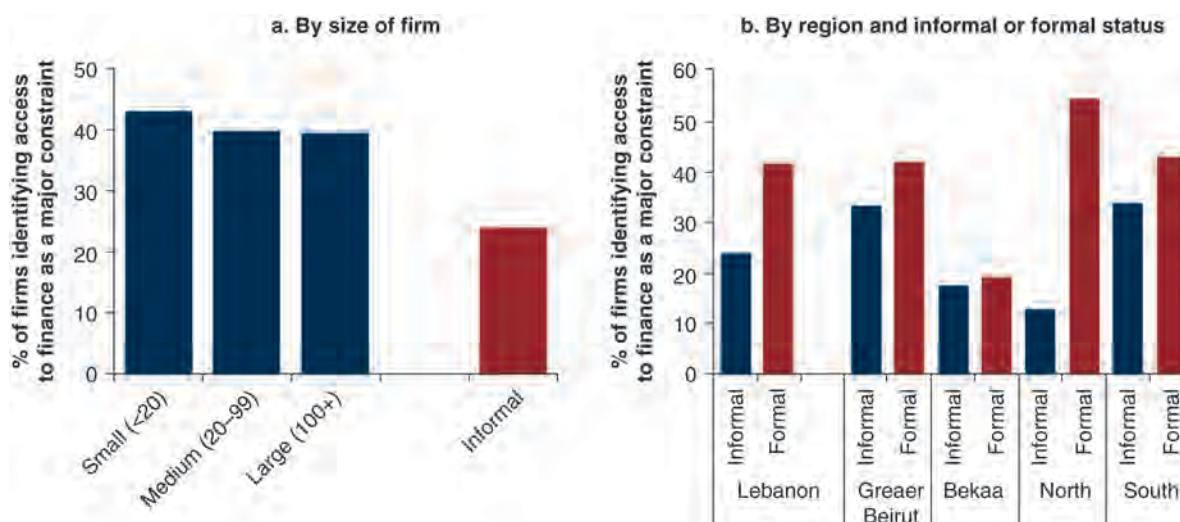
Access to Finance. Although access to finance is not the overriding constraint that it is in many other countries in the region, it is still very significant and a larger constraint for small and medium enterprises than for large and informal firms. It remains a significant obstacle (in excess of 40 percent) for formal firms across the country, with the exception of the Bekaa Valley (figure 3.26). Ongoing efforts initiated by the central bank and other governmental and quasi-governmental agencies (such as Kafalat) to promote SMEs and improve their access to finance are showing potential for some success, but their limited track record, large collateral requirements, and lack of an established relationship with the financial intermediary discourage start-up firms in particular.²⁶

The recent BdL 331 circular has had a catalytic effect on venture capital. This bodes well for

the future of early-stage equity investments, although the sector is still in its infancy. The supply of viable companies (the deal-flow) is limited, and innovative high-growth-potential companies at the seed and early stages of development need both financing and other support. Rebalancing the market has implications for job creation. Enterprise Survey data reveal that small firms and “other services” sectors (including ICT) created the largest number of jobs during 2010–13, and evidence from firm surveys in other countries shows that young companies who experience high growth early on create the bulk of SME jobs.

However, evidence from focus groups—in addition to survey data—suggests that entrepreneurs and start-ups do not receive sufficient support from commercial banks. Given the lending behavior of commercial banks, support to foster private sector-led job creation requires a focus on reforms of the non-bank financial sector and related institutions, such as the work being done to develop the payments systems, capital markets authority, leasing, and

FIGURE 3.26 Access to Finance by Firm Size, Location, and Formal or Informal Status in Lebanon, 2013–14



Source: 2013–14 Enterprise Survey.

Note: Indicators for formal firms are survey-weighted. Informal enterprises are unweighted.

microfinance sector. It also requires efforts to diversify financing products and to strengthen the equity, credit, insurance, and microfinance systems (World Bank 2013f). In addition, reforms on secured transactions would allow SMEs to offer and banks to accept movable collateral, enabling higher and safer lending and thus larger job creation.

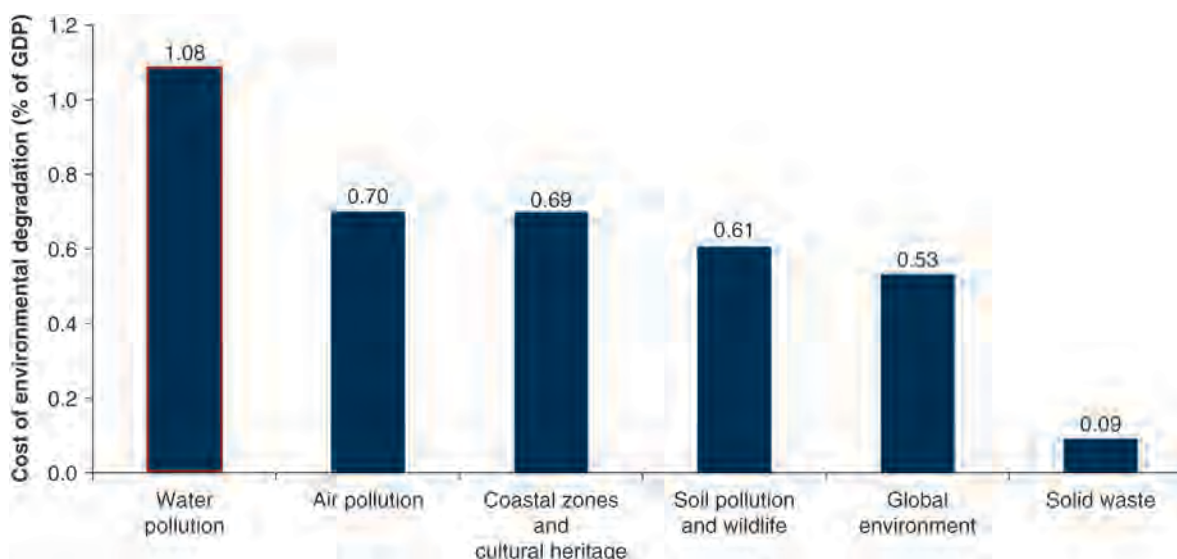
Environmental Degradation

Lebanon suffers from large environmental degradation that disproportionately affects the poor (World Bank 2011b). In 2005 the environmental cost was estimated at 3.2 percent of GDP. Water and air pollution as well as coastal erosion are the costliest causes of environmental damage in Lebanon (figure 3.27). Environmental degradation disproportionately affects poorer communities because they rely more directly on ecosystem services for their well-being. According to the World Wide Fund (2014), “Damage to the environment, as well as a lack of clean water and land suitable for farming or growing food, leads to more hunger, illness, poverty, and reduced opportunities to make a living.” In addition,

poorer households are more susceptible to environmental pollution by virtue of differences in health status and access to medical care.

Water Pollution. Water pollution is a growing concern in Lebanon. Untreated sewage, industrial effluent, and agricultural runoff are often discharged into valleys, rivers, and the Mediterranean Sea, creating substantial pollution of water resources. Key sources of pollution include households, as only 8 percent of wastewater is treated (Ministry of Energy and Water 2012a),²² and industries, which discharge untreated industrial waste into major water bodies, including the Mediterranean Sea and the Litani River. Even operational, downstream municipal water treatment facilities lack proper technological capabilities to treat toxic effluents, representing a serious threat to the water quality of potable water supplies, irrigation, and ecosystem services (World Bank 2014h). A third source is agriculture, as the runoff and infiltration of residues from fertilizers and pesticides are further polluting Lebanon’s water resources. In drinking water and groundwater samples collected in major Lebanese cities, chlorine

FIGURE 3.27 Costs of Environmental Degradation in Lebanon, 2005



Source: World Bank 2011b.

and organophosphate pesticides were frequently detected in large quantities (Kouzhaya et al. 2013).

Solid Waste Disposal. Municipal solid waste disposal is a persistent and critical issue. As of 2007, only 53 percent of municipal solid waste was disposed in the country's two sanitary landfills: Nahmeh and Zahlé. As discussed in box 3.3, these figures have worsened substantially in the past two years due to the influx of Syrian refugees (World Bank 2013b). The remaining solid waste is being disposed in a contained landfill and in 700 open dumps. Open and uncontrolled dumps are polluting air, watersheds, and coastal zones (World Bank 2011b). The closure of the over-extended Nahmeh landfill in July 2015 resulted in the worse environmental crisis in Lebanon's recent history. Piles of garbage have accumulated on street corners, dumped under bridges, valleys and forest area, thrown in river beds or simply burnt in open space. It has also brought large protests organized by citizen groups such as "You stink" "We demand accountability" and the most recent "Women Uprising" movement. Civil society is demanding an end to years of corruption in the waste sector and more transparency in managing public resources.

Strengths, Sources of Resiliency, and Opportunities

Despite a challenging environment, Lebanon possesses some important drivers of growth, sources of resilience, and significant opportunities. These have enabled the economy to perform well amid adversity. After the civil war, Lebanon experienced the strongest post-conflict recovery of any country with a conflict lasting more than 10 years (see appendix B). Lebanon was also one of the fastest-growing economies in the world during the global recession that started in 2008. Lebanon's resilience even in times of great stress has helped to prevent a relapse of the violence witnessed during the civil war and created opportunities for both stabilizing the country and addressing fundamental structural problems.

Relatively Strong Human Capital

Compared to countries in the region or at a similar level of development, Lebanon performs relatively well: Lebanon ranks 65 out of 187 countries in the World Bank's 2013 human development index, which puts the country in the

BOX 3.3 The Impact of the Syrian Conflict on Lebanon's Environment

This box summarizes the findings of a recent assessment undertaken by the Ministry of Environment (2014). In addition to huge social and economic challenges, the Syrian conflict is putting serious pressure on Lebanon's fragile natural resources and ecosystems in the following areas.

Solid waste management. The incremental quantity of municipal solid waste attributed to refugees is estimated at 325,000 tons per year, representing a 15.7 percent increase in municipal solid waste generation. While part of the waste is being managed within existing facilities, more than half is disposed of in open dumps, which increases land, soil, and water contamination and creates serious health risks.

Water supply and quality. The increase in domestic water supply is estimated between 43 million and 70 million cubic meters, representing an increase in national water consumption of 8–12 percent. This increase has exacerbated an already stressed water situation and resulted in decreasing groundwater tables (ranging between 1 to 20 meters in wells across the country between April 2013 and April 2014). The consumption of poor-quality water and improper sanitation and hygiene in refugee settlements have also increased the incidence of diarrheal and other communicable diseases. The resulting increase in pollution load from wastewater discharge has been significant.

Air quality. While it is difficult to attribute an increase in air pollution precisely, the incremental demand being placed on road transport, residential heating, open burning of solid waste, and electricity production has increased air pollutants an estimated 20 percent.

Land use and ecosystems. The influx of refugees has increased Lebanon's population density from 400 to 520 persons per square kilometer. This urban densification creates many environmental and social stresses, generating more waste, water, and sanitation problems, noise pollution, and overcrowding. Refugees who have settled in informal tented settlements outside urban areas have encroached on agricultural land, engaged in excessive felling of forest trees, and weakened sensitive ecosystems.

A conservative estimate of the costs to mitigate the environmental impact of the Syrian conflict is US\$3.5 billion (with US\$300 million in operation and maintenance per year). This estimate only accounts for measures that could be quantified during preparation of the report.

category of “high human development” (second below “very high human development”).

Based on the World Economic Forum's 2013 human capital index, Lebanon's performance is not as strong (74 out of 122 countries), largely as a result of severe underperformance in its “enabling environment.” Lebanon is, nonetheless, particularly strong in education, where it significantly outperforms upper-middle-income and Middle East and North Africa countries, ranking 32 out of 122. Lebanon invests heavily in its human capital, especially in education, primarily through high private spending. The quality of the (privately dominated) education system is high, ranking 13 out of 122. While return on human capital is low, many Lebanese continue to

invest strongly in (private and high-quality) education, which allows them to compete favorably at the international level and to get well-paid jobs abroad, especially in countries in the Gulf Cooperation Council (this brain drain, however, makes it difficult to retain talent at home). Lebanon's health outcomes also improved markedly and now compare favorably with those of Middle Eastern countries or countries at similar levels of development.²⁸

Large Diaspora and Remittance Flows

Given large and sustained outmigration, Lebanon has one of the largest diaspora in the world as

a proportion of the resident population. Remittances are a large and stable source of financing for the country, both for the balance of payments and for public finances. In 2013 Lebanon was the ninth largest country in the world with regard to personal remittances received²⁹ as a share of GDP (17.7 percent). Remittances are also contributing to the buoyancy of the real estate sector and are key to the continued growth of the banking sector, among others. The Lebanese diaspora, which is very skilled and residing mostly in countries with advanced economies, has strong links to the home country. Beyond remittances, the diaspora can contribute to the economic development of Lebanon through productive and pro-development investment, mentorship, and business networking (ILO, 2010).

Strong Support from the International Community in Critical Times

Given the scope of shocks and macroeconomic vulnerabilities that the country has experienced, Lebanon would have been in a dire economic situation had it not received international support in difficult times. The Paris I, II, and III conferences (2001, 2002, and 2007, respectively³⁰) as well as the 2008 Doha Agreement are examples of international support. However, international support to help Lebanon to cope with the severe impact of the Syrian crisis and especially the large number of Syrian refugees has been more muted, possibly reflecting the difficult domestic, regional, and international geopolitics of the situation.

Dynamic Private Sector

Lebanon's people have a long and illustrious tradition as merchants and traders going back as far as the Phoenicians. Situated at the crossroads of the East and the West, Lebanon has a long-standing trading culture and recognition of the role of private firms and markets. Throughout this rich history, the private sector has always had a strong international orientation. The Lebanese

diaspora is globally diversified and internationally competitive. When combined with new opportunities for trade and investment throughout the region, these sources of economic vitality will constitute significant sources of resilience and potential growth—once the right political, institutional, and security conditions have been created.

A key challenge is to delink private sector from sectarian interests by increasing accountability, managing conflicts of interest, mitigating opportunities for corruption, and promoting a more equitable distribution of investments into lagging regions. While positive overall, the private sector (and to a certain degree civil society)—through its alignment with sectarian actors and interests—reinforces inequality. Unlocking the inclusive development potential of the private sector could yield important gains, especially in the absence of improvements in public social spending and policies in the near term. Private sector engagements that are not sectarian in nature could also help to build confidence, trust, and collaboration between sectarian communities.

Large and Profitable Banking Sector

A resilient, large, and profitable banking sector has been the lynchpin of the country's development model since the civil war. Lebanon's banking sector is liquid, profitable, and well regulated. In 2013 the ratio of tier-one capital to risk-weighted assets was 12.2 percent, double the Basel III requirement. Tier-one capital constitutes the principal funding source for commercial banks, with the ratio of deposits to total liabilities at 87.5 percent. By 2015, the BdL mandates that banks should have an additional 4 percent conversion buffer, compared to the Basel III mandate of 2.5 percent. Moreover, banks are highly liquid, nonperforming loans are low, and return on equity is in the double digits.

However, banks have substantial exposure to the sovereign, with more than 55 percent of bank assets concentrated in the public sector and the BdL. In an effort to diversify, banks have

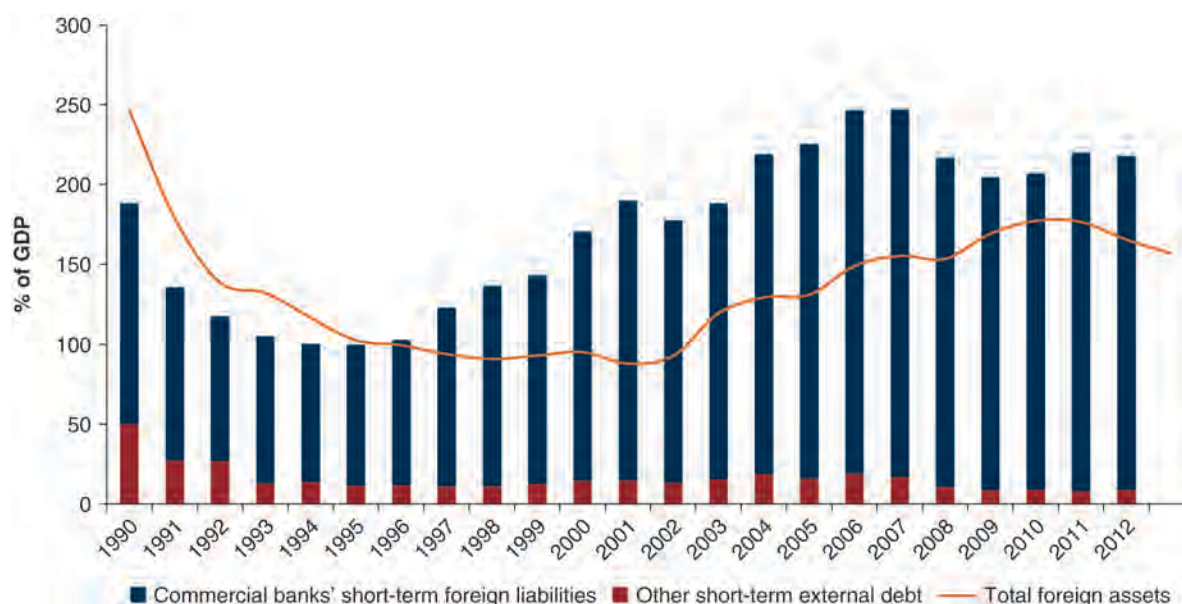
expanded regionally, with mixed results to date. For example, diversification into Syria has proved costly because of the conflict, whereas diversification into other countries in the region has been more positive.

The sector's strength mitigates sustainability concerns regarding the sovereign and overall macroeconomic weaknesses for several reasons. First, an estimated 80 percent of government debt is held by domestic financial institutions and the BdL. Additionally, large external financing needs are met partly by deposits of Lebanese expatriates who are familiar with the political and security situation of the country and the region and have confidence in the BdL and the Lebanese banking system. As a result, deposits have been growing at an average of 14 percent annually since 1993, attracted by large interest rate spreads.³¹ Due to base effects, the growth of nonresident inflows has been slowing, from an average of 21.5 percent during 1993–2002 to 16.2 percent during 2003–11 and to an average of 7.4 percent since 2011 and the onset of the Syrian crisis. This lower rate of growth is sufficient to

meet the country's financing needs.³² Other mitigating factors include banks' substantial net foreign assets³³ and sizable gross international reserves at the BdL—comfortable buffers that help to anchor investor confidence. Additionally, the BdL has demonstrated its readiness to be the ultimate guarantor of the financial sector via its large foreign exchange reserves and crisis management, especially its interventions in the government debt market.

