

LEBANON ECONOMIC MONITOR

THE GREAT CAPTURE

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PREFACE

The *Lebanon Economic Monitor* provides an update on key economic developments and policies over the past six months. It also presents findings from recent World Bank work on Lebanon. It places them in a longer-term and global context, and assesses the implications of these developments and other changes in policy on the outlook for Lebanon. Its coverage ranges from the macro-economy to financial markets to indicators of human welfare and development. It is intended for a wide audience, including policy makers, business leaders, financial market participants, and the community of analysts and professionals engaged in Lebanon.

The *Lebanon Economic Monitor* is a product of the World Bank's Lebanon Macro-Fiscal Management (MFM) team. It was prepared by Wissam Harake (Country Economist) and Samer Matta (Economic Analyst), under the general guidance of Eric Le Borgne (Lead Economist) and Auguste Kouame (Global Practice Manager). Nadwa Rafeh (Senior Economist) authored the Special Focus on the health sector, while Jana Harb (Economic Analyst) authored the Special Focus on governance. May Ibrahim (Senior Executive Assistant) provided Arabic translation, Nada Abou-Rizk (Program Assistant) provided French translation and Zeina El Khalil (Communications Officer) print-produced the report.

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LIST OF KEY ABBREVIATIONS USED

bps	Basis points
H1, H2:	First half of the year, second half of the year.
3mma:	Three-months moving average
pp	Percentage points
Q1 (Q2, Q3, Q4):	First (second, third, fourth) quarter of the year
qoq:	Quarter-on-quarter
sa:	Seasonally adjusted
saar:	Seasonally adjusted, annual rate
yoy:	Year-on-year
lhs, rhs:	Left hand side, right hand side (for axis of figures)

EXECUTIVE SUMMARY

I. Systematic failures in governance in the face of seismic shocks in an environment of endemic corruption could result in a rupture.

Creeping political paralysis has rendered the three branches of government either vacant or ineffective. Moreover, the collapse of public services, such as electricity, water supply and a visually powerful garbage crisis that has left piles of it uncollected on the streets, led to sizable popular demonstrations. All the while, Lebanon continues to face momentous challenges emanating from the war in Syria, including hosting the largest assembly of Syrian refugees (in proportion to the population).

II. Notwithstanding the political dysfunctionality, improved security conditions have provided a boost for economic activity in 2015.

Growth has been driven by a resurgent tourism sector and continued expansion in private lending as Banque du Liban (BdL) renewed its stimulus package in the amount of \$1 billion this year; tourist arrivals increased by 16.6 percent, year-on-year (yoy), in the first eight months of 2015, compared to a mere increase of 0.7 percent during the corresponding period in 2014. On the other hand, the real estate sector has acted as a drag on growth, with construction permits and cement deliveries contracting by about 18.8 percent and 16.7 percent, respectively, during the first seven months of 2015. Overall, we project that growth will remain around 2 percent this year, largely unchanged from 2014.

III. The decline in oil prices has so far had net positive effects on the Lebanese economy, freeing up savings for both internal and external imbalances.

Fiscally, lower transfers to the state-owned Electricity du Liban (EdL), in addition to increased scrutiny of expenditures by the present Ministry of Finance, are expected to help maintain a primary surplus in 2015. This is despite a small

projected rise of 0.6 percentage points (pp) in the overall fiscal deficit to 7.2 percent of GDP due primarily to lack of the one-off revenue measures that boosted revenues in 2014. Externally, lower oil prices, as well as a more broad contraction in imports, are expected to induce a 5 pp narrowing of the current account deficit, which will nevertheless remain elevated at a forecast 21 percent of GDP. This, however, was more than offset by lower capital inflows adversely affecting the net foreign asset position of the financial sector. Nonetheless, gross foreign exchange reserves at BdL are expected to increase to US\$ 34.5 billion by end of 2015 as commercial banks continue to repatriate their foreign assets in search of higher yields.

IV. A negative output gap combined with declining commodity prices lead to a deceleration in prices.

Real GDP growth continues to lag behind, compared to an average rate of 4.4 percent from 1993 to 2014. In addition, headline inflation plummeted from 2.7 percent in 2013 to a forecast 0.2 percent in 2015 and is expected to remain tempered over the medium term. This, in addition to exchange rate stability reflected in a gradual fall in the dollarization rate, has provided the basis for an expansionary monetary policy as reflected in the series of BdL stimulus packages in the form of subsidized loans.

