Lebanon Country Brief

Lebanon is a small, high-middle-income country of 4.2 million people with a large Diaspora, an area of 10,452 km², and an average GDP per capita of around US$ 706.00 in 2008. Though it has no natural resources, it is one of the few countries in the region with ample water resources and plentiful rainfall. The country is highly urbanized. More than 85 percent of the population lives in cities with Beirut hosting about half of the population. Regional disparities in living conditions are significant. Poverty is concentrated in the suburbs of large cities and in remote rural areas with 8 percent of Lebanese households living below the poverty line equivalent to US$2.4 per capita per day (2005).

The Lebanese economy is a service-oriented economy that has a long-standing and proactive commercial tradition. Services and trade sectors account for 60 percent of GDP and 73 percent of jobs; both sectors have a significant potential for growth. Tourism services and financial services, notably banking, are seen as the backbone of the Lebanese economy. Lebanon receives massive financial transfers and capital inflows from abroad—net foreign inflows of services, capital, income and remittances reached 60 percent of GDP in 2009. Among the underlying reasons for this is the comparative advantage of the Lebanese banking system, which is governed by bank secrecy. It has exhibited strong resilience to adverse external shocks as well as to the political instability that has marked the history of the country.

Lebanon’s growth and job creation performance has been below potential in the face of its huge financial resources and overall improvement of key macroeconomic indicators over the last decade. Most of these financial resources are consumed or unproductively invested, hence, preventing the extension and modernization of productive capacities, and in turn, economic growth and job creation. There has been moderate increase in investment which has been essentially directed to the real estate sector, which has accounted for close to 70 percent of total investments since 1997. Most of the remaining investments go to metallic industries that provide the construction sector with intermediary goods. In turn, these sectors rely mostly on non-Lebanese labor. Hence, concentration of investments in these sectors has little impact on the employment of Lebanese nationals while channeling productive resources into activities where productivity gains are potentially scarcer. Macroeconomic imbalances and related perceived risks (resulting in relatively high interest rates), as well as many barriers reducing competitiveness and investment opportunities are among the key factors that discourage longer-term productive investments in the economy.

Lebanon is recognized for its human capital and the entrepreneurship skills of its citizens; however it has traditionally faced significant migration and brain drain. With 54 percent gross enrollment rate in tertiary education, Lebanon exceeds by far the 26 and 23 percent rate registered respectively for the Middle East and North Africa (MENA) region and for Middle Income Countries (MIC). However, human capital seems to be undervalued in the domestic labor market. Gross private returns to education are low compared to international standards—an estimated 9 percent for Lebanon against 21 percent worldwide. This reflects low levels of productive investments in sectors that demand skilled labor. Along with political instability, low returns for education is a major factor behind the Lebanese brain drain. Migration is traditionally a large phenomenon with the Lebanese Diaspora considered to be one of the largest in the world in terms of proportion to resident population. The Lebanese Diaspora has traditionally strong linkages to their home country: Lebanon was the 7th largest country in the world in terms of remittances to GDP in 2008 with 25 percent, making remittances inflows larger than FDIs. Remittances remained strong in 2009 at 20 percent of GDP.

The hostilities in the summer of 2006 resulted in serious human and physical losses and caused a significant damage to the Lebanese economy. Though estimates vary, it is likely that total direct damages were around US$2.8 billion, with a further US$700-800 million in indirect damage. Economic performance and employment has been severely affected with a significant loss of output from the hostilities in 2006. These events, however, have amplified the urgency of reform and donor response. In the months following the hostilities and while addressing the urgent reconstruction and recovery needs, the Government worked to adapt its medium-term economic program to the new circumstances and presented it at the Paris III donor conference in January 2007. The program made an effort to balance fiscal measures needed for stabilization with structural measures needed for higher growth. Donors responded favorably and generously to the program, pledging a total of US$7.6 billion
assistance, of which 76 percent were signed into agreements and more than 52 percent disbursed by the end of May 2010.

The reform efforts suffered a significant setback with a prolonged political impasse through May 2008, but reconstruction and recovery progressed speedily. While the strong recovery helped in containing the fiscal and public debt position, Lebanon’s fiscal deficit before grants remains high (9.7 and 8.5 percent of GDP in 2008 and 2009, respectively) and continues to feed a very high public debt (148.0 percent of GDP in 2009). The majority of Lebanon’s public debt (US$50.7 billion at end-2009) is held by private creditors, particularly by domestic commercial banks. It is very probable that high interest rates linked to the public debt overhang do not encourage long term productive investments. Unless Government financing needs strongly decline, investors would continue to prefer to invest in highly remunerative short-maturity bonds. Significant levels of new growth and fiscal effort are, in turn, required to stabilize Lebanon’s presently unfavorable debt dynamics.

Despite the protracted political and security crisis and the adverse external economic environment in the aftermath of 2006 hostilities, the economy recovered at a much faster pace than originally envisaged. The real growth rebounded to 7.5-9.3 percent in 2007-08. Preliminary figures for 2009 show a real growth rate of 9.0 percent and the 2010 estimate is 8.0 percent. Although there was in 2009 some slowdown in foreign trade-in-goods and overall transactions in the economy, reflecting the adverse impact of the global economic downturn, this impact remained much more measured than originally envisaged, leading the Central Bank (Banque du Liban- BdL) to revise the real GDP growth projections for 2009 up from 3 percent expected early in the year. While the growth performance in 2007 is explained by a low base in 2006 (when real growth was 0.6 percent), the growth thereafter was supported by strong regional demand for Lebanon’s goods and services and large inflows of transfers and capital.