Notwithstanding its proven resilience to large shocks, the size of the sector exposes the country to significant macroeconomic risks. Lebanon's short-term foreign liabilities surpass its reserve of foreign assets (figure 3.28), exposing the country to the risk of a sudden change in investor confidence that would require drastic policy measures. The short-term liabilities are largely foreign liabilities of commercial banks, which reached 222 percent of GDP in 2013. Lebanon's total foreign assets, consisting of BdL gross foreign reserves (foreign currency and gold) and commercial bank foreign assets, equaled 157 percent of GDP in 2013.

FIGURE 3.28 Short-Term Foreign Liabilities and Total Foreign Assets in Lebanon, 1990–2012



Source: Banque du Liban and Ministry of Finance.

Strong Sense of Political Self-Preservation

At the political level, the restraint exhibited several groups with respect to the Syrian conflict illustrates a general desire to avoid the kind of descent into conflict and warfare associated with the civil war. The situation remains fluid, however, and severe clashes with armed elements in Aarsal and Tripoli have shown how quickly tensions can escalate.

Urbanization and Higher Income Potential

Lebanon is one of the most urbanized countries in the region and the world. Its urban population is estimated at 89 percent, with almost 4 million people living in cities and urban areas. An estimated 64 percent of the Lebanese population lives in large agglomerations, mostly in the city of Beirut and its surrounding suburbs, along with Saidia, Tripoli, Tyr, and Zahle. However, contrary to patterns observed in most of the world, the share of the population in Lebanon's primary city—Beirut—has declined over time (World Bank 2011c). Measures that increase factor mobility may help to increase the productive potential of Lebanon's cities.

Highly Productive Agriculture

A small and stable part of Lebanon's economy, agriculture is highly productive by regional standards. Agriculture's share of GDP has remained relatively stable at around 6 percent, roughly equivalent to the regional average of 8 percent. Lebanon's varied altitude (sea level to 2,000 meters) and annual rainfall (200 to 1,600 millimeters) have resulted in a range of agricultural products, including grains, orchard fruits, olives, and tubers (mainly potatoes), as well as milk and processed dairy products. However, while only 3 percent of the labor force is employed full time in agriculture, this figure may be as high as 20 percent when part-time and seasonal labor is included. This compares to a regional average of 29 percent, resulting in labor productivity that is more than 15 times the regional average.

Future growth of the agriculture sector will require continued upgrading of supply chains for high-value products—in particular fruits, vegetables, and livestock products for regional, European, and domestic markets. Lebanese products have achieved good-quality reputations and are particularly competitive in the Gulf Cooperation Council countries, Turkey, and the Arab Republic of Egypt, with some market entry in Europe. However, expanding or even maintaining these markets will require additional investments in quality control and certification to meet increasingly stringent phytosanitary and food safety standards. At the same time, expanded production of these products will require investments in high-quality irrigation systems on lands currently used for lower-value, mainly rain-fed grain, production. These investments are consistent with both improving farm incomes as well as generating additional, sector-based employment throughout the value chain.

Game-Changing Opportunities

Lebanon's economy and its prospects for more inclusive growth could also be bolstered by potentially game-changing opportunities.

Recovery and Reconstruction in the Region. Peace and stability in the region would strongly benefit Lebanon. The World Bank (2013b) estimates that the conflict in Syria is lowering Lebanon's real GDP growth by 2.9 percentage points every year. Not only would peace in Syria be expected to lift this negative spillover, but the recovery and reconstruction of Syria would likely benefit Lebanese firms. Lebanese entrepreneurs and banks were playing an important and rapidly growing role in Syria's economy in the mid-2000s as Syria moved toward greater market-based mechanisms. Given their familiarity with Syria, the Lebanese private sector should be well positioned to benefit from an expanding Syrian economy. Iraq is another market where Lebanese businesses have comparative advantages that could be leveraged as the situation on the ground stabilizes.

Hydrocarbon Wealth. Recent three-dimensional seismologic mapping of Lebanon's offshore area reveals the likely presence of sizable hydrocarbon resources, which are likely in excess of 25 trillion cubic feet, mostly gas (IMF 2014). The discovery of such a large amount of natural resources could be a game-changer for Lebanon, as it could provide sufficient financial resources to address the country's large public debt and large current account deficit as well as to invest in badly needed infrastructure and social services. This could result, over the medium term, in a less vulnerable balance sheet (lower public debt, smaller banking sector), more fiscal space, and less need to pay high interest rates on deposits to attract funds into the country. While no fiscal revenue is likely to accrue to the sovereign before 2020, international evidence shows that these revenues could be substantial, especially for a relatively small economy. Becoming a gas producer could also enable Lebanon to use some of its gas resources to fuel its power generation sector (which is designed for gas inputs, but so far has been fueled by more expensive and less efficient oil).

Potential hydrocarbon wealth, therefore, represents a sizable opportunity for the economy to generate jobs and enhance the welfare of the population, but it also entails challenges, especially if Lebanon continues on its current path of weak institutions and poor accountability. In order to avoid a resource curse (or Dutch disease), good governance (in the form of strong institutions and accountability mechanisms, which unfortunately Lebanon has yet to establish) needs to be at the forefront of this new sector (Jamali and Le Borgne 2014).

Levant Trade Integration. As a small open economy with a strategic location among regional trade routes, Lebanon could materially benefit

from stronger trade integration in the region (given a resolution of the Syrian conflict and a more stable Iraq). As detailed in a recent report (World Bank 2014j), economic complementarities between Egypt, Iraq, Jordan, Lebanon, Syria, Turkey, and the West Bank and Gaza are significant, with substantial welfare gains expected from increased trade, investments, and, ultimately, economic integration.

With a population of 224 million, a land area of 2.4 million square kilometers, a nominal GDP of US\$1.4 trillion, and proximity to major markets and transportation corridors, these "New Levant" countries have significant economic weight and promise. Similarities in stages of economic development, resource endowments, or factor costs generate high potential to benefit from competitiveness and complementarities. The volume and structure of trade and investment flows among these countries indicate the presence of large untapped potential for deeper and wider integration in the sub-region.

Decentralization of Authority. Reforms to decentralize authority and empower local governments could help to address concerns about inequities in public spending and service delivery and serve as a means for increasing trust in and accountability of the state. Despite previous attempts to decentralize authority, these reforms have been operationalized only partially, and the Lebanese state remains extremely centralized. The allocation of resources to local governments is perceived to be inequitable. The former president of Lebanon introduced a draft law on administrative decentralization in April 2014. If these reforms are supported and introduced, they could provide an impetus for increasing the capability, transparency, and accountability of local governments.

Notes

1. The 2013 World Bank Enterprise Survey data reveal that almost 42 percent of firms identify access to finance as a major constraint, which is above the regional average (38.5 percent) and

significantly above the global average (29 percent). Furthermore, despite efforts initiated by the central bank and other governmental and quasi-governmental agencies (such as Kafalat, a loan

- guarantee agency) to promote small and medium enterprises and improve their access to finance, World Bank (2014d) finds that entrepreneurs and small businesses cite obtaining access to credit as a constraint due to a limited track record, large collateral requirements, and lack of an established relationship with the financial intermediary. The financial sector's incentives to intermediate a large share of its liabilities toward productive investments remain weak, and collateral requirements for loans are high. Product regulations have also tended to bias investment decisions in favor of either liquid instruments or real estate.
2. As provided in Article 86 of the Constitution and public accounting law decree no. 14969/1963, in the absence of approved budgets for 2006–13, government expenditures are incurred on the basis of the “one-twelfth rule,” by which the government is authorized to spend monthly one-twelfth of the last approved budget (that is, the 2005 budget) and other enabling legislation. In October 2012, parliament approved an increase in the legal spending limit from the last approved budget. During 2006–12, successive governments incurred extra-budgetary expenditures. Controversy arose regarding the extra-budgetary expenditures incurred during 2006–10, when certain members of the March 8 coalition requested a review of these expenditures by the Audit Court. The minister of finance and other members of parliament have proposed draft laws seeking to approve the extra-budgetary expenditures that have not yet been approved. This controversy has contributed to parliament's failure to approve the budgets for 2006–12, which has limited the government's ability to have a budget approved for 2013 (Ministry of Finance 2014).
 3. Most recently these include budget preparation reforms such as the adoption of a new budget classification.
 4. This is due to a high real implicit rate of return on contributions, reaching 12 percent for civilian personnel and 13 percent for military personnel compared to a sustainable rate of 3 percent (Boustany and Moubayed 2013).
 5. For a game-theoretic analysis of monetary and fiscal policy coordination issues using a Stackelberg competition model, see, for example, Lambertini and Rovelli (2004).
 6. Experts estimate that only 15, 65, and 20 percent of Lebanon's main road network is in good, fair, and poor condition, respectively. By comparison, in Jordan (whose upper-middle-income services-oriented economy most resembles Lebanon's in the region), 60, 28, and 12 percent of the road network is in good, fair, and poor condition, respectively.
 7. All cities in the region have either built such systems (Cairo, Dubai, Rabat, and Tunis) or are in the process of building them (Amman, Jeddah, and Riyadh).
 8. Morocco's rural roads program in recent years has caused a drop of 43 percent in the cost of transporting goods and a rise of 39 percent in average monthly income per household among the rural poor.
 9. For details, see World Bank 2010d and 2012c.
 10. Lebanon only stores 6 percent of total resources, compared to the regional average of 85 percent.
 11. This section summarizes the analysis of existing governance data gathered from the AGI Data Portal (www.agidata.org).
 12. Two draft laws—one on right to information and the second on whistleblower protection—were submitted to parliament in 2009 and 2010, respectively.
 13. Lebanon's inequality-adjusted human development index is 20.8 percent lower than its unadjusted ranking, among the largest losses in the group of countries categorized as having high human development.
 14. Despite the important role of confessional organizations in the provision of social and welfare services, inequalities exist even in coverage for in-groups. In many cases, service provision by confessional organizations is politically motivated and selective, that is, it targets important electoral constituencies, implying that the most vulnerable do not necessarily benefit. For a fuller analysis, see Cammet and Issar (2010).
 15. Lebanon's private education system is also free for a large share of students as private schools receive public or private subsidies. These subsidies are available to (a) children of public employees (accounting for about 19 percent of all students in Lebanon), (b) households in which at least one member is a private sector wage earner (5.7 percent of pupils have received a grant from private employers, a small share as surveys find that many employers avoid paying grants), and (c) students who are simply exempted from school fees (about 8.5 percent of students).
 16. Public schools achieve lower scores in international and national assessments. The achievement of public school students was 10 percent lower than that of private school students in the 2011 Trends in International Mathematics and Science Study (TIMSS) results.

17. For example, Mount Lebanon has the highest density of physicians and nurses (42 and 33 percent, respectively), compared to Bekaa, with only 7.8 percent of Lebanon's physicians and 19 percent of nurses (Ammar 2009).
18. The poorest households spend about 14 percent of their income on health, while the richest households allocate 4.2 percent (World Bank 2013a).
19. These programs include (a) social services and programs targeted to certain categories of the population (disabled persons, juvenile delinquents, school dropouts, orphans) provided by the Ministry of Social Affairs, with the majority of its budget distributed to nongovernmental organizations and welfare associations, and (b) fee waivers for hospitalization in public and private hospitals, which are for persons not covered by the National Social Security Fund and lacking the means to purchase insurance. Finally, the National Poverty Targeting Program of the Ministry of Social Affairs is the first poverty-targeted social assistance program for the poorest and most vulnerable families.
20. For detailed studies, see World Bank 2009a and 2009b.
21. Only Chad, the Côte d'Ivoire, the Islamic Republic of Iran, Mali, Pakistan, Syria, and the Republic of Yemen score lower on the 2014 gender gap index.
22. 0.00 = inequality; 1.00 = equality.
23. Lebanon granted women the right to vote in 1952, while countries like Bahrain, Oman, Qatar, and the United Arab Emirates only did so more than 50 years later.
24. The Lebanese private sector, like the broader political, social, and economic system, has proved remarkably resilient to instability and shocks (both domestic and regional), which it has been able to mitigate and manage with some degree of success, as a cost of doing business. However, current threats to security and political stability (in particular those related to the Syrian conflict) are considered a more fundamental and far-reaching set of risks, potentially beyond the capacity of domestic coping mechanisms to handle.
25. This survey is not statistically representative of the country. The sample was drawn from random walks undertaken by enumerators in targeted urban and periurban areas (additionally stratified to ensure locations with and without known concentrations of Syrian refugees). The enumerators operated within predefined areas delineating target locations on a grid. The informal enterprise survey had a sample of 1,015 informal businesses drawn from four regions of Lebanon (Bekaa, Greater Beirut, North Lebanon, and South Lebanon) and 25 urban and periurban areas. Businesses interviewed were small manufacturers, retail providers, and other services. Almost 600 enterprises from the sample were one-person businesses, 186 had between three and five employees, and 260 were two-person operations.
26. These findings are confirmed by a recent study (World Bank 2014d), which found that entrepreneurs and small businesses, especially those run by women, consider obtaining access to credit as a constraint.
27. 2012 data, which do not take into account the sharp increase in wastewater generated by the large influx of refugees.
28. Lebanon continued to invest in population-based disease prevention programs that helped the country to improve health status, attain the Millennium Development Goals, and even surpass other countries in the region. Similarly, the Ministry of Public Health, being aware of the inefficiencies in the system, especially in the curative sector, launched several reform efforts to improve the regulatory system. These included establishing a hospital accreditation program and developing fairly advanced hospital performance-based contracting mechanisms.
29. Personal remittances are defined by the World Bank (2014l) as personal transfers and compensation of employees.
30. See Government of Lebanon 2002 and 2007 for details of the Paris II and III conferences.
31. The key interest rates in this arrangement are the international dollar rate, a local rate on deposits in dollars, and a local rate on deposits in Lebanese pounds. The spread between the local and international dollar rates attracts deposits in dollars, while the spread between the Lebanese pound and local dollar rates encourages deposits in local currency. Nonetheless, like much of the economy, Lebanon's banking system is highly dollarized (64 percent).
32. A growth rate of 8 percent is sufficient to cover the country's financing needs and keep reserves high (IMF 2014).
33. Lebanon's banking sector has proven resilient through several pronounced cycles, with a tier-one capital to risk-weighted asset ratio of 12.2 percent in 2013, though both profitability (still double digits) and asset quality have deteriorated during the Syrian crisis. Banks' liquidity depends on the BdL's willingness to refinance government debt and redeem its certificates of deposit

(55 percent of banking assets concentrated with the public sector and the BdL). Bank profitability also reflects an “accommodating” BdL (for example, incentive programs, cheap funding) and the lack of diversification within the banking sector, as

many banks are lending to the same select clients and few have significant revenues or operations outside of Lebanon to diversify macro risks. The move by Audi Bank to develop a more regional franchise is one approach to diversifying this risk.

Chapter 4

Risks and Sustainability

Macroeconomic and Fiscal Sustainability

Lebanon's political economy is such that key stakeholders have few incentives to change the economy's suboptimal equilibrium, unless a crisis is imminent. The confessional approach to policy making has resulted in large, unproductive, and inefficient spending combined with limited revenue mobilization. The sovereign finds it easy to meet its large structural financing needs through the banking system. For its part, the banking sector has limited alternative in terms of lending to the public rather than to the private sector, given the risk premium required over the "risk free" and simple business of lending to the sovereign. Hence, other than tourism and real estate, which are externally driven, the private sector is, at some level, subject to selective crowding out (World Bank 2012b). As a result, the economy is dependent on its own brain drain and on highly cyclical sectors that are sensitive to external shocks. This macroeconomic volatility is a primary source of uncertainty for domestic and foreign investors, inhibiting private investment and reducing potential output. The lack of fiscal space squeezes investment, causing infrastructure degradation, particularly with regard to transportation, water supply, and electricity. It also lowers potential output. However, key stakeholders in the economy, such as policy makers and the business elite, have weak incentives to push for reforms, as the limited contestability of markets (economic and political) ensures good rents. Only in times of stress have reforms been introduced and implemented, such as the introduction of the value added tax in 2002 during the fiscal crisis.

While Lebanon's macroeconomic environment is highly vulnerable, the country has been able to withstand large shocks, as these same

vulnerabilities limit the exit options, and outside financing has, so far, arrived during shocks. Lebanon's high debt level, large twin deficits (fiscal and current account), large banking system, and highly dollarized pegged economy present significant macroeconomic vulnerabilities (Berthelemy, Dessus, and Nahas 2007; IMF 2014). Although these vulnerabilities have been present for nearly two decades, in times of stress, Lebanon has, so far, been able to avoid a crisis thanks to a powerful set of stabilizing forces.

First, a strong financial sector has helped to sustain Lebanon's macroeconomic stability and resilience to shocks. Capital, liquidity, and non-performing loans are robust in Lebanon and are critical to maintaining confidence during periods of stress.¹ Banks also recognize the risk of over-lending to the sovereign, but are unable to reduce it due to the perceived lack of alternatives and the inability to lend out deposits in Lebanese pounds. Many have expanded regionally to boost growth and diversify, and are increasingly interested in Africa, given links with the diaspora.

Second, many see Armageddon as the alternative to the status quo. Investors and lenders fully understand that, given the country's intertwined balance sheet vulnerabilities, stopping to fund the country's large gross financing needs would affect the peg and result in massive and sudden financial insolvency for core parts of the economy (i.e., the sovereign and the banking system). It also would impoverish a large part of the population through balance sheet shocks and a surge in inflation, with likely dire social impacts.