V. Spillovers from the war in Syria remain a principal short-term challenge, despite the recent respite, which cannot be guaranteed due to severe volatility.

Moreover, uncertainty over America's Federal Reserve Board (FED) tightening this year has made monetary policy expectations in Lebanon somewhat ambiguous; despite the preferred expansionary stance reflected in the subsequent BdL stimulus packages, upon FED tightening, Lebanon would be bound to follow suit to maintain the margin on USD and LBP deposits in Lebanon. This

will negatively impact lending to the private sector and raise Lebanon's large debt service, as new debt will need to be contracted at higher interest rates given the ongoing large gross financing needs.

VI. Lebanon's post-civil war governance system has evolved and deteriorated to a point of failing the country and its citizens (Special Focus #1). The public sector has become increasingly governed by bribery and nepotism practices, failing to deliver basic public services and incapable of resolving the most urgent needs. This has culminated in the comprehensive breakdown in the political process, with the three branches of government either vacant or effectively idle, and the only national plebiscite abrogated. Since the summer, a series of protests and civil disobedience measures erupted—sparked by failure to collect garbage in the country—and is targeting the ruling political class with emphasis on corruption and incompetence. Current conditions are unsustainable, and without significant political and economic reforms, a widening and worsening of socio-economic unrest is not unfathomable.

VII. Lebanon's healthcare system is a complex amalgam of public and private institutions, providing health services to the population (Special Focus #2). Key challenges include; (i) low public spending on health; (ii) high household out-of-pocket spending on health; (iii) disproportionate allocation of resources on expensive curative rather than preventative care; and (iv) emerging epidemiologic and population trends associated with unprecedented influx of refugees having significant implications on the delivery and financing of the health sector. Despite the challenges and prolonged periods of instability, the Ministry of Public Health embarked on several successful reforms that contributed to the resilience of the system in the face of the crisis.

الأساسية ومعالجة الاحتياجات الطارئة، ممّا أدى إلى تفكك في الهيكلية السياسية وإفراغ أو تعطيل السلطات الحكومية بفروعها الثلاث، كما تم إلغاء المنظومة الانتخابية الوطنية الوحيدة في البلاد. وقد أشعلت أزمة النفايات هذا الصيف شرارة الحراك الشعبي والعصيان المدني، وركّزت تلك التحركات على فشل النخبة الحاكمة والفساد المتفشّي فيها. فالوضع الحالي غير قابل للاستمرارية، وإذا ما تم تفعيل الجهود الإصلاحية بشكل جديّ، فليس من المستبعد أن تتفاقم الاضطرابات الاقتصادية والاجتماعية.

vii. النظام الصحي في لبنان هو مزيج معقد من المؤسسات الخاصة والعامة التي تقدم الخدمات الصحية إلى المواطنين (تحليل خاص رقم ٢). ونذكر التحديات الرئيسة كالتالي: (١) تدني الإنفاق العام على قطاع الصحة، (٢) النسبة العالية التي تتفقها الأسر من جيوبها الخاصة على الخدمات الصحية، (٣) عدم التوازن في تخصيص الموارد حيث يتم الإنفاق بشكل أعلى على الرعاية العلاجية المكلفة مقارنةً بالرعاية الوقائية الأقل كلفة، و(٤) الاتجاهات الوبائية والسكانية الناشئة المتعلقة بتدفق غير مسبوق للاجئين، ممّا يؤثر سلباً على أداء وتمويل القطاع الصحي في لبنان. وبالرغم من التحديات والفترات الطويلة من عدم الاستقرار، شرعت وزارة الصحة العامة في إطلاق العديد من الحملات الإصلاحية التي ساهمت في تثبيت النظام الصحي أمام الأزمة الحالية.