Inflation decelerated in 2009, following the drop in international prices, which have brought import costs down. Imported inflation in Lebanon has a strong impact on the Consumer Price Index (CPI) since imports of goods amount to about 40 percent of domestic absorption. The deceleration of prices was particularly prominent between April and October when CPI increased by only 2.1 percent on average (y-o-y)—overall, increase in the CPI remained low at 2.8 percent in 2009 compared to 10.7 percent increase in 2008. It should be noted that the CPI index does not directly reflect trends in real estate prices, which, following a substantial increase in 2008 (about 50 percent on average), remained high in 2009, reflecting strong capital inflows, and persistent demand and supply in the sector.

The decline in international prices of commodities had a positive impact on Lebanon’s foreign accounts. The trade-in-goods deficit increased by only 0.8 percent in 2009 (y-o-y) compared to a 41 percent a year earlier, reflecting mainly the deceleration in imports. Exports of services continued to improve in 2009 with tourism arrivals to Lebanon increasing by a substantial 39 percent during this period. As a result, current account deficit is expected to decline to 15.5 percent in 2009 (from a high 18.5 percent in 2008) and continues to be easily financed by external inflows.

Lebanon’s financial market developments have been favorable despite the global financial turmoil. Deposits and reserves have risen sharply since 2008. The money supply increased by US$13.4 billion (39 percent of GDP) in 2009. Lending to the private sector remained strong, increasing by 15 percent. This reflects the sharp increase in Banks’ resources as well as the increase in incentives from BdL to promote lending in local currency. The incentive measures included expansion in the sector coverage of the subsidy on interest rates, and exemptions on compulsory reserves for loans denominated in local currency (LBP), excluding consumer loans and real estate lending. Gross foreign currency reserves hit a new high of US$25.7 billion in December 2009 (equivalent to about 19 months of imports of goods and 80 percent of GDP). The dynamics of reserves reflect both higher capital inflows and shift by depositors out of dollars into the local currency because of interest rates advantage.

Following the parliamentary elections of June 2009, a new government of national unity was formed in November. The Government set four major strategic directions for economic and social policy: (i) enhancing the potentials of economic growth through structural reforms that improve the material, institutional and legal infrastructures, (ii) maintaining the macroeconomic, financial and monetary stability necessary for growth, (iii)
implementing Paris-III reform program and launching infrastructure programs and, (iv) designing a new social policy that would improve the quality and the coverage of social services. Among objectives are increasing the capacity of the power sector by 600 MGW by end-2010; launching a national plan for public transportation; improving internet services and broadband services and; promoting private-public partnership in all sectors.

Current Challenges

The key near-term policy challenge for Lebanon is maintaining a prudent approach to economic management. Lebanon’s financial sector has so far prospered despite the global financial turmoil. However, with high twin deficits and public debt, Lebanon remains vulnerable to external shocks and has limited fiscal space. Therefore, careful fiscal management to maintain confidence of all (domestic and foreign) depositors and investors remains critical for Lebanon’s economic prospects given the substantial exposure of commercial banks to the public sovereign risk. Continued prudent monetary policies are also critical to managing risks and buffering Lebanon from the effects of the global crisis.

Over the medium term, however, sustaining high growth rates will call for implementation of key structural reforms. While fiscal adjustment is certainly a necessary condition to improve Lebanon’s long term growth potential, it is not a sufficient one. Resources currently invested with the government could well not be made available for productive investments while monetary policy continue to directly influence medium to long term interest rates, and financial sector’s incentives to intermediate a large share of its liabilities towards productive investments remain weak. Improving the performance of the country in terms of growth and employment creation, however, requires addressing deeper structural economic causes that will help create new growth and facilitate fiscal adjustment. The initiation of structural reforms (particularly energy, water, telecom and private sector development) would improve the business/investment environment, competition, the entry and operation of Small- and Medium-Enterprises (SMEs), and service delivery, which collectively would upgrade the long-term growth potential of the Lebanese economy.

World Bank Assistance

Over the past fifteen years, the World Bank has supported Lebanon in a wide range of sectors, including in emergency reconstruction and rehabilitation; municipal development and infrastructure; revenue enhancement; administrative rehabilitation; agriculture and irrigation; solid waste and environmental reform; vocational and technical education; education and health; roads; power; community development; water and wastewater; urban transport; and protection of cultural heritage. In August 2010 a new Country Partnership Strategy (CPS) was discussed by the Bank’s Board of Directors. The CPS has a flexible approach and focuses on five strategic axes over the next four years: (i) sustained fiscal stability and improved public financial management governance; (ii) competitive business environment; (iii) improved basic infrastructure services; (iv) quality public education system and; (v) an expanded, sustainable and inclusive social protection system (social safety nets, pensions, health insurance, and other forms of income protection for the most vulnerable). The CPS also addresses gender and integration within the region.

All dollar figures are in US dollar equivalents. September 2010

For more information, please contact:
In Washington: Najat Yamouri, nyamouri@worldbank.org