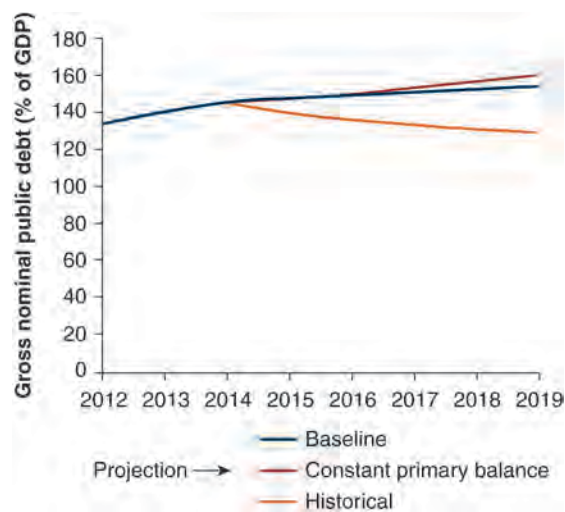
Third, the status quo financially rewards those able to benefit from it. Given the stability of the peg—unchanged in nominal terms since 1997—using dollars to lend to the sovereign in pounds has been a very profitable carry trade for depositors and investors alike.

Fourth, a core group of rich countries supports Lebanon. For financial and geopolitical reasons, Lebanon has (until recently) always received prompt and decisive financial support from core countries. Timely support has included the transfer from Saudi Arabia of US\$1 billion to the central bank at the onset of the 2006 Israel conflict and another US\$1 billion in early 2008 during a period of domestic political gridlock to instill confidence in the peg. Gulf Cooperation Council countries, Europe, and the United States have also provided political and financial support through a series of donor conferences (Paris I, II, and III in 2001, 2002, and 2007, respectively), in which Lebanon pledged to undertake structural reforms (which remain broadly unimplemented) in return for financial aid (Government of Lebanon 2002, 2007). As Lebanon is a relatively small economy compared to the wealth of its supporting countries, the financial assistance provided is large enough to boost confidence.

And fifth, a supportive and wealthy diaspora maintains strong ties to Lebanon. Once rich donor countries send strong signals of support, the diaspora's confidence in the peg is strong enough that capital outflows, when they have occurred, have remained manageable and short term.

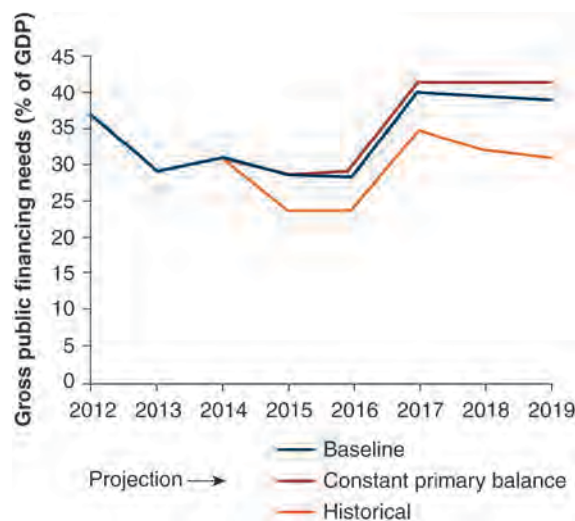
Notwithstanding the economy's remarkable resilience to shocks, public debt dynamics are not sustainable based on current policies and projections. The International Monetary Fund, in its 2014 Article IV consultation, undertook a detailed debt sustainability analysis based on three scenarios: baseline, constant primary balance, and historical. The results indicate that public debt is expected to increase from more than 143 percent of gross domestic product (GDP) in 2013 to 155 percent in 2019 (figure 4.1). Gross financing needs will also deteriorate from around 30 percent of GDP in 2013 to 40 percent by 2017 (figure 4.2). Such large gross financing needs make the economy vulnerable to sudden stops, with potentially severe impacts on poverty and inclusive growth. Additionally, debt dynamics and financing needs are sensitive to macroeconomic shocks, especially to growth, interest rate, and contingent liability shocks.

FIGURE 4.1 Gross Public Debt in Lebanon, 2012–19



Source: IMF 2014.

FIGURE 4.2 Gross Financing Needs in Lebanon, 2012–19



Source: IMF 2014.

Political and Social Sustainability

Since 2005, all governance and institutional indicators have worsened markedly as the policy-making process has come to a halt, highlighting the limits of Lebanon's post-civil war governance arrangements. The political equilibrium achieved with the Taef Accord reached its limits after 2005,

as no outside actor has been capable of enforcing decision making when domestic politics have become more divisive and resulted in a political standoff. As discussed in chapter 3, key governance indicators such as control of corruption and rule of law have worsened rapidly and significantly since 2005–06, while political instability and incidents of violence and conflict have risen. These trends are evident regardless of the source of data.

Such a marked deterioration in quality of governance and policy-making indicators raises strong concerns regarding Lebanon's (inclusive) growth potential, given the core role that institutions and governance play in a country's development (World Economic Forum 2013). While the current political situation does not allow for the implementation of much-needed countrywide governance reforms, an alternative, more gradual approach could support the implementation of reforms aimed at improving the business environment and service delivery at the local level, while engaging in much more complex reforms (for example, human resource management) at a later stage.

The conflict in the Syrian Arab Republic is also challenging the delicate societal and communal balance in Lebanon. A porous border and close links between political and militarized groups in Lebanon and Syria have exacerbated existing political divides along sectarian lines and prompted violence across the country. The conflict spillovers, including the steady stream of Syrian refugees, are seen as an existential threat to the country. Refugees have the largest impact on the relatively poor host population (via competition for low-cost housing, basic commodities, and low-wage jobs), and the continuous waves of displacement are leading to an increase in poverty rates among the Lebanese population. This raises the prospects of a large backlash from the host population.

Environmental Risks and Sustainability

Lebanon's growth model is also unsustainable on the environmental front, as highlighted by the

depletion of the country's total wealth. To measure sustainability, physical, financial, natural, human, and social (intangible) forms of capital (wealth) are required to generate income, now and in the future. Wealth analysis allows us to ask if GDP growth is sustainable or if Lebanon is living off its capital, including natural capital. A country's total wealth can be measured through the adjusted net savings (ANS) rate. The ANS measures the true rate of savings in an economy after taking into account investments in human capital, depletion of natural resources, and damage caused by pollution. In 2012 Lebanon's ANS was –2.2 percent of gross national income (GNI). This is dangerously low and compares to +17.8 percent of GNI in middle-income countries and +7 percent in low-income countries (World Bank 2014l). A negative ANS implies that Lebanon is depleting, not accumulating, wealth.

The sustainability of Lebanon's growth is even more concerning when expressed in per capita terms, which is the measure that citizens care about. In economies with growing populations, and especially in developing countries that aspire to higher material standards of living for their citizens, sustainable development requires not just increasing wealth, but also increasing per capita wealth (World Bank 2014a, 2014i). Unfortunately, Lebanon's per capita wealth has been depleted over the past years, decreasing by US\$416 in 2005 and US\$667 in 2010 (in 2010 U.S. dollars; World Bank 2014l). During the same period, Middle East and North African countries, on average, increased their wealth per capita by US\$101, and upper-middle-income countries expanded theirs by US\$1,039. Lebanon ranks in the bottom third of upper-middle-income countries that depleted their wealth per capita in 2010.

Lebanon's per capita wealth depletion is driven mostly by the large depreciation of produced capital (15.5 percent of GNI) and comparatively limited increase in human capital formation (1.4 percent of GNI). Natural capital depreciation, as currently estimated, is negligible, though likely underestimated to a significant degree, as factors such as coastal erosion, water and sanitation, fisheries, and marine resources are not yet

included in the calculations. Several of these omitted factors, however, are particularly weak in Lebanon and have been rapidly worsening over the past years, driven in part by the surge of Syrian refugees since 2012 (World Bank 2013b).

Large and rapidly growing environmental degradation could materially affect Lebanon's key growth drivers, such as tourism. For example, the country's natural heritage is being affected by uncontrolled urban sprawl, quarries, and solid waste dumps, placing increasing pressure on natural sites such as the karst heritage of Lebanon in the Caza of Kesrouan and the natural bridge of Fakra and Nabaa el Laban (World Bank 2011b).

Haphazard urbanization has been affecting Lebanon's urban environment, morphology, and ability to facilitate economic growth. Numerous illegal structures and building additions were constructed during the civil war and are still evident today. Recent years have witnessed a surge in building permits, new construction, and residential developments in major cities, largely in the absence of strict enforcement of urban planning and building regulations. The result is urban congestion, depletion of open spaces, a deteriorated urban landscape, and a threat to the architectural heritage.

Real estate and rents have multiplied in price, and housing prices have been associated with segregation between affluent and poor neighborhoods, where services (water, sanitation, roads networks) are strained and quality of life suffers.

The influx of refugees has exerted additional pressure on natural resources. The 1.1 million Syrian refugees registered with the United Nations High Commissioner for Refugees (as of January 2015) represent an increase of more than 25 percent of the Lebanese population prior to the crisis. Most refugees are concentrated in the impoverished areas of Bekaa (35 percent) and North Lebanon (35 percent) that were previously poorly served by public services. This surge in population strains overburdened social services and scarce resources, such as solid waste management, clean water, and sanitation. Box 4.1 details the effects of climate change.

Infrastructure and Public Service Sustainability

The financial situation of the electricity sector is undermining the sustainability of public finances and limiting the capacity of Electricité du Liban (EdL) to improve electricity supply to households and industry. EdL's assets, including its power stations, are rapidly aging. Its large financial problems also limit its capacity to invest in much-needed additional production capacity. In June 2010, the government endorsed a policy paper for the electricity sector outlining policy and investments aimed at increasing the level and quality of electricity supply, managing demand, decreasing the average cost of electricity production, increasing revenues, improving sector governance, and ultimately improving service delivery and reducing the fiscal burden that the sector places on public resources (Ministry of Energy and Water 2010). However, the majority of plans laid out in the paper have not been implemented, and the sector continues to constitute a significant drain on the Lebanese economy.

The rapid and massive influx of Syrian refugees in Lebanon since 2011 is further straining Lebanon's already weak infrastructure and adding stress on already vulnerable communities and municipalities (World Bank 2013c). The influx of refugees is equivalent to a 25-year shock for Lebanon: in its 2005 infrastructure master plan for the 25 years ahead, the Council for Development and Reconstruction had forecast an increase in the Lebanese population of 1.5 million over the quarter century. This number of registered Syrian refugees alone may soon be reached in Lebanon. With regard to communities and municipalities, municipal services are not geared to such a spike in population, leading to a decline in the quality of services (with potential long-term negative impact). Social cohesion is straining, and tensions are rising in communities where refugees are finding it hard to sustain themselves and hosts are affected by overcrowding, saturation of basic public services, rising rents, pressure on salaries, and increasing costs. The arrival of a large number of Syrian refugees has also challenged the

BOX 4.1 Impacts of Climate Change on Lebanon

Lebanon's climate change model projections suggest a more rapid warming than the global average and an annual reduction in precipitation. This would lead to less runoff, more evapotranspiration, and longer periods of drought. The average number of heatwave^a days observed in cities in the region is between 0 and 7 and is expected to increase to 93 days in a 2°C world and to more than 187 days in a 4°C world (Lelieveld et al. 2013, cited in World Bank 2014k). Additionally, by 2040, maximum temperatures are predicted to increase between 1°C along the coast up to 2°C in the mountainous inland; by 2090 the predicted increases are from 3°C to 5°C, respectively. Significant reductions are projected for rainfall, which will be more severe from the coastal to the inland areas, ranging from –10 to –20 percent in 2040 and from –25 to –45 percent in 2090.

Snow water storage and the ski winter season are also likely to become a growing concern. Mountain areas in Lebanon play an important role in water supply and in tourism during the winter months. However, mountainous areas are expected not only to experience a reduction in total precipitation, but also a reduction in the fraction of precipitation falling as snow, affecting snow cover and snow water storage. Changes in melt-water regimes are expected to bring about a shift in peak river flows toward the earlier months of the year, with negative impacts on downstream riparian systems during the hot and dry summer months. Lebanon's Second National Communication analyzed the Upper Nahr el Kalb Basin under a stylized warming of 2°C and 4°C. Snowpack volume was projected to shrink from 1,200 million cubic meters to 700 million and 350 million cubic meters, respectively (Ministry of Environment 2011).

Other sectors vulnerable to climate change include agriculture, electricity, coastal zones, forestry, public health, and human settlements and infrastructure, for which adaptation measures need to be implemented. Agriculture is one of the most vulnerable sectors due to limited availability of water and the effects of population growth and urbanization on agricultural yields of crops, particularly fruit trees.

Higher electricity demand in summer will require between 87 and 438 mega-watt expansion of installed capacity, given that an increase in total consumption will be 1.8 percent for a 1°C increase in temperature and 5.8 percent for a 3°C increase.

Current sea-level rises average approximately 20 millimeters a year in the Levantine Basin, and a 30–60 centimeter rise in 30 years will significantly affect coastal zones, human settlements, and infrastructure. In addition to changes in temperature and rainfall, expected changes in Lebanon's bioclimatic levels will adversely affect Lebanon's forests and nature reserves, frequency and periodicity of fires, and regeneration, overall area, and population of certain tree species.

Direct and indirect effects of climate change will affect public health on many fronts, with 2,483–5,254 additional deaths per year expected between 2010 and 2030 due to higher temperatures, with vulnerable groups particularly at risk.

Sources: Lebanon's Second National Communication to the UNFCCC, Ministry of Environment, 2011 ; World Bank (2014) "Draft Turn Down the Heat III," Washington DC ; and Lelieveld J., et al. (2013), "Model projected heat extremes and air pollution in the eastern Mediterranean and Middle East in the twenty-first century," Regional Environmental Change, Springer-Verlag.

a. Heatwave days are calculated by the warm spell duration index, which is defined as the longest annual spell of at least six consecutive days with maximum temperatures exceeding the local 90th percentile relative to a reference period (in days).

delicate societal and intercommunity balance in Lebanon. Lebanese women and girls are particularly affected, as insecurity and violence rise.

Decentralization has long been discussed as a possible answer to the unsustainable deterioration in key public services. During his term, President Suleiman introduced a draft law on

administrative decentralization in April 2014. Called for in the Taef Accord, the legal reforms aim to redistribute the authority, responsibility, and financial resources needed to provide public services across tiers of government. The bill contains 147 items and prioritizes the powers and rights of municipalities, particularly with respect

to financial autonomy. The aim is to create an elected council in each of the country's 25 *qadas* (districts) with wide-ranging financial and administrative powers. However, decentralization reforms in Lebanon are linked to the confessional structure of government and the way power is shared between the various groups, making passage of the draft law challenging.

Service delivery at the municipal level is overburdened by the surge in demand for services at a time when municipal finances are erratic. Municipal financing is a perennial issue in Lebanon. Municipal revenues are broadly considered to be insufficient and provided in a manner that greatly constrains the ability of municipalities to offer services and conduct local development projects. Municipalities have two main sources of revenue: transfers from central government, which are distributed through the Independent Municipal Fund (about 70 percent), and local taxes and fees, representing the remaining 30 percent. The Independent Municipal Fund allocations are based on (a) the number of registered voters in the municipality (not the number of actual residents) and (b) the total amount of revenues collected in the previous two years. This formula is considered inequitable, as it fails to take into account the size of individual municipalities and makes it difficult for smaller municipalities to provide an acceptable level of service. In addition, payments from the Independent Municipal Fund tend to be irregular, with payments sometimes delayed up to two years.

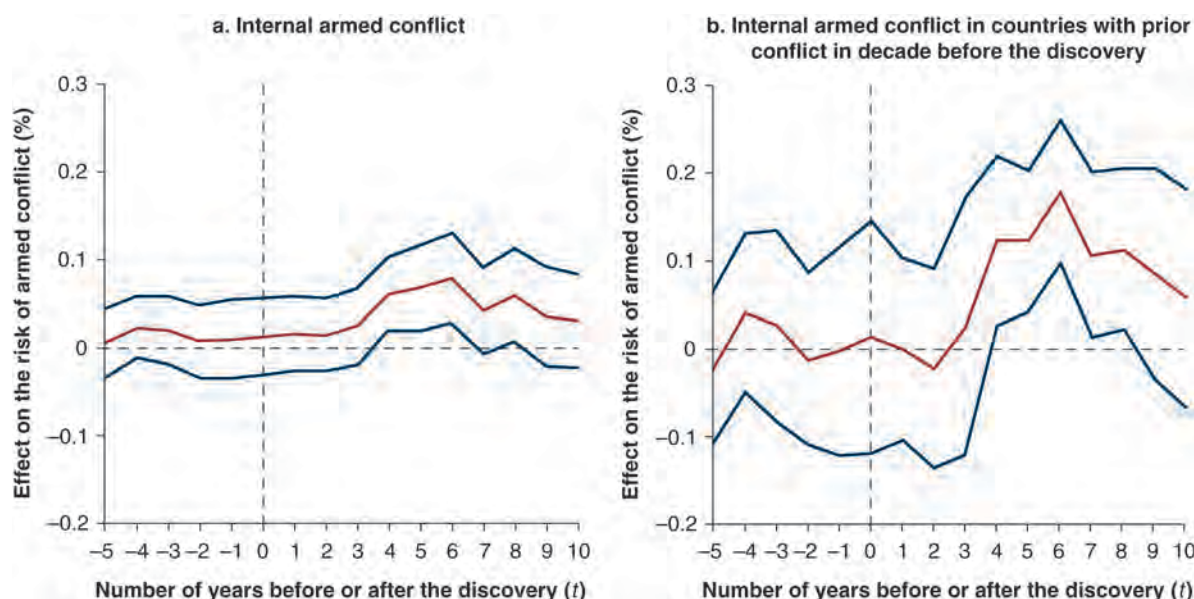
Hydrocarbon Wealth and Risks: Conflict, Macroeconomic, and Fiscal Mismanagement

Large hydrocarbon discoveries pose significant risks of social tension and conflict for Lebanon. Windfall revenues from hydrocarbon discoveries (or from increases in the price of hydrocarbons) can spur violence in the attempt to appropriate these revenues.² As supported by recent evidence, this is more likely to be the case in countries where political violence can achieve political and

economic gains. For example, Lin and Michaels (2014) find that, on average, giant oilfield discoveries increase the risk of internal armed conflict by about 5–8 percentage points within four to eight years of discovery compared with a baseline probability of about 10 percentage points. This effect is even larger for countries that experienced at least one civil conflict in the decade before the discovery (figure 4.3). Similarly, Calì and Mulabdic (2014) find that increases in the value of point-source commodity exports (driven by international prices) lead to a higher risk of conflict.³ They also identify several factors that affect the relation between the value of hydrocarbon export revenues and the risk of conflict. The most significant are the level of economic inequality, the level of ethnic and religious divisions, and a history of recent conflict. The increase in the risk of conflict is higher in countries with higher levels of ethnic and religious fractionalization, with greater levels of economic inequality, and with a civil conflict in the last 10 years.

Lebanon fits the profile of a country exposed to conflict risk from hydrocarbon exports too well. The country has a relatively high level of economic inequality and religious fractionalization, and it is experiencing a low-intensity civil conflict.⁴ These characteristics increase the risk of conflict induced by a hydrocarbon discovery in Lebanon relative to the average country. Table 4.1 quantifies the increased risk due to each of these factors on the basis of the marginal effects computed in Calì and Mulabdic (2014). For example, for a country with the average level of religious fractionalization (0.35), a 1 standard deviation increase in hydrocarbons and mineral exports raises the risk of conflict by 2.5 percent. At the level of fractionalization of Lebanon (0.79), the increased risk is more than double, at 5.7 percent. A similar story applies to the two other main factors: economic inequality and recent conflict. At the same time, other factors, such as level of democracy, level of accountability, presence of conflict in neighboring countries, and share of trade with neighbors, yield smaller differences between Lebanon and the average country.

FIGURE 4.3 Effect of a Giant Oilfield Discovery on Internal Armed Conflicts, 1946–2008



Source: Lin and Michaels 2014.

Note: The red lines show the estimated coefficients, and the dark blue lines show the 95 percent confidence intervals based on robust standard errors clustered by country.

TABLE 4.1 Risks of Conflict from Hydrocarbon Exports in Lebanon

Risk	Mean	Lebanon	Average effect (%)	Lebanon effect (%)	Significance
Inequality (Gini)	45.44	55.33	2.10	4.20	Yes
Religious fractionalization	0.35	0.79	2.50	5.70	Yes
Recent conflict	0.28	1	2.20	4.10	No
Level of democracy	-1.21	7	1.90	1.90	No
Accountability	3.24	5	2.40	0.90	No
Neighbors in conflict	0.52	Yes	2.00	2.30	No
Share of trade with neighbors	0.12	0.03	2.00	2.10	No

Source: For the computations, Cali and Mulabdic (2014). For the mean and Lebanon values, Solt (2009) for inequality data; Alesina et al. (2003) for religious fractionalization; UCDP/PRIO database for recent conflict (mean) and International Country Risk Guide (ICRG) for recent conflict (Lebanon); polity 2 data for level of democracy; ICRG for accountability; UCDP/PRIO for neighboring conflict (mean) and ICRG for neighboring conflict (Lebanon); and COMTRADE for share of trade with neighbors.

Note: Mean is the mean value of the variable across the entire sample over which the marginal effect of the export price index is computed in Cali and Mulabdic (2014). Average effect is the increased probability of conflict due to a standard deviation increase in the point-source commodity export index measured for the mean value of the variable. Lebanon effect is the same increased probability measured at the value of the variable for Lebanon.

Another key risk related to becoming a commodity producer and exporter is the associated macroeconomic and fiscal challenges. One common economic challenge is the possible occurrence of “Dutch disease,” which refers to the risk that sustained, large external inflows could rapidly stimulate aggregate domestic demand and the economy beyond its potential, creating

inflationary pressures and leading to real exchange rate appreciation. This would, in turn, diminish the export competitiveness and possibly lead to persistent trade account deficits. While the resource extraction sector can generate substantial revenues, it is not labor intensive. Hence, any loss in competitiveness from the non-resource part of the economy could

potentially result in large employment losses (World Bank 2014g). Another challenge is the high volatility of revenue and spending—typically higher than for non-commodity producers—and associated procyclicality (IMF 2014). In addition, resource revenue is exhaustible, raising issues of sustainability and intergenerational equity. This calls for smoothing government consumption over time and avoiding the need for massive fiscal adjustment once resource wealth has been depleted (IMF 2014).

Agriculture Sector Risks and Opportunities

In general, the lack of diversification of incomes of farm-based households raises significant risks regarding the sector's impact on the World Bank Group's twin goals. The primary concerns regarding sustainability and risk in relation to agricultural growth and poverty reduction are the need to facilitate diversification of farm incomes through both on-farm (increased production of high-value products and value addition) and off-farm employment opportunities. In addition, some on-farm investments will require land consolidation to permit scale economies in production. Government's ability to influence the sector is limited largely to capital investments due to low budget allocations for the Ministry of Agriculture and very low levels of staffing, which weaken the ability of the ministry to provide standard agricultural services.

If not addressed, the huge amount of surplus labor from Syrian refugees will generate social tensions in rural areas. This is because the massive increase in labor supply and the sudden availability of relatively cheap labor have led to a decline in real wages and in opportunities for “decent” jobs. For example, the influx of Syrian workers may have reduced the daily agricultural wage rate as much as 60 percent (FAO 2013). According to a survey by the International Labour Organization in 2013, three out of four Syrian refugees were paid less than US\$400 per month.

Moreover, low wages may depress the nutritional standards of the poorest quintiles of the population, especially the health of young children and women.

The Syrian crisis has shifted Lebanon's agriculture sector from exports to domestic food production. A significant change has been the shift to domestic production from exports previously oriented toward the Syrian market. Moreover, prior to the civil war, Syria subsidized fertilizers and pesticides. Many Lebanese farmers traded or smuggled agricultural inputs from Syria. As this informal and cheap source of agricultural inputs has dried up, farmers have had to rely on inputs from the domestic market, which is increasing production costs. The tense security situation of farmland alongside the Syrian-Lebanese border and the diversion of trade routes have also increased production costs. While the export sector has been hurt, the massive number of refugees has led to increased demand for domestically produced food items. This occurs largely because the international community distributes food aid for Syrian refugees in the form of cash. At the same time, there has been a sharp decline in imported agricultural products. This has benefited Lebanese farmers who produce for the domestic market, as they face less competition and benefit from a supply of cheap labor.

The change in market structure presents both opportunities and challenges. It is likely that the shift will have significant impact on Lebanon's agriculture sector over the medium term. On the one hand, the increase in domestic demand and labor supply could be regarded as an opportunity to develop the agriculture sector in Lebanon further. On the other hand, the ongoing shift in the structure of production suggests upcoming challenges, as Lebanon needs to diversify its exports into alternative markets. One option is for the export sector to reorient production toward new regional or perhaps European markets. As the sector is dominated by a dynamic private sector, this reorientation could be supported by providing entrepreneurs with adequate market information.

Notes

1. The balance sheet mismatch on short-term foreign assets exposes the country to sudden stops. Lebanon's short-term foreign liabilities surpass its reserve of foreign assets, which exposes the country to a sudden stop. Short-term foreign liabilities are largely those of commercial banks, which reached 222 percent of GDP in 2013. On the other hand, Lebanon's total foreign assets reached 157 percent of GDP that the same year.
2. Various theoretical models can account for this effect, usually called the "state prize" or "rapacity effect" (for example, Besley and Persson 2009; Dal Bó and Dal Bó 2011).
3. Point-source commodities include hydrocarbons and mineral products (Cali and Mulabdic 2014).
4. This categorization of conflict follows from the International Country Risk Guide (ICRG) data and the UCDP/PRIO Armed Conflict Database. In the first seven months of 2014 ICRG assigns an average value of 2 to Lebanon in the civil war category (on a scale to 1–4), placing the country in the top decile of that category. The current low-intensity conflict in Lebanon is also in line with the UCDP/PRIO definition of "a contested incompatibility that concerns government and/or territory where the use of armed force between two parties, of which at least one is the government of a state, results in at least 25 battle-related deaths."

Chapter 5

Prioritizing Challenges and Highlighting Opportunities

Introduction

This chapter presents a prioritized list of the most critical constraints facing Lebanon in accelerating progress toward the twin goals of reducing poverty and promoting shared prosperity and suggests opportunities to address them. As diagnosed in chapter 3, Lebanon faces substantial overarching and nested constraints that have challenged progress toward ending extreme poverty and promoting shared prosperity in a sustainable manner. Should the status quo persist, Lebanon risks exacerbating an already fragile situation, as presented in chapter 4. While tackling these constraints simultaneously may seem daunting, this Systematic Country Diagnosis highlights critical constraints that, if addressed, could help Lebanon to make meaningful progress toward achieving growth, inclusion, and sustainability.

The SCD's prioritization of constraints aims to assist in the identification of reforms to support the growth and poverty reduction efforts of the government and donors, and to inform the World Bank Group's Country Partnership Framework, which will be defined and agreed with the government of Lebanon. The agreed framework will outline the World Bank Group's work in Lebanon over the next four- to five-year period. As the SCD is a public document, it is also intended to be a resource for the general public.

Methodology

While any prioritization of development challenges contains large subjective and normative components, the methodology used in this SCD

sought to be analytical, transparent, and participatory. The constraints on job creation and achievement of the twin goals were prioritized through the process described in this section.

First, a comprehensive list of constraints was established. These were obtained from the analytical work done for chapters 1–4. The robustness of the analytical work in identifying a comprehensive set of constraints was validated through extensive stakeholder consultations.¹ Whenever stakeholders identified constraints that were not adequately reflected in the initial draft of the SCD, World Bank Group sector experts were asked to consider this new information, along with available supporting evidence, in revising the SCD.

Second, experts were asked to score each of the long list of constraints. World Bank Group experts who worked on the Lebanon SCD scored each of the constraints on the comprehensive list. These experts consisted of two broad types of World Bank Group staff. The first type included sector experts who are assigned to Lebanon as part of their country coverage (for example, a water sector expert assigned to work on Lebanon and a few other countries); these experts are very knowledgeable on the relative strengths and weaknesses of Lebanon in their specific sector of expertise. The second type included country experts who work on a broad range of sector issues in Lebanon (for example, a country economist or a program leader); these experts are very knowledgeable about the comparative strengths and weaknesses of sectors within the economy. The World Bank Group experts also included a good representation of staff based inside and outside of Lebanon. This diversity in sector and

country background as well as a desirable mix of bird's-eye view and deep local knowledge were meant to provide strong assurances that the ranking of priorities captures the complexity of the country's development challenges. The diversity of experts also was useful for checking the robustness of the final ranking.

When scoring each constraint, experts were instructed to base their assessment on the following five criteria:

- *Impact on goals.* Assess the size of the potential impact on eliminating poverty and ensuring a sustainable increase in the welfare of the less well-off; relative to the other criteria, give the highest weighting to the overall impact on achieving the twin goals
- *Time horizon of impacts.* Calculate the balance of short-term and longer-term impacts when looking at the timeframe within which the impact could be realized so as to include interventions that will deliver quick (visible) wins
- *Preconditions.* Identify the constraints that need to be addressed first in order to unlock wider potential
- *Complementarities.* Weigh the degree to which addressing these constraints would have influence across different domains (for example, growth, inequality, sustainability) or would magnify the positive impact of addressing other constraints
- *Evidence base.* Evaluate the degree of confidence in the evidence base (for the problem and the solution).

Political feasibility, which has been used in other World Bank Group SCDs, was not incorporated as a separate criterion, as it was already captured in the overarching constraint of elite capture.

Third, the expert scores were ranked. The results from the World Bank Group experts were tabulated, and constraints were ranked based on the average score of each individual constraint. To provide a reasonable trade-off between having a narrowly focused set of priorities and having an excessively long list of priorities, which would dilute the prioritization exercise, it was

decided that Lebanon's priorities consisted of the top third of the ranked constraints. This top third of constraints yielded common themes and sectors, generating a list of 11 *ranked* priority areas.

While priority areas were identified, the prioritization exercise was undertaken at the *intensive margin* (that is, while the education sector was one of the areas identified, the top priority was not the sector itself, but specific issues such as the "stark inequality in education between the public and private education systems" or the "influx of refugees from the Syrian Arab Republic that exacerbates problems related to access and quality of education in public schools"). The value added of a ranking based at the intensive margin is that it provides clear directions on specific issues that are bottlenecks to developing and creating numerous quality jobs.

Fourth, sensitivity analysis and robustness checks were conducted. To check the sensitivity or robustness of the ranking of priorities that emerged from the scoring process, the impact that alternative criteria would have on the priorities identified was analyzed.² The fact that the World Bank Group experts were from very diverse professional and personal backgrounds enabled us to analyze the robustness of the ranking by splitting the voting results along these various factors. Reassuringly, the priorities identified were robust to all reasonable alternatives used.

Results of Prioritization

Eleven priority areas for reform were identified and ranked.³ Of these, two consist of the overarching areas of (a) elite capture behind a veil of confessionalism and confessional governance and (b) conflict and fragility. The nine nested areas—in *prioritized* order of binding constraints—are related to governance, information and communication technology (ICT), energy, macroeconomics and the fiscal environment, the business climate, education, transport, the environment, and water. Data availability also arose as a foundational constraint. The heat map

presented in table 5.1 reflects these 11 areas across the ranking framework's five criteria. Of the top 10 constraints, the top 4 were related to governance, ICT, and energy, followed by elite capture, conflict, and macroeconomic and fiscal constraints.

Jobs emerged strongly as the outcome or goal that stakeholders perceive is needed for Lebanon and its citizens to achieve their development potential. "Jobs" are not a separate cluster in the top constraints, as they are the outcome, not the determinant, of existing challenges. Weak job creation, especially for the increasing number of women in the job market and in locations beyond Beirut (for example, Tripoli), limits the development of economic and human capital, and high unemployment is often of long duration. The stakeholder consultations highlighted that insufficient job creation is a cross-cutting theme, particularly for the poor, with the caveat that social protection also has a strong role to play for the more vulnerable members of society. The consultations also emphasized that the lack of quality, well-remunerated jobs pushes youth and others who are disillusioned with the status quo to emigrate. The country's low-jobs-producing economy is also exacerbated by the influx of Syrian refugees, who are increasingly competing for jobs and putting downward pressure on wages, especially affecting the unskilled, women, and youth. Unlocking the prioritized constraints would stimulate the creation of jobs, with beneficial effects on living standards, productivity, and social cohesion.

The following paragraphs synthesize the top third of constraints grouped by cluster. The two overarching areas are presented first, followed by the nested constraints, listed from the highest to the lowest ranked constraints in the cluster.

Overarching Constraints

An overarching constraint for Lebanon is pervasive elite capture and corruption hidden behind a confessional veil. Significant progress on job creation and achievement of the twin goals is severely constrained by elite capture of the

distribution of power and lack of accountability. This system allows political interference in public institutions and concentrates political influence and wealth among a privileged few at the expense of broader economic development and robust job creation. It fails to manage conflicts of interest between the business community and the political elite, which creates economic rents. Ultimately, this system is fueled by corruption, including payment of bribes in both the public and private sectors.

Conflict, security, and fragility, including the recent Syrian crisis, is another overarching constraint. Lebanon suffers from a fragile and dysfunctional political system resulting in a state that is severely constrained and, at times, unable to regulate conflict and exercise sovereign authority, due to both internal and external factors. Security shocks have historically rendered growth volatile. For example, the recent Syrian crisis and ensuing influx of refugees are affecting Lebanon's economy and exacerbating problems of access to and quality of education, health care, public and social services, as well as environmental degradation. Conflict also aggravates corruption, which directly links to the overarching constraint of elite capture.

Nested Constraints

Governance emerges as the top nested constraint for Lebanon, with the lack of political will and vision and the lack of capacity of government institutions (including the judiciary) as particularly binding. Governance and institution-related challenges are the most binding nested constraints for Lebanon's achievement of the twin goals, with the top-ranking constraints being "lack of political will, capacity, and institutions to design and enact new laws, policies, and strategies and to implement reforms." Stakeholder consultations highlighted a lack of vision and leadership, whether manifested in insufficient planning, lack of continuity of government policies, or absence of clarity on what the vision is for addressing short- and long-term challenges, including poverty. Public institutions are perceived as

TABLE 5.1 Heat Map of Identified Priority Areas in Lebanon

Priority Area	Summary of Constraints	Impact on goals			Time horizon of impacts			Pre-condition?		Complementarities			Evidence Base		
		Small	Medium	Large	Short	Medium	Long	Yes	No	Weak	Medium	Strong	Weak	Medium	Strong
Overarching															
Elite capture under confessionalism veil	Corruption and lack of accountability, conflict of interest between business community and political elite, concentration of political influence and wealth among few families, confessional system that drives distribution of power and political interference in public institutions.														
Conflict, security and fragility (including recent Syrian conflict and refugees)	Fragile and dysfunctional political system and state, unable to regulate conflict and exercise sovereign authority, conflict as overarching constraint affecting macroeconomy, jobs, environment, with recent Syria crisis increasing competition for jobs, economic and fiscal costs, exacerbating: environmental degradation, weak public and social services access and quality of education in public schools														
Nested															
Governance and Institutions	Lack of political will to implement reforms, weak and inefficient public institutions, absence of political consensus on national priorities,lack of vision and planning to address challenges such as poverty, weak accountability, slow, costly and corrupt judicial system, low capacity of public sector to deliver quality public services, lack of continuity of government policies, favoritism in government officials' decisions, state that is absent/hollowed out for many parts of society.														
ICT	Infrastructure deficiencies including need for improved telecommunications infrastructure, mobile phone subscriptions, broadband and internet services.														
Energy	Energy sector and EdL specifically as source of macroeconomic vulnerability and lack of political will and vested interests prevent effective reforms.														
Macroeconomic and fiscal environment	Unequal economic development across Lebanon, fiscal policy that lacks basic accountability, captured, inefficient and unproductive; public financial management system suffers from														

table continues next page

TABLE 5.1 Heat Map of Identified Priority Areas in Lebanon (Continued)

Priority Area	Summary of Constraints	Impact on goals			Time horizon of impacts			Pre-condition?		Complementarities			Evidence Base		
		Small	Medium	Large	Short	Medium	Long	Yes	No	Weak	Medium	Strong	Weak	Medium	Strong
	constraints that hinder its proper functioning, frequent shocks rendering growth volatile, lack of approved budgets (since 2005), Syrian crisis impact on economy and public finances, unproductive spending/fiscal leakages, diversion of public funds, macro-fiscal framework with large vulnerabilities.														
Business	Weak business environment for private sector limits firm creation, reduces efficiencies and competitiveness of operations, monopolies linked to politicians hinder competition, lack of diversity in economy mainly focused on real estate and tourism, relatively high import and export costs, bad infrastructure and cumbersome procedures.														
Climate															
Education	Stark inequality in education between public and private education systems, influx of Syrian refugees that exacerbates problems related to access and quality of education in public schools.														
Environment and Water	Large and rapidly growing environmental degradation particularly water pollution, a deteriorated water supply network, lack of universal access to potable water, and Syrian refugee crisis exacerbating environmental degradation incl. solid waste and access to clean water and sanitation.														
Transport	Lack of reliable public transportation combined with high traffic congestion in Greater Beirut.														
Foundation															
Data availability and access to information	Lack of strong statistical base and capacity to collect data to measure poverty and other issues, as well as lack of access to information by civil society which is exploited by politicians.														

Note: The color coding is as follows: red = very binding; orange = moderately binding; yellow = slightly binding.

extremely weak, inefficient, and corrupt, possessing low capacity to provide high-quality services, which is particularly damaging to vulnerable and less well-off citizens. The judicial system is singled out as being slow, costly, and corrupt, suffering from a lack of capacity, and being saddled with an inefficient and outdated legal framework.

Other predominant governance constraints include: (a) an absence of political consensus on national priorities among political actors due to the severe political prioritization that, since 2006, has paralyzed decision making; (b) weak accountability of the executive; (c) favoritism in decisions of government officials; and (d) a state that is totally absent or hollowed out for many parts of society.

Infrastructure deficiencies significantly hamper the achievement of the twin goals, especially telecommunications infrastructure, broadband, and Internet services. Given its complementarities with all sectors, the weak ICT sector is severely limiting job creation, growth, and ultimately the development of human capital and was the second highest ranked constraint and the highest infrastructure-related constraint. More reliable and lower-cost telecommunication and Internet services would positively affect citizens and the private sector alike.

The energy sector is in unequivocal need of reform. This sector captured the third and fourth top-scoring constraints. Lack of political will, vested interests, and corruption all prevent effective reforms in infrastructure, especially energy. *Electricité du Liban* is a major source of macroeconomic vulnerability given its drain on public finances and its impact on the balance of payments, with the sector suffering from operational inefficiencies, an outdated tariff policy, and serious deficiencies across the entire chain from generation to distribution. Reforms in this sector require special attention given its impact on public finances, the business climate (where electricity is the second biggest obstacle to private sector firms), and poverty reduction, where the poor have limited access to both government-supplied electricity and private generators (the latter mostly due to the high cost).

The macroeconomic and fiscal environment exhibits large vulnerabilities and has led to unequal economic development across Lebanon. Numerous macroeconomic and fiscal constraints entered the top third, constituting the second highest number of nested constraints after governance. The highest ranking of these relates to unequal economic development across the country, which has disproportionately benefited some areas and population groups, while largely ignoring others, including border areas. Constraints related to fiscal policy and public finance management dominate this cluster, led by fiscal policy that lacks basic accountability, is captured, inefficient, and unproductive, and is in need of oversight and is suffering from a stalled budget process. The lack of approved budgets since 2005 is itself perceived as an impediment to the twin goals, as it undermines the efficiency, accountability, and contestability of public policy decisions. Unproductive and wasteful government spending, the diversion of public funds, and fiscal leakages are significant and widespread, crowding out effective poverty reduction and social safety net programs. The inefficient use of public resources is attributed to a public finance management system that suffers from challenges that hinder its proper functioning and weaken its transparency. Frequent shocks, especially those related to the security environment, render growth volatile and contribute to a largely vulnerable macro-fiscal framework, including high fiscal deficits and an over-indebted sovereign. The recent Syrian crisis has exacerbated these weaknesses by further straining the economy and public finances.

The weak business climate limits firm creation by the private sector, which directly affects achievement of the twin goals. Four constraints related to finance, markets, trade, and competitiveness enter the top third. New firms face obstacles to entry due to a weak business environment that reduces efficiencies and competitiveness of operations and monopolies linked to politicians cum businessmen that hinder competition. The lack of diversity in the economy, which focuses mainly on real estate and

tourism, also impedes firm creation. From a competitiveness perspective, particularly for trade, relatively high import and export costs, bad infrastructure, and cumbersome procedures all contribute to an uninviting business climate.

Stark inequality in the access to and quality of education between public and private education systems is a challenge to human capital accumulation for a large share of the population. Education is key to the accumulation of human capital and critical to obtaining high-quality jobs, economic growth, and shared prosperity. While Lebanon exhibits relatively strong average human capital, particularly in education, the poor quality of public school education generates large inequality of opportunities among citizens, depending on the wealth and income status of their parents. This, in turn, widens inequality in the country, both spatially and over time. The recent influx of Syrian refugees has heightened this problem in public schools, with some schools overcrowded and teachers managing different curricula to accommodate the different needs of Lebanese and Syrian children. This situation is affecting the quality of learning of all students.

Large and rapidly growing environmental degradation and lack of universal access to potable water are important binding constraints given that environmental risk affects poverty. The environment, with a focus on water issues, was reflected in four constraints, with the highest concern being a deteriorated water supply network due to low public capital expenditures. Environmental degradation is a key constraint, particularly water pollution from untreated sewage, industrial effluent, and agricultural runoff discharged into water bodies. The Syrian refugee crisis is rapidly exacerbating environmental degradation given the limited quality and capacity of public water supply, solid waste challenges, and access to sanitation.

A lack of reliable public transportation, combined with high traffic congestion in the Greater Beirut area, impedes the twin goals. The last infrastructure constraint to break into the top third, this issue has repercussions for both households and businesses, resulting in monetary and

nonmonetary costs. The impact of an unreliable public transport system lowers countrywide connectivity, weighing heavily on economic growth and inclusion.

Data availability and access to information are foundational constraints that affect evidence-based policy making and impede an informed population. Major deficiencies exist in the timeliness of data, the reliability of available data due to weak statistical capacity, and limited data coverage, especially regarding poverty, income distribution, and economic measurements such as balance of payments. While some ministries have enhanced the disclosure of data and reports published, the general public has limited or no access to information that is typically publicly available in other countries, given that a freedom to information act has yet to be enacted. Such gaps in knowledge and facts can be used by the elite to sustain a confessional discourse.

Opportunities for Unlocking the Overarching Constraints

Internal challenges and pressures from the Syrian crisis have placed Lebanon at a crossroads. The country must urgently capitalize on opportunities to unlock its development constraints. While Lebanon has proven resilient to myriad internal and external crises, it has often (re)acted only in the face of crisis. Today Lebanon is confronting a “perfect storm” of protracted shocks. These include significant internal and external security threats, a presidential vacuum, widening macroeconomic vulnerabilities, and the arrival of an unprecedented number of refugees. These have the potential to alter Lebanon in significant ways over the medium term. The protracted nature of these shocks is of particular concern, as it is testing the limits of the country’s resilience.

Political leaders, decision makers, the private sector, and civil society need to be engaged to realize the extent of Lebanon’s challenges, agree on a vision for the future, and implement ambitious reforms. Quick wins for job creation need

to be urgently considered, particularly for vulnerable groups. With dysfunctional policy making at new highs, there is no room for complacency at this uncertain time of internal and regional instability and heightened risks.

At the same time, the Syrian conflict continues to undermine the stability of Lebanon, its development, as well as the overarching constraints of elite capture and fragility. At this juncture, considerable uncertainty surrounds future trajectories in the Syrian crisis. For the purposes of this document, three medium-term scenarios are identified and possible implications for Lebanon's overarching constraints are highlighted:

- *Resolution of the conflict in Syria (best-case scenario).* A ceasefire or a negotiated resolution of the conflict in Syria would lead to the cessation of large-scale violence and conflict, which would improve security conditions throughout the region. The implications for Lebanon could include a decrease in domestic political tensions and polarization, and an increase in the space for dialogue and reform. Improving security conditions in Syria could also lead to the beginning of the return of refugees, although a prolonged presence in Lebanon for the majority is still a possibility due to poor social and economic conditions in Syria over the short term. Finally, the start of economic recovery and reconstruction in Syria would provide the Lebanese private sector with significant opportunities for investment, trade, and services.
- *Continuation of the current situation (status quo scenario).* The continuation of the conflict in Syria, characterized by periodic positional warfare (that is, no major or decisive military operations) and insurgent activity and by limited will or prospects for peace negotiations, would continue to destabilize Lebanon, deepening its fragility. In this scenario, aggravation of both overarching constraints could be possible, including the deepening of elite and confessional divides, resulting in higher risks of political and social destabilization and a

progressive downward spiral of the economic and fiscal situation due to both government inaction and unmanaged pressures created by the refugee situation.

- *Escalation of the conflict in Syria.* A significant escalation of the conflict in Syria, including increased large-scale military confrontations and violence, could lead to further displacement of populations as well as renewed drives by belligerents to mobilize further support through regional networks and alliances. In such a scenario, the risk of a significant spillover of the conflict could severely destabilize Lebanon, with possible implications including the wholesale collapse of the political equilibrium, the degeneration of political and sectarian tensions into violent confrontations, and the collapse of government and state institutions. Potential political destabilization and the possibility of a renewed large-scale influx of Syrian refugees into Lebanon could significantly destabilize the social and economic situation, leading to popular unrest and tensions between communities throughout the country.

Mitigating the Impact of the Overarching Constraints on Development

While Lebanon's overarching constraints are deep-rooted—being the result of decades of institutional, social, and political evolution—potential ways to mitigate them do exist. Regardless of how the situation evolves in Syria, important opportunities exist for addressing Lebanon's twin overarching constraints, bolstering the country's resilience, and reducing its vulnerability to external shocks.⁴ These sources of resilience and options for reform can be classified broadly in two types of mitigation strategies: (1) those that directly aim to lessen the overarching constraints themselves and (2) those that take the overarching constraints as a given and work on lessening the nested constraints by designing a reform program that is incentive-compatible

with the overarching constraints. By aiming to lessen the overarching constraints, the first strategy carries the potential of a large payoff for the country's development, but, given the deep-rooted and symbiotic nature of the overarching constraints, it will take time to bear fruit. The second strategy is more suited to delivering gains in the short term, but, given the weight of the overarching constraints, these gains are likely to be more limited in scope and might be contingent on the emergence of "windows of opportunity."

The following options illustrate ways of approaching reform in a country, like Lebanon, with deep-rooted overarching constraints. Lebanon's overarching constraints are fluid, and these options should be seen as indicative of the overall approach to reform that should be undertaken. They do not claim to be comprehensive.

Strategy 1: Lessening the Overarching Constraints (Benefits: Medium-Term but Large)

Implementing Key Elements of the Taef Accord. Implementing key outstanding elements of the Taef Accord would likely yield significant results by lessening elite capture. These elements include a decentralization law and creation of a lower chamber of parliament that would be elected on a non-confessional basis (while having the upper chamber maintaining a confessional basis in order to protect minorities' rights).

Decentralization, if properly designed, could be a means to restore the link between elected policy makers and voters or consumers of public services. Empowering local governments through decentralization may mitigate opportunities for elite capture. Divesting power (financial, political) to the local government, or at least power over a few priority services, could create a clear line of accountability from the local officials to the citizens they represent and facilitate government responsiveness to citizens' needs. Working to implement the draft decentralization law could leverage the viability of this option.

The creation of a second chamber that, by design, would be non-confessional and tasked to legislate based on a non-confessional basis likely would significantly lessen the power that a few elites have been able to amass over the years by using the veil of confessionalism. Minorities' confessional rights would still be protected through an upper chamber of parliament, but the upper chamber would not have the key agenda-setting role that it currently has.

Improving Access to (Statistical) Information.

Access to information is a core tenet of an open and inclusive society, and constitutes an integral part of creating a level playing field. It would allow more fair competition within the private sector and help civil society and citizens to hold government accountable. It would also help to show the real costs—both economic and social—of the current system of governance. Increased transparency by the Lebanese public sector would offer access to government information and socioeconomic data and statistics. This could facilitate the participation of citizens, media, and civil society organizations in informed policy dialogue and increase accountability, as these groups would be able to scrutinize information. Adopting proactive disclosure measures, before passing legislation (as legislation does not necessarily translate into implementation; implementation is often a function of political will in individual ministries, departments, and agencies), could mitigate elite capture by moving toward equal access to information, limited discretionary opportunities, and increased accountability.

Improving Services in High Demand.

Strategically improving services in high demand from the public and the private sectors may create appropriate demand and provide an incentive for public officials to put the public interest ahead of elite capture. In Lebanon, actual responsibility for local service delivery falls under the remit of the central administration, which is captured by the elite. As such, public sector spending, human capital, and, ultimately, delivery of services are

governed not necessarily by need, but by a patronage system based on religious and political alliances. In addition, many local officials are appointed by the central government, as opposed to being elected locally.

Improving the services most used or considered most important by the general public could increase the demand for reforms from across confessions, which could create incentives for public sector entities to engage in further reforms. Such sectors may include health, education, land administration, and access to personal documents. The same can be said for reforms that would benefit the private sector more broadly. Reforms could include automation of common documents, e-services, simpler administrative procedures, and efforts to address low-level corruption, such as bribery of administrative officials. Improved service delivery may ultimately lead to a shift in attitudes toward serving the public interest rather than protecting elite capture.

Promoting Political Stability. At the political level, the restraint exhibited by local confessional coalitions with respect to the Syrian conflict illustrates a general desire to avoid the kind of descent into conflict and warfare associated with the civil war. The gains achieved through national dialogue since 2006 and through instruments such as the Doha Accord—though interrupted—are important steps that could form the basis for a new political consensus on the nature of the political system and definition of national priorities.

Key pathways for action could include (1) promoting national dialogue and reconciliation, building on post-2006 precedents and (2) creating space for participatory dialogue and engagement on critical political and governance reforms, with a focus on increasing equitable and inclusive decision making and governance at all levels.

Engaging in Institutional Reform and Development. Despite the destruction of the 2006 conflict with Israel and the current

pressures created by the Syrian refugee crisis, efforts have been made to strengthen national institutions, including through international assistance. While these efforts have not always translated into more equitable or efficient public services, they provide an important foundation for future capacity development to increase transparency and provide equitable services and constitute a starting point for future economic and development reform programs.

Key pathways for action could include (1) reforming key institutions, including transparency in targeting and allocative decision-making processes, and improving the quality and equity of service provision (an additional focus could include risk-based targeting); (2) strengthening public-private partnerships regarding social spending, based on common policy or planning frameworks and transparent or equitable rules governing allocation; and (3) developing institutional capacity development programs in key sectors, with a focus on addressing demographic and regional inequalities and promoting citizen-based policy development (as opposed to more narrow sectarian or confessional approaches).

Strategy 2: Tackling the Nested Constraints by Designing Reforms That Incorporate Existing Overarching Constraints

In the absence of the two overarching constraints, designing reforms at a sector level would focus on the technical issues that need to be reformed within the sector. In Lebanon, undertaking a technical analysis of sector reforms is a necessary, but not a sufficient condition for reforms to take place and be successful. For that to happen, a prior analysis of (1) key stakeholders' incentives and powers and (2) the sensitivity of the sector to conflict and fragility is required. If, for example, the stakeholder analysis reveals that one powerful confessional party derives strong personal rents from the sector and is in a position to veto any reform attempts in it, then even the most solid technical solution

will not produce the desired results. Once reformers have a solid understanding of the impact that confessional governance, conflict, and fragility have on the sector, they can design a reform package that is incentive-compatible with these two overarching constraints. This section provides examples of how such a package could be designed.

Making a Grand Bargain. Grand bargaining can help to mitigate competition over power (political and economic) between the confessional parties and elites that have captured the Lebanese economy. Currently, the status quo among the elite is to respect the sphere of influence of others by assigning religious confessions to lead, for example, specific ministries and the services delivered to their own constituents. Grand bargains would encourage different stakeholders to share the pains of reform in return for sharing the benefits.

In order for grand bargaining to be successful, an understanding of common strategic interests, incentives, access to information, power conditions, extent of mutual trust, and enforcement of accountability are needed. The alternative to not cooperating (i.e., conflict) is dire and imminent. Grand bargaining would most likely go beyond political parties in Lebanon to involve or incorporate international actors who influence Lebanese politics.

Seizing Opportunities. Being ready to seize windows of opportunity when they arise, such as when the overarching constraints become temporarily less binding (for example, because a regional peace accord significantly lessens both confessional governance, and conflict and fragility). Such an opportunity might be opening up in the governance sector, where several reform initiatives have recently been launched or are about to be launched. For example, the Ministry of Finance is considering wide-ranging reforms to the land administration process and has taken steps to address the widespread corruption in it. The Ministry of Health has taken steps to address unsafe food and drug practices.

Stakeholders could support and use these interventions to create spillover effects that benefit governance in other sectors as well—for example, by improving general accountability mechanisms involving the public sector or promoting access to information and transparency that touch on many different sectors.

Working around Elite Capture. Working around elite capture entails working with actors outside the public sector that could advocate for necessary reforms or bring key services to citizens. Many actors—private sector, civil society, political parties, and religious groups—currently compensate for the lack of services offered by the public sector; as a result, services are delivered on an ad hoc basis, with poor accountability.

Engaging Horizontally. Lebanon's civil society and private sector are often considered through sectarian filters—that is, as part of the broader sectarian system and the institutions to which they are affiliated. But the history of Lebanon since the civil war highlights the potentially positive role that civil society can play in fostering integrative and horizontal dynamics with respect to both political and economic issues.

A key strategic pathway is to strengthen the integrative and nonsectarian organization and engagement of civil society and the private sector—in particular, the Arab Spring generation—in the development of inclusive national agendas on reform and institutional development. At the local level, engaging these actors in efforts to mitigate social tensions (including those associated with the influx of refugees) could strengthen social cohesion and resilience and facilitate the development of mechanisms for managing associated social and economic pressures.

Managing the Influx of Syrian Refugees and Turning It into an Opportunity. It is likely that Lebanon will need to address a protracted presence of Syrian refugees over the medium term, regardless of how the Syrian crisis develops. While humanitarian assistance has been essential in sustaining the refugees and in partially

mitigating associated fiscal requirements, there is an opportunity to consolidate and sustain these gains over the medium term, while also strengthening and improving public and private capacities as a development outcome in their own right.

This bridging of the humanitarian-development continuum could include three strategic pathways: (1) improving safe asylum space by strengthening the capacity of host communities to manage economic and social tensions associated with the refugee presence; (2) providing support to the government to address fiscal requirements, while also developing the basis for medium-term improvements in infrastructure and public service delivery; and (3) promoting greater self-reliance and economic autonomy among the refugee population through targeted livelihoods assistance and policies for their medium-term inclusion in the national economy. The second point is critical for a country like Lebanon, which is providing the international community with the global public good of hosting refugees while also preventing or mitigating the proliferation of a global public bad, such as international terrorism (should prevention interventions such as tackling poverty be left largely unfunded).

Opportunities for Unlocking the Nested Constraints

Subject to the design of reforms that are incentive-compatible with the twin overarching constraints, taking advantage of opportunities in four areas could materially improve Lebanon's development prospects.

Infrastructure Reforms

Infrastructure reforms in electricity, ICT, water supply, and transport would improve the quality of life for all, in addition to stimulating job creation. Electricity sector reform is paramount and would result in higher cost recovery for EdL, improved fiscal and external balances, and lower carbon dioxide emissions. Reliable electricity would satisfy a prerequisite to support the

transport sector, which would itself unleash improved connectivity and stimulate growth. Such reforms would help to attract foreign direct investment and stimulate investments in real estate and government bonds, which would enhance Lebanon's competitiveness. Factoring renewable energy into Lebanon's energy mix is an opportunity to create green jobs, particularly as Lebanon has set a target of 20 percent of the country's energy mix to be met by renewable energy by 2020.

Upgrading ICT infrastructure would generate jobs, as would creating new services in intermediary sectors pertaining to broadband, such as those in e-banking, e-health, and new industries such as export-oriented information technology-enabled services. Such ICT advances would also support Lebanon's burgeoning technology ecosystem and stimulate the creation of more high-quality jobs.

Targeted Investments in Agriculture and Water

Some of the challenges of the Lebanese labor market could be addressed through targeted investments in agriculture and water. The agriculture sector is experiencing shifts in its production structure and declining wage income. Yet the Syrian crisis presents a sizable opportunity for domestic producers. Concrete investments could include support for the rehabilitation of irrigation schemes through both soft and hard infrastructure investments, consistent with the government's 2015–19 agricultural strategy, which aims to revitalize the sector (water scarcity and efficiency are identified as a main constraint for the expansion of agricultural production). Moreover, the export sector will need to reorient itself away from traditional markets in Syria and continue to diversify. It will need to upgrade the supply chains for high-value products, in particular, fruits and vegetables.

Likely areas of support could be analysis and market information systems, targeted export promotion programs, and institutional support to enhance the sector's efficiency and organization.

Human Capital Investments

Investments in human capital are crucial at all levels of education. Quality early childhood education has been documented as a barrier to escaping poverty and could be a medium-term win. At the secondary and tertiary levels, educational programs that are better suited to meet the demands of Lebanon's labor market are critical. Related, the presence of career counselors to guide youth in their selection of a major and a career offers another opportunity.

Youth need to be given hope that they can be a catalyst for change in Lebanon and be given the skills to succeed. For the most part, they are disengaged from the political process and demotivated to affect any real change in Lebanon. Hence their strong propensity to emigrate. Curricula need to be revised to ensure that graduates have skills that employers need, and entrepreneurship skills need to be integrated in the education system at the secondary and tertiary levels to motivate youth to initiate start-ups and create their own jobs. Establishing common spaces for youth from different backgrounds such as community centers and sports clubs could mitigate confessionally-designated spaces.

Soft Opportunities

While technical solutions are known for achieving reform and progress in each of the prioritized constraints, additional soft opportunities could be considered. There is scope for the state to regain the trust of its citizens, with state rebuilding as key and rule of law at its heart. Horizontal social engagement is one option.

In addition to focusing on job creation, another option is to propose and implement a youth engagement policy, launch campaigns on good governance, organize competitions to promote Lebanese identity, and publish inspirational and economically empowering content on jobs, scholarships, and grants. Behavioral change could be inspired through positive stories by recognizing administrations, agencies, and leaders that are delivering on their mandate by serving citizens well.

Lebanon could transform negative pressure points into positive ones. Confessionalism, when not exploited as a veil for corruption and elite capture, can serve to foster and respect Lebanon's diversity. Entry points in the confessional system could be identified in order to drive change, such as engaging the confessional structure in planning and discussions on public goods, job creation, and economic growth. Lebanon could also redefine itself amid demographic changes. For example, the country could capitalize on its changing comparative advantage in the agrifood business. Opportunities also exist for Lebanon's private sector given its experience in recovery and reconstruction, as troubled countries in the region stabilize.

The Lebanese diaspora has an important role to play in supporting reform. The strong support of the diaspora in providing a large base of remittances has been a source of strength for Lebanon. The diaspora could be mobilized to influence key decision makers in Lebanon to support reforms and could play a role in supplying talent, funding investment in productive assets, and mediating domestic political tensions by helping to focus private sector and civil society efforts away from confessional interests.

Notes

1. The multidisciplinary SCD team of experts across 16 global practices and cross-cutting solution areas from the World Bank, the International Finance Corporation, and the Multilateral Investment Guarantee Agency analyzed the existing literature and conducted new analysis to

identify constraints. Between June and December 2014, the World Bank also held eight stakeholder consultations with representatives from civil society, academic institutions, think tanks, the private sector, and the public sector in Beirut and Tripoli and held additional sessions with government

representatives, United Nations and donor representatives, youth, and a sample of the Lebanese diaspora in Washington, DC. These consultations provided additional insights and validated or informed new constraints.

2. These included using the results of the scores from (1) the core SCD team because they would have a comprehensive knowledge of Lebanon's constraints and from (2) all of the voters who answered at least 120 out of the 122 constraints because voters who only answered a small subset of questions would not have a comprehensive assessment of Lebanon's development challenges.
3. The average score of the final list of 122 constraints stood at 3.3 with a standard deviation of 0.5. The highest-ranking one-third of constraints was captured at a cutoff of the highest-scoring 41 constraints corresponding to 11 key priority areas when clustered thematically.
4. Despite the internal and external factors that contribute to Lebanon's fragility, there are also some important sources of resilience, including gains achieved over the past decade, which have prevented a relapse of the violence witnessed during the civil war. These sources of resilience constitute opportunities for both stabilizing the country and addressing fundamental structural problems.

Appendix A

Statistical System and the SCD

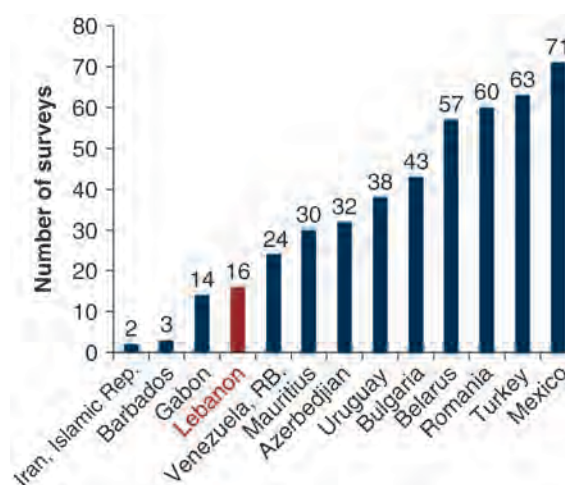
Overall statistical capacity in Lebanon is weak, in part due to the lack of resources and autonomy of the Central Administration for Statistics (Berthelemy, Dessus, and Nahas 2007; IMF 2014; World Bank 2010b). This is reflected in the indicator of low statistical capacity constructed by the World Bank. In 2010 Lebanon had the second lowest indicator after Gabon among countries at similar levels of economic development, as measured by gross domestic product (GDP) per capita in purchasing power parity (PPP) terms. Weak data impede both decision making and economic and social analysis. For instance, the span and frequency of the national accounts data limit the scope of the analytical work that can be undertaken in the Systematic Country Diagnostic. Neither cross-country regressions nor estimates of potential output, which require the use of advanced econometric techniques (such as filtering), can be performed with the currently available data.

In addition to low resources and capacity, key reasons underlying the weak statistical system in Lebanon are the political and sectarian sensitivities associated with data. The delicate political-confessional equilibrium described in the main body of the SCD gives rise to particular issues regarding the collection of household data in Lebanon. Given the sectarian nature of the political system, population demographics—the foundation on which much of a country’s statistical system is built—have always been a sensitive and highly politicized issue. There is a fear that some groups may claim more power if statistics show a shift in population demographics (Lebanese Information Center 2013). The last official census in Lebanon was conducted in 1932. The Lebanese administration updated the 1932 census results in 1942. The latest update of the population figures was in 1964, drawing on

civil status registers within the Ministry of the Interior (European Union 2009).

Lebanon is lagging behind other middle-income countries in collecting and making available microdata, which are the data needed to monitor the twin goals. Figure A.1 shows the number of microdata surveys available in the Central Microdata Library of the World Bank. The catalogue only has 16 surveys for Lebanon, compared to 63 surveys for Turkey and 71 for Mexico. A particularly severe problem in Lebanon is the lack of household surveys and data. Among the 16 surveys deposited in the catalogue, only two are household budget surveys. These household surveys collect the type of data from which poverty and distribution of income growth are estimated. Lebanon also does not have regular labor force surveys, which limits the analysis of the labor market and job developments.

FIGURE A.1 Number of Microdata Surveys Deposited in the World Bank’s Central Microdata Library, as of April 21, 2014



Source: Central Microdata Library.

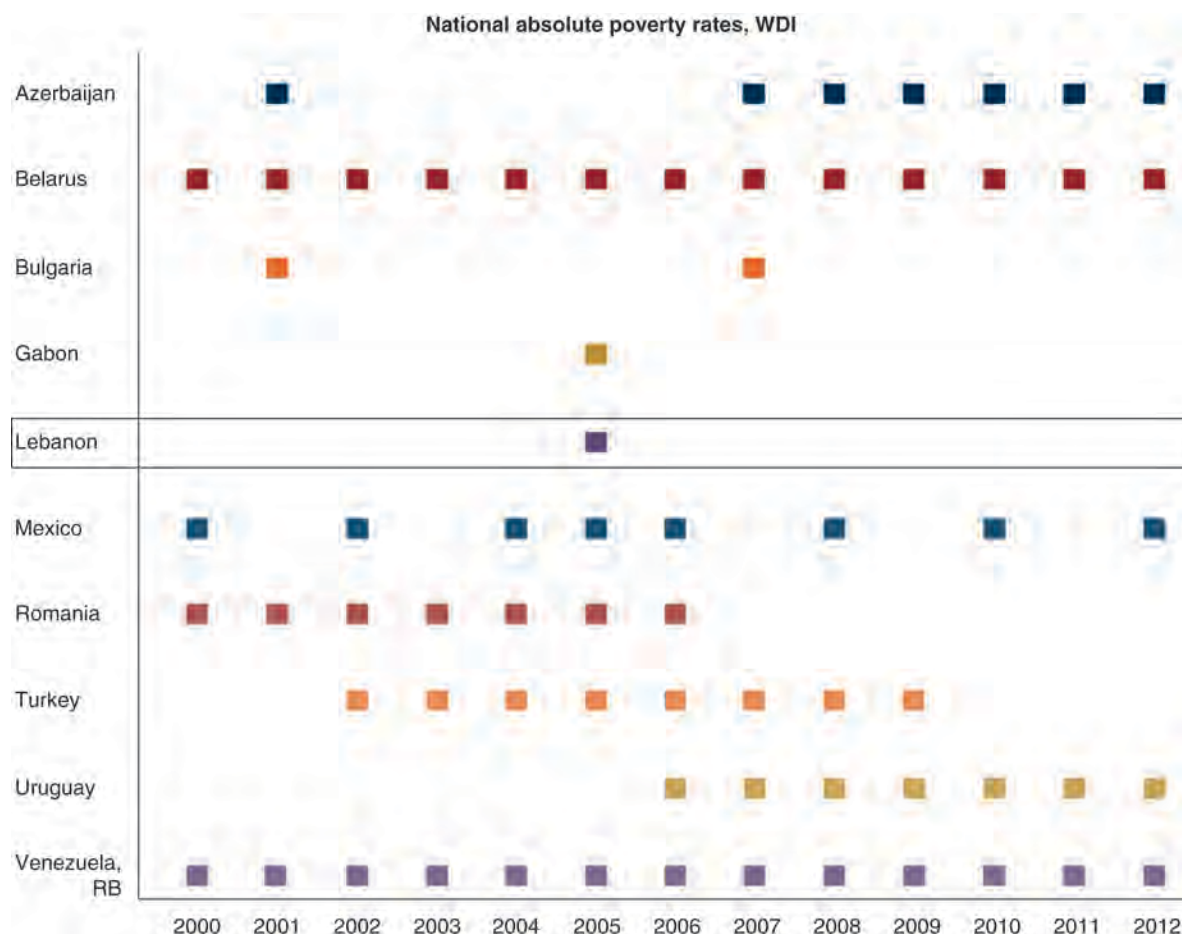
Note: Countries selected had GDP per capita in U.S. dollars PPP 10 percent higher or lower than Lebanon in 2010.

Lack of microdata in the World Bank catalogue can be driven by lack of availability or lack of access. For example, the Islamic Republic of Iran collects a plethora of household budget surveys, but does not share them with the World Bank. In contrast, Lebanon has conducted only two household budget surveys since 2000, and only one has been used to measure poverty and inequality. The national absolute poverty rate for Lebanon is only available for 2005, while many other countries measure national absolute poverty rates regularly (figure A.2).

Partly driven by political and sectarian issues, the importance of data collection and statistics

is not highlighted in the government's policy strategy documents. For example, data issues are not mentioned in Lebanon's national social development strategy (Ministry of Social Affairs 2011), even though the latest poverty estimates are for 2005. This imposes an important constraint on the government's ability to assess accurately and define core social development and poverty reduction goals, which perpetuates important social and economic inequalities. These inequalities reinforce political and social cleavages and exacerbate tensions, perpetuating and deepening Lebanon's vulnerability to conflict.

FIGURE A.2 National Absolute Poverty Rates in Lebanon and Selected Comparators, 2000–12



Source: Based on Azevedo 2011. World Development Indicators data as of June, 19, 2014.

Beyond the lack of data for analyzing the twin goals, some important issues also exist with the statistical information available for economic monitoring and analysis:

- *National accounts.* In addition to being compiled only on an annual basis, Lebanese national accounts cover only the 1997–2013 period (as of October 2015). The compilation of national accounts has improved recently, as the Central Administration of Statistics published, in October 2013, new national accounts for the 2004–11 period based on (a) a new framework that is consistent with the international standards (UNSC 2008) and (b) new data (for example, value added tax returns, imports of services).
- *Balance of payments.* Despite some modest improvements (such as the compilation of an international investment position statement), the International Monetary Fund (IMF 2014) notes that current account data have uncertainties related to estimates of private sector services, worker remittances, and investment income. The quality of the capital and financial account data is also weak, as uncertainties plague the data on foreign direct investment, equity investment, nonbank private sector, and corporate borrowing abroad.
- *Prices and inflation.* Prior to December 2013, consumer price inflation data did not provide (a) a comprehensive breakdown of prices (rental data are now collected on a monthly basis), (b) an updated weighting scheme for the inflation basket, or (c) a geographic breakdown of the consumer price index (CPI). The CPI also did not accurately reflect the dynamics of aggregate prices, as rental surveys, which accounted for 16 percent of the old CPI basket, were only undertaken once every three years. The Central Administration of Statistics also did not collect CPI data between January and May 2013, resulting in a break in the CPI series.
- *Labor market and productivity.* The latest official unemployment data are from 2009.¹ No labor force survey is periodically undertaken. Data on total factor productivity are not available. The absence of these data prevents analytical work on the role of different factors of production and technological changes in driving growth.
- *Access to capital and returns to private investments.* Data on sectoral access to capital are limited. While data on the cost of finance can be obtained, private returns to investment data are not available.

Note

1. The one-off MILES project (World Bank 2012d) somewhat attenuates the lack of labor market data, but these data date from 2010.

Appendix B

Economic Performance and the Civil War

As Lebanon's economic performance is materially affected by fragility and conflict, a long-term perspective on the country's growth is instructive. For example, Lebanon's economic performance has been profoundly affected by the 1975–90 civil war and has had lasting impacts on all core determinants of economic growth, from human and physical capital to institutional and social capital.

Led by services and private consumption, economic growth and growth per capita were robust between 1950 and 1974. The Lebanese economy grew, on average, an estimated 7 percent during 1950–74 (Makdisi and Sadaka 2003). Real GDP per capita growth exceeded 3 percent in 1950–74 (Gaspard 2004) and 3.3 percent during 1964–74 (Eken et al. 1995). While robust, this per capita growth was nonetheless lower than the average growth of seven neighboring countries.¹ In terms of sectoral contributions to GDP, the large services sector (69.5 percent of GDP) was the main driver of growth in the immediate pre-civil war period (1966–71). On the expenditure side, private consumption accounted for 78.5 percent of GDP, constituting the main driver of growth, by far, during that period (World Bank 1973). At the onset of the civil war, the structure of the economy resembled that of a developed economy with relatively small agriculture and industry.

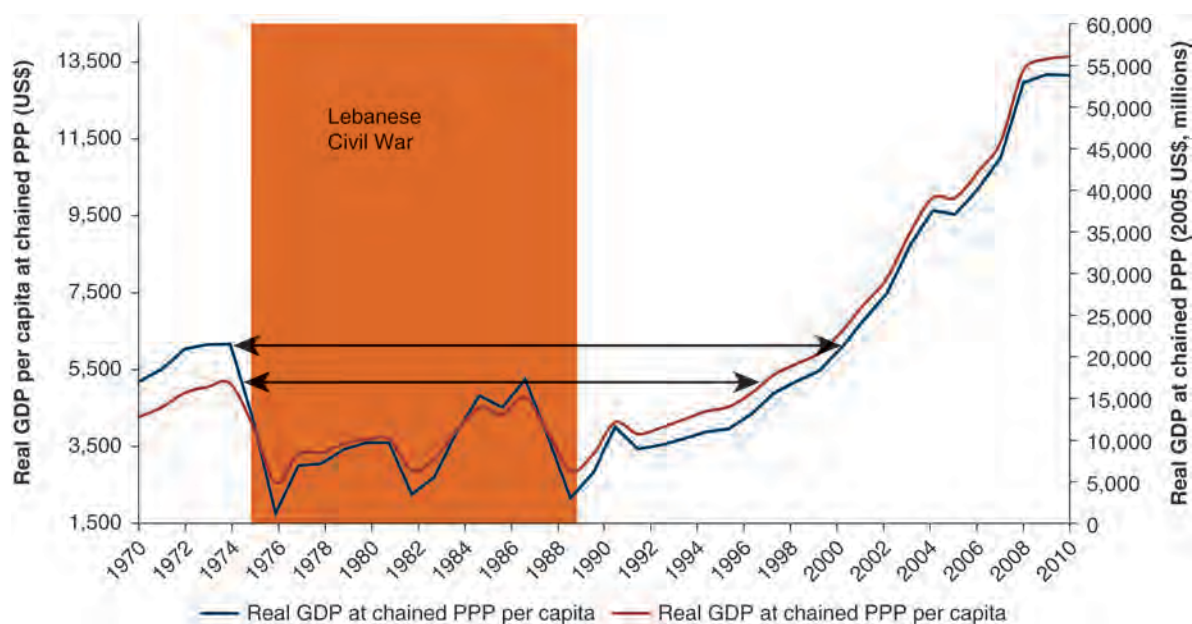
Lebanon suffered large and persistent economic and human (among other) losses during the civil war. Human losses are estimated at 144,000 fatalities (or 5 percent of the resident population at the time) and more than 184,000 injuries (Makdisi and Sadaka 2003). Lebanon's economy halved during the civil war² due to a large decline in investment, the dislocation of goods and labor markets, widespread destruction of physical capital stock (estimated at

US\$25 billion), and emigration of an estimated 200,000 skilled Lebanese, or 7.3 percent of the population (Eken et al. 1995; World Bank 1993). The economy only returned to its pre-conflict level (1974) level in 1998. In per capita terms, given rapid population growth (and notwithstanding the casualties of the civil war and the large and sustained outward migration), per capita real GDP only returned to its 1974 level in 2002. Thus in economic terms, it took one generation to return to the country's (average) welfare prior to the war. As described in chapters 1 and 2, the war also took a toll on institutions, governance, and the role of the state.

The civil war set back Lebanon's development for at least one generation (figure B.1). In the early 1970s Lebanon ranked in the top 31 percent of countries in the world in GDP per capita (PPP terms). That ranking dropped markedly because of the civil war and has not yet fully recovered (Lebanon was in the top 35 percent of countries in 2011).³ A slightly more positive assessment arises when looking at Lebanon's performance against countries that had the same PPP-adjusted GDP per capita in 1974 as Lebanon. As shown in figure B.2, Lebanon trailed its comparators (12 countries) until the 2000s. Since then, it has rapidly caught up, and by 2011, Lebanon ranked toward the middle of its 1974 peer group and is now again at par with Chile and Turkey, but still far behind the group's top performers (for example, Cyprus, with a PPP-adjusted per capita GDP that is 114 percent higher than Lebanon's). Similarly, the size of the Lebanese economy recovered only in 2009 the gap it had compared to the U.S. economy in 1974—that is, 41 percent in PPP terms (figure B.3).

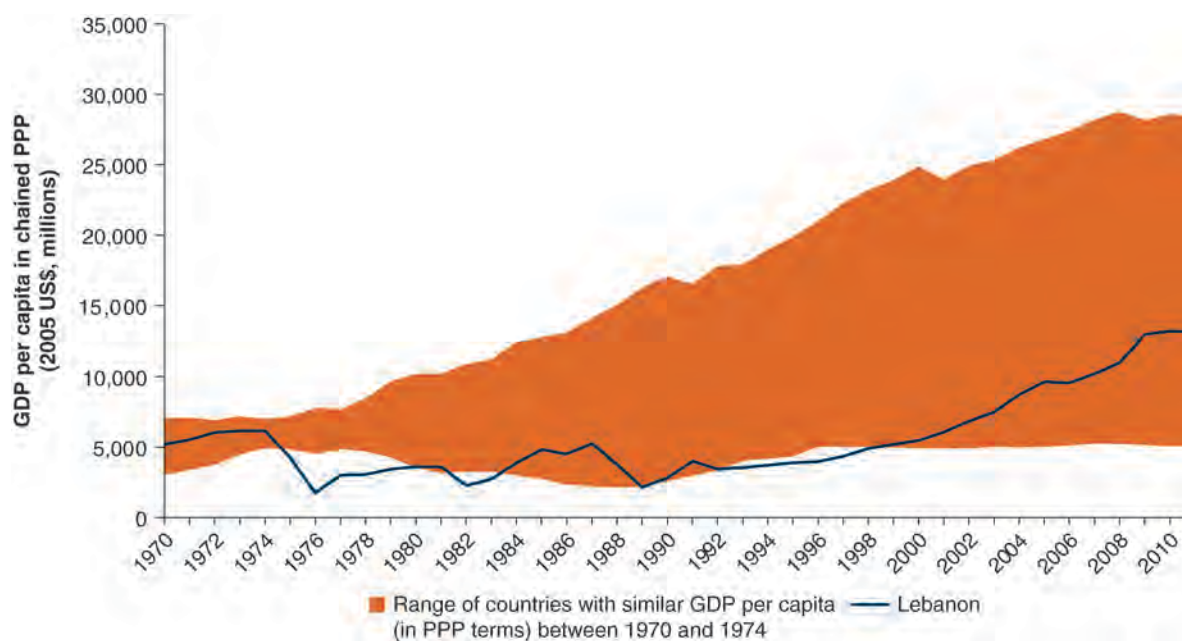
The country's recovery from the civil war was comparatively strong (figure B.4). Compared to 12 countries that had experienced a conflict

FIGURE B.1 Real GDP at Chained PPP in Lebanon, 1970–2010



Source: Penn World Tables 8.0 data.

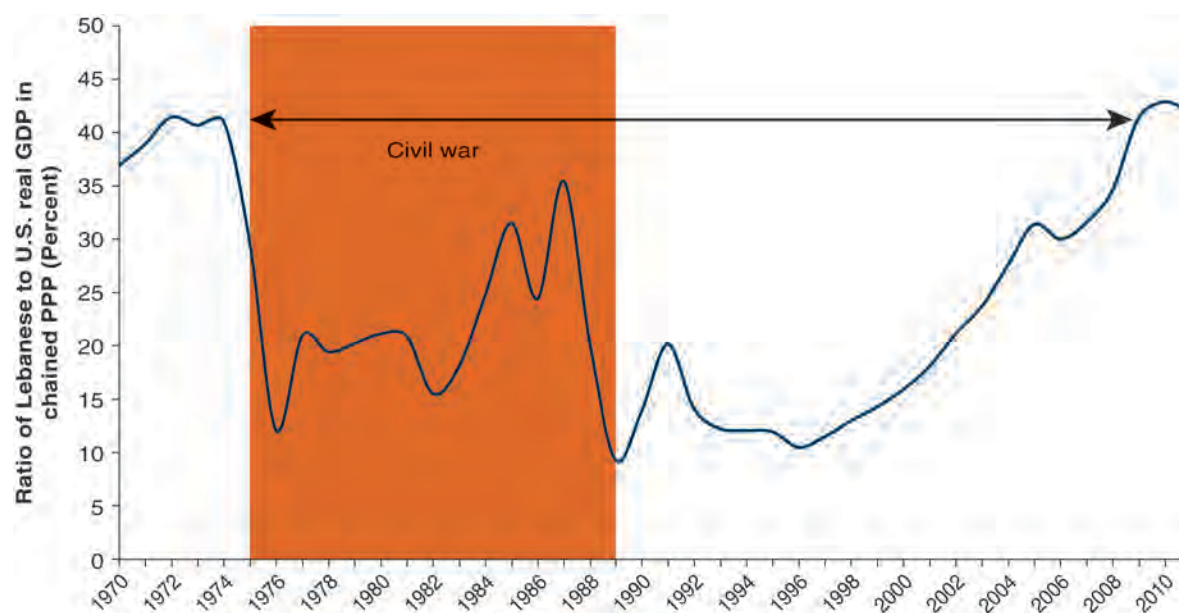
FIGURE B.2 GDP per Capita at Chained PPP in Lebanon and Comparator Countries, 1970–2010



Source: World Bank 2014I.

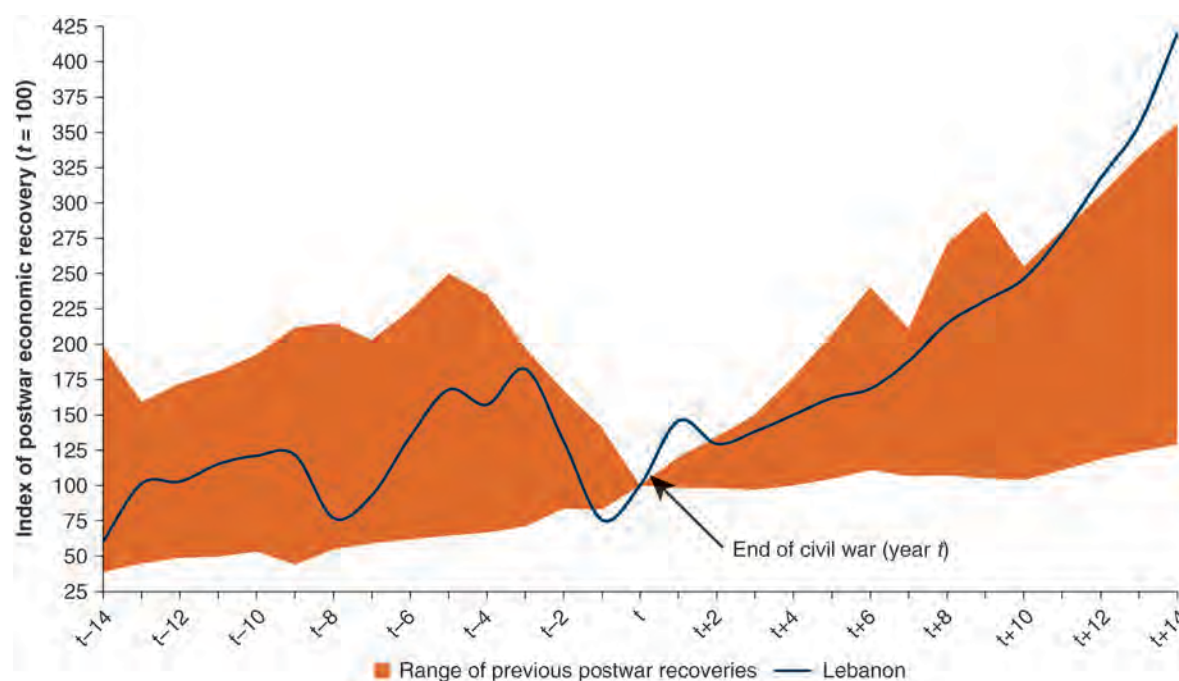
Note: The comparator countries are Antigua and Barbuda, Chile, Colombia, Costa Rica, Cyprus, Hungary, Jamaica, Poland, South Africa, Turkey, and Uruguay.

FIGURE B.3 Real GDP at Chained PPP in Lebanon and the United States, 1970–2010



Source: Penn World Tables 8.0.

FIGURE B.4 Postwar Economic Performance in Lebanon



Source: Penn World Tables 8.0 data.

lasting at least 10 years,⁴ Lebanon's real GDP rebounded rapidly and later became the best-performing one. This strong performance might be attributed to (a) Lebanon's highly skilled human capital, (b) the rapid, large inflow

of capital early in the recovery and reconstruction process, which has been maintained since, in large part due to remittances of the Lebanese diaspora, and (c) large-scale reconstruction efforts.

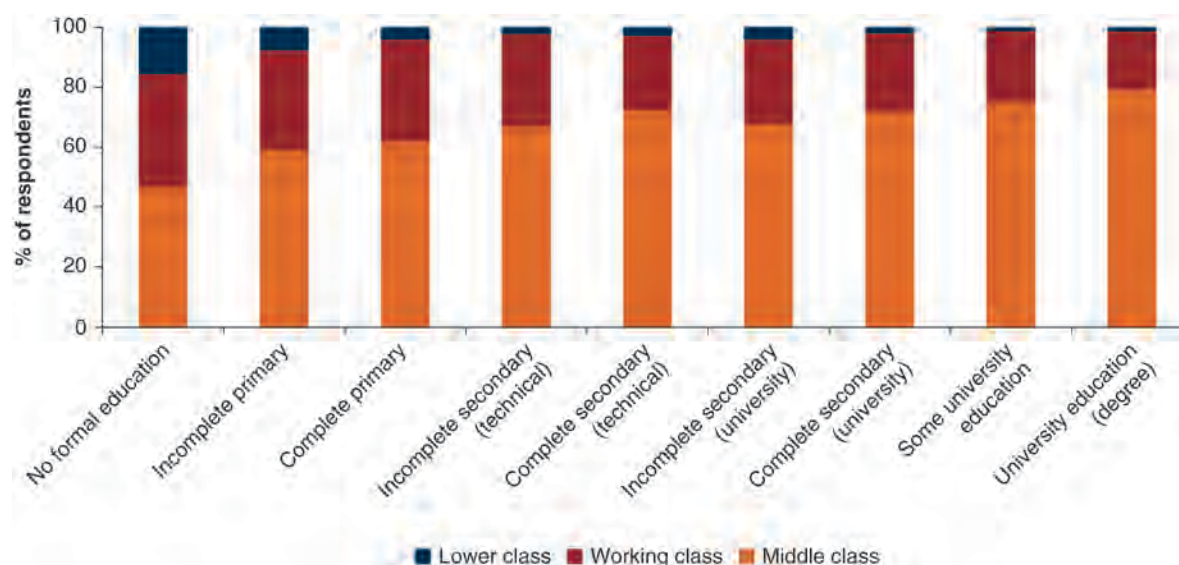
Notes

1. These are Cyprus, the Arab Republic of Egypt, Israel, Jordan, the Syrian Arab Republic, Tunisia, and Turkey.
2. By 1990, real GDP stood at 48 percent of its 1974 level, according to data from the Penn World Tables 8.0. Eken et al. (1995) find the same number by putting together various information sources.
3. Penn World Tables 8.0.
4. Real GDP (at chained PPP) is normalized at 100 at the last year of each conflict. The comparator countries were selected from the list of countries that experienced conflicts lasting at least 10 years during 1960–2011 (World Bank 2011d). The resulting countries are Angola, the Republic of Congo, El Salvador, Guatemala, Indonesia, Lebanon, Liberia, Mozambique, Nepal, Peru, Rwanda, Sierra Leone, and South Africa.

Appendix C

Supplemental Tables and Figures on Poverty and Access to Public Services

FIGURE C.1 Respondents to the World Values Survey in Lebanon and Comparator Countries, by Class and Education Level, circa 2013



Source: World Values Survey, wave 6.

Note: Surveys were conducted in different years in different countries. "Do not know" and "no answer" were excluded from calculations.

FIGURE C.2 Respondents to World Values Survey in Lebanon and Comparator Countries, by Class and Employment Status, circa 2013



Source: World Values Survey, wave 6.

Note: Surveys were conducted in different years in different countries. "Do not know" and "no answer" were excluded from calculations.

TABLE C.1 Marginal Effects from Probit Model Explaining Being in Bottom 40 Percent of Respondents Based on Self-Assessed Ranking of Income Scale in Lebanon, 2013

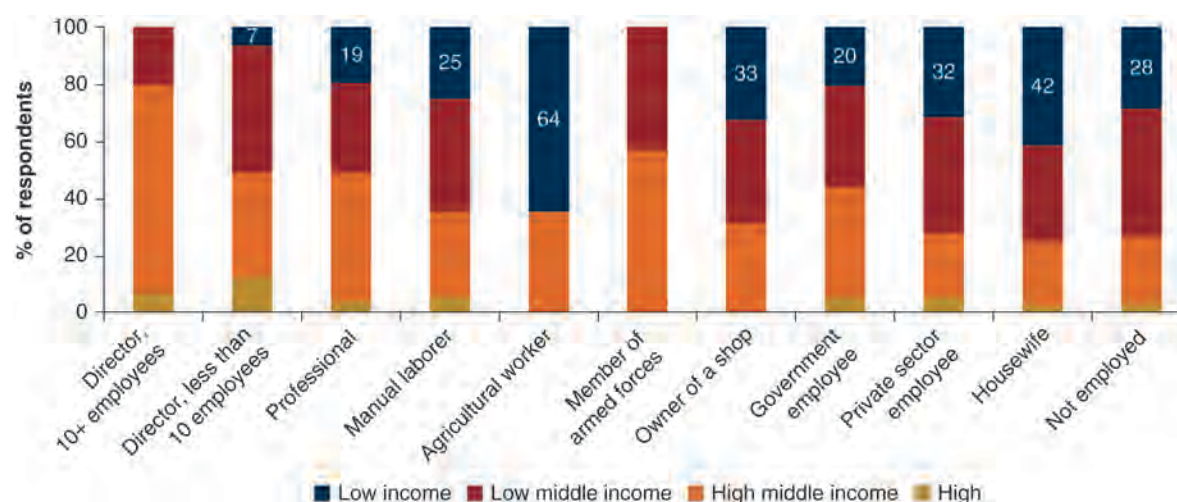
Explanatory variable	Coefficient	t-statistic
Age	-0.001	[-0.133]
Age squared	0.000	[0.445]
Male	0.014	[0.493]
<i>Education</i>		
No education		Omitted
Incomplete primary school	-0.118*	[-1.899]
Complete primary school	-0.165***	[-3.636]
Incomplete secondary school: technical	-0.228***	[-5.946]
Complete secondary school: technical	-0.186***	[-4.241]
Incomplete secondary school: university	-0.207***	[-4.970]
Complete secondary school: university	-0.220***	[-5.228]
Some university-level education	-0.221***	[-5.050]
University-level education, with degree	-0.292***	[-7.658]
<i>Employment status</i>		
Full-time worker	-0.0953**	[-2.053]
Part-time worker	-0.041	[-0.727]
Self employed	-0.181***	[-4.139]
Retired	-0.061	[-0.981]
Housewife	-0.108**	[-2.180]
Student	-0.084	[-1.608]
Unemployed		Omitted
N		1,159

Source: World Values Survey, wave 6.

Note: "Do not know" and "no answer" were excluded from estimation.

* Significant at the 10 percent level ** Significant at the 5 percent level *** Significant at the 1 percent level.

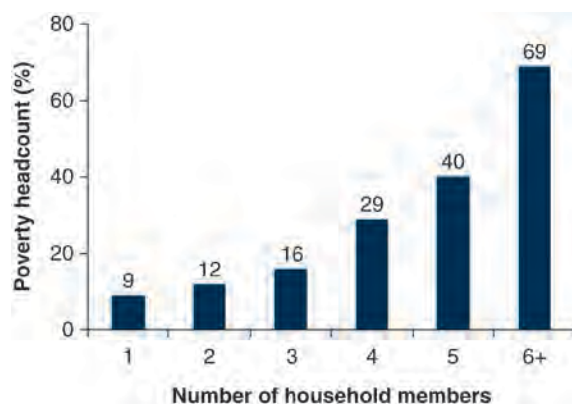
FIGURE C.3 Labor Force Status in Lebanon, by Household Income, 2010



Source: Arab Barometer Survey.

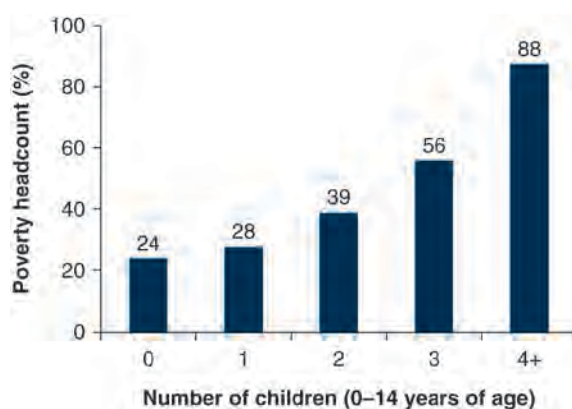
Note: Individuals without answers about household income status were excluded from calculation.

FIGURE C.4 Poverty Rates in Lebanon, by Number of Household Members, 2012



Source: 2012 Financial Literacy and Capabilities Survey.

FIGURE C.5 Poverty Rates in Lebanon, by Number of Children, 2012



Source: 2012 Financial Literacy and Capabilities Survey.

TABLE C.2 OLS Regression Explaining Math TIMSS Score in Lebanon

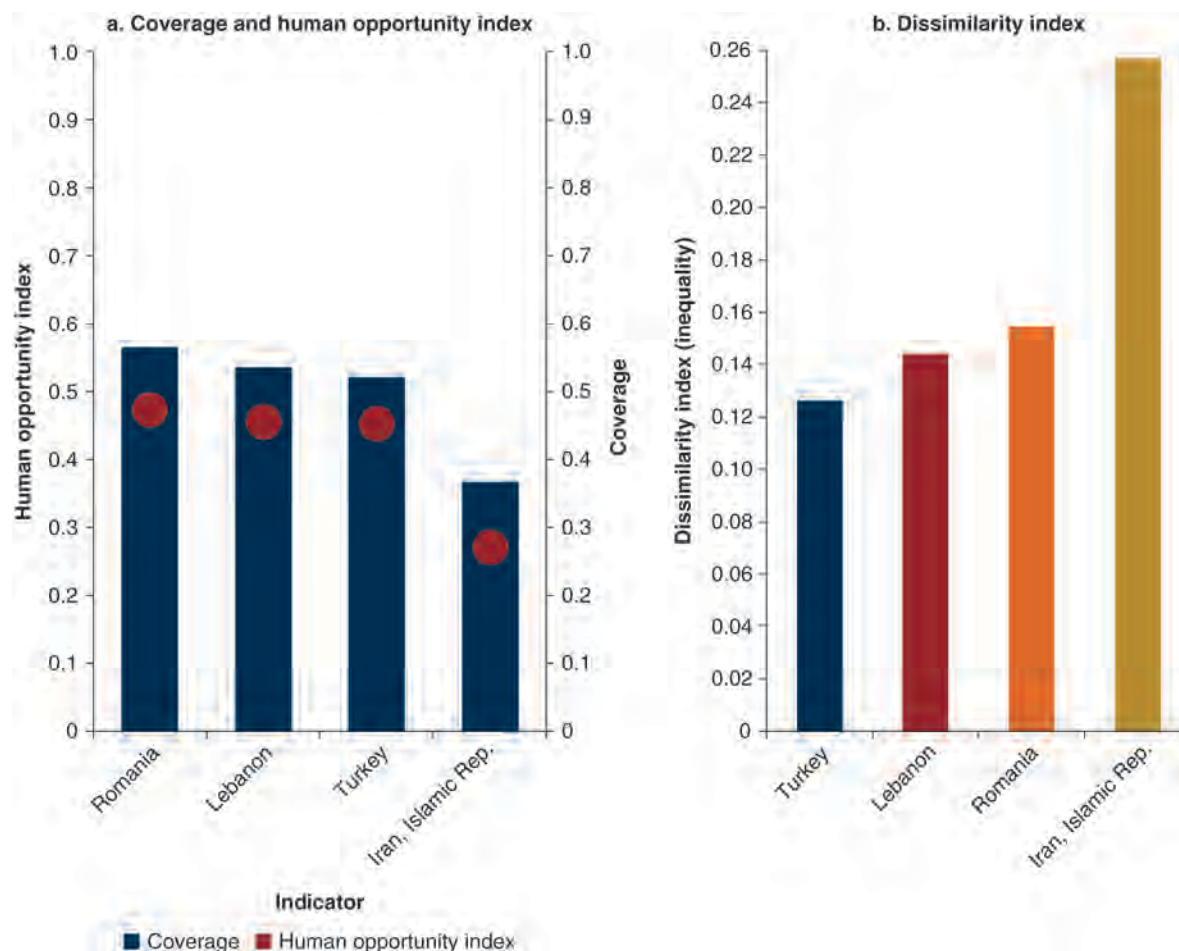
Dependent variable: Math score	
<i>Teachers' experience</i>	
Experience 10–20	1.4 [3.956]
Experience 5–10	–20.44*** [4.182]
Experience <5	–21.68*** [4.577]
More than 20 years	Omitted
<i>Access to internet and computer</i>	
No internet	–13.43*** [2.451]
No computer	–29.41*** [3.771]
<i>Migrant</i>	
Was not born in the country	–9.343*** [2.971]
<i>Attitude to math</i>	
Like a little math, science	–18.97*** [2.612]
Do not like math, science	–35.08*** [3.615]
Completely dislike math and science	–52.14*** [3.390]
Like math and science a lot	Omitted
<i>Region</i>	
Bekaa	7.997 [5.312]
Mount Lebanon	20.68*** [5.178]
Banlieue	3.5 [4.418]
Nabatieh	–21.63*** [6.345]
North	–14.48*** [4.949]
South	–17.83*** [5.172]
Beirut	Omitted
<i>Area of residence</i>	
Suburban	14.55*** [4.269]
Medium size city	14.92*** [3.163]
Small town	1.943 [3.740]
Remote rural	–13.58 [8.671]
Urban	Omitted
Boy	5.819*** [2.243]
English	–2.75 [2.832]
Constant	481.9*** [5.353]
Observations	3,438
R-squared	0.198

Source: 2011 Trends in International Mathematics and Science Study (TIMSS).

Note: Observations with missing values were removed from estimations: 536 from 3,974 observations. *t*-statistics are shown in parentheses. Students' weights were used.

* Significant at 10 percent ** Significant at 5 percent *** Significant at 1 percent

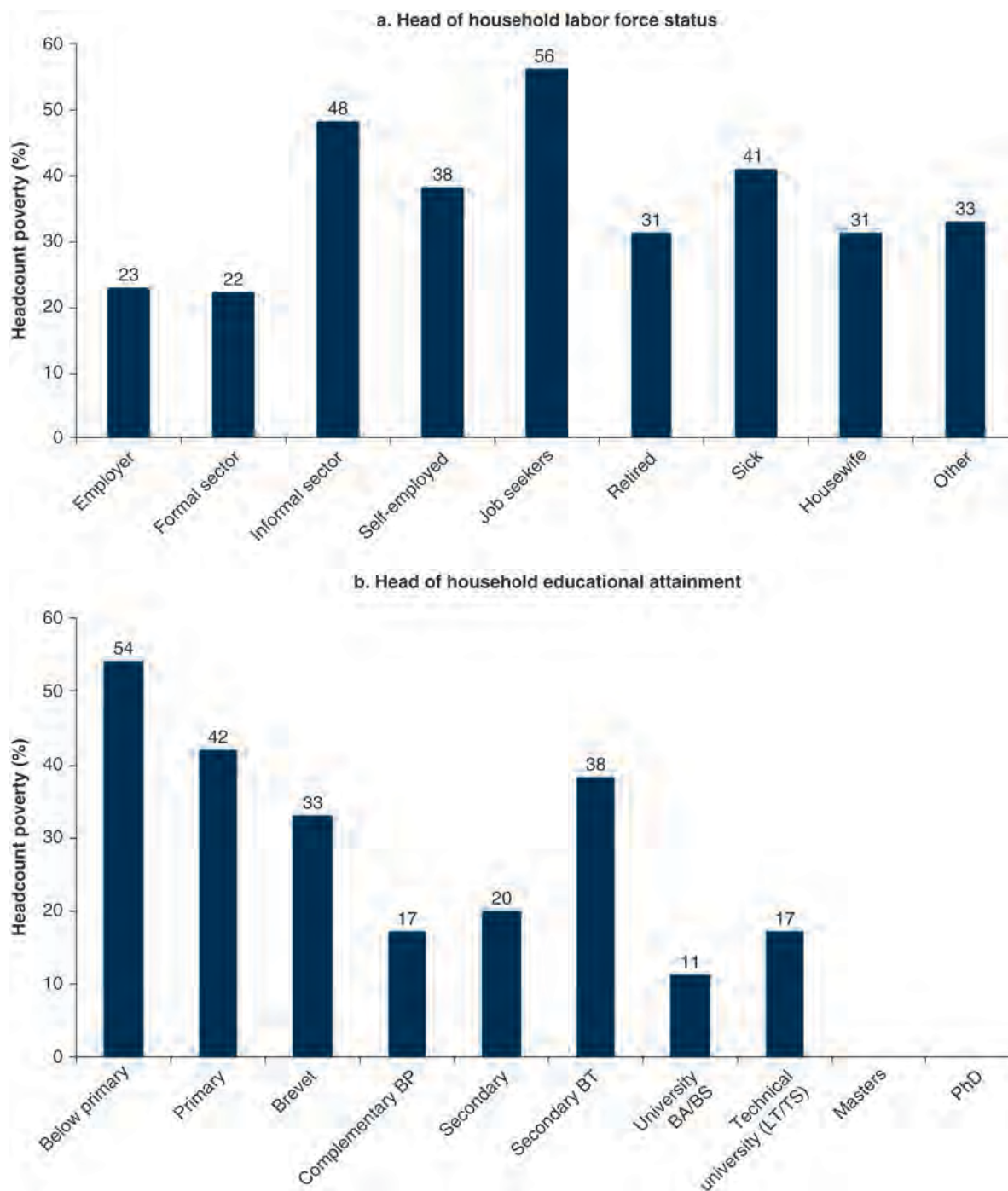
FIGURE C.6 Coverage, Human Opportunity Index, and Dissimilarity Index for a Select Set of Countries Based on Math TIMSS Score



Source: 2011 Trends in International Mathematics and Science Study (TIMSS).

Note: Students' weights were used. Dissimilarity index measures inequality of opportunity and ranges from 0 to 1, with higher values meaning higher inequality. An eighth-grade child has opportunity if his math test score is higher than the average for the Islamic Republic of Iran, Lebanon, and Turkey: 439.

FIGURE C.7 Poverty Rates in Lebanon, by Labor Force Status and Educational Attainment of Head of Household, 2012



Source: 2012 Financial Literacy and Capabilities Survey.

The human opportunity index (HOI) is a measure that combines into a single indicator both the coverage of or access to a particular opportunity and how equitably that access is distributed (Barros et al. 2009; Cuesta and Abras 2013). More formally:

$$\text{HOI} = C^*(1 - D), \quad (\text{C.1})$$

where C is the average coverage rate for opportunity and D is the dissimilarity index or inequality of opportunity.

The HOI index runs from 0 to 1. A society with universal coverage will have an HOI equal to 1, or 100 percent. A society with coverage of 90 percent that is distributed unequally in favor of one group (say, urban population) will have an HOI lower than 90 percent, with the exact value depending on how unequal access is across the rural and urban populations. Intuitively, the HOI takes access to opportunity and discounts it if opportunity is not allocated equitably.

The dissimilarity index measures the dissimilarity of access to an opportunity across different groups of people (in our case, urban and rural) compared with the average rate of access to this opportunity for the whole population. It ranges from 0 to 1 and equals 0 in a situation of perfect

equality of opportunity. It can be estimated econometrically and decomposed into the contribution of characteristics selected to define groups of population.

The following simple numerical example illustrates how HOI is calculated (Cuesta and Narayan 2011):

	Number of children of age 6–10 enrolled in school	
	Country A (100 children)	Country B (100 children)
Urban (50 percent of population)	40	30
Rural (50 percent of population)	20	30
Total enrollment	60	60

The average enrollment or coverage rate for both countries is the same: 60 children or 0.6 (60/100). However, in country A, access in rural areas is lower than equal allocation: 20 versus 30, meaning that 10 children need to be reallocated to achieve equality.

$$\text{HOI}_A = C(1 - D) = 0.6^*(1 - 10/60) = 0.5$$

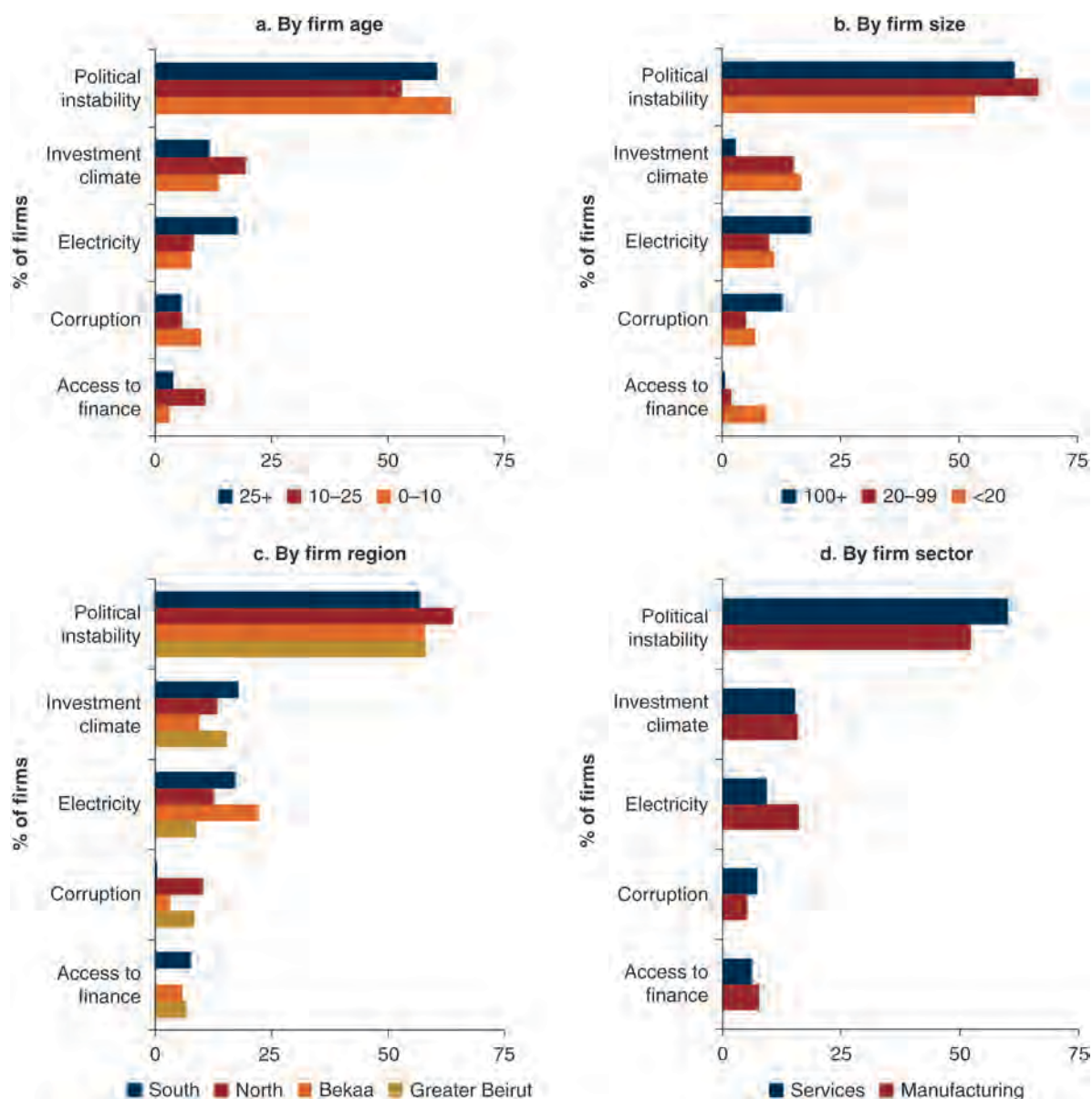
$$\text{HOI}_B = C(1 - D) = 0.6^*(1 - 0/60) = 0.6.$$

As a result, the HOI for country A (0.5) is lower than the coverage rate for country B (0.6).

Appendix D

2013–14 Enterprise Survey: Additional Results

FIGURE D.1 Largest Obstacles to Business Operations in Lebanon, by Firm Age, Size, Region, and Sector, 2013



Source: 2013–14 Enterprise Surveys.

Note: Figures are survey-weighted. Top five national-level obstacles are shown. The investment climate indicator pools seven relevant indicators (tax rates and administration, customs and trade regulations, licenses and permits, labor regulations, courts, access to land, and informal practices).

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