الملخص التنفيذي

i. قد يؤدي الفشل المنهجي في الحوكمة، وذلك في سياق صدمات زلزالية وضمن بيئة يستشري فيها الفساد، إلى تدهور هيكلية النظام الحالي في لبنان. أما الشلل السياسي، فيستمر بالزحف نحو السلطات الحكومية بفروعها الثلاث، حيث أمست إما فارغة أو معطلة. ونضيف إلى ذلك تدهور الخدمات العامة، كالكهرباء، وإمدادات المياه، وأزمة النفايات التي تراكمت في أكوام تعيق النفس والبصر، مما أشعل حراكاً شعبياً ضخماً. هذا، وما زال لبنان يواجه تحديات جسيمة ناجمة عن الحرب في سوريا، بما في ذلك استضافة أكبر نسبة من اللاجئين السوريين مقارنةً بالعدد الإجمالي لسكان البلد.

ii. على الرغم من الشلل السياسي، أدى الهدوء النسبي في الأوضاع الأمنية في لبنان إلى دعم الاقتصاد في العام ٢٠١٥. كما أن بعض الانتعاش الحاصل في قطاع السياحة إضافة إلى السياسة التوسعية التي استمر في اعتمادها المصرف المركزي عبر إطلاق حزمة إجراءات تحفيزية جديدة هذا العام بقيمة مليار دولار أميركي، قد حفزاً النمو الاقتصادي هذه السنة؛ حيث ارتفع عدد الوافدين إلى البلد من السياح بنسبة ١٦,٦ بالمئة في الأشهر الثمانية الأولى من العام ٢٠١٥ (على أساس سنوي)، مقارنة بارتفاع بسيط بنسبة ٠,٧ بالمئة خلال الفترة نفسها عام ٢٠١٤. من ناحية أخرى، فرض القطاع العقاري عبئاً على النمو الاقتصادي، وقد برز ذلك من خلال الانكماش الحاصل في تراخيص البناء وفي حركة تسليم الإسمنت بحوالي ١٨,٨ بالمئة و١٦,٧ بالمئة على التوالي، خلال الأشهر السبعة الأولى من العام ٢٠١٥. وبشكل عام، من المتوقع أن تبلغ نسبة النمو ٢ بالمئة هذه السنة، دون تغيير ملحوظ مقارنة بالعام ٢٠١٤.

iii. أدى انخفاض أسعار النفط إلى ارتدادات إيجابية على الاقتصاد اللبناني، مما سمح باستخدام المدخرات للمساعدة في تغطية النقص الحاصل في الموازنات الداخلية والخارجية. من الناحية المالية، فمن المتوقع أن يساهم الانخفاض الحاصل في التحويلات النقدية إلى شركة كهرباء لبنان العامة وتكثيف عملية التدقيق المالي من قبل وزارة المالية، في الحفاظ على الفائض الأولي للعام ٢٠١٥. هذا بالرغم من توقع ارتفاع بسيط بنسبة ٠,٦ نقطة مئوية في العجز المالي الإجمالي إلى ٧,٢ بالمئة من الناتج الإجمالي المحلي، وذلك بسبب عدم وجود التدابير المالية المرحلية التي عززت الإيرادات في العام ٢٠١٤. أما من الناحية الخارجية، قد يؤدي انخفاض أسعار النفط والتقلص في الواردات إلى تضيق العجز في الحساب الجاري بنسبة ٥ نقاط مئوية، ولكن يبقى العجز مرتفعاً حيث من المتوقع أن يبلغ ٢١ بالمئة من الناتج

الإجمالي المحلي. في مواجهة هذا التحسن في نسبة العجز، أثر الهبوط في تدفقات رأس المال على نحو أكثر سلبية على وضعية صافي الأصول الأجنبية في القطاع المالي. ومع ذلك، من المتوقع أن ترتفع احتياطات النقد الأجنبي الإجمالية في مصرف لبنان لتبلغ ٢٤,٥ مليار دولار أميركي في نهاية العام ٢٠١٥، حيث أن المصارف التجارية سوف تستمر بإعادة أصولها الأجنبية بهدف تحصيل عائدات أعلى.

iv. يؤدي ظهور الفجوة السلبية في الإنتاجية، بالتزامن مع انخفاض أسعار السلع الأساسية، إلى تباطؤ الأسعار. ويستمر النمو الحقيقي للناتج المحلي الإجمالي في تباطؤ مقارنة بمعدل ٤,٤ بالمئة بين العام ١٩٩٣ والعام ٢٠١٤. إضافة إلى ذلك، انخفضت نسبة التضخم من ٢,٧ بالمئة في العام ٢٠١٣ إلى ما هو متوقعاً للعام ٢٠١٥، أي إلى ٠,٢ بالمئة، ومن المحتمل أن تبقى نسبة التضخم محدودة على المدى المتوسط. وقد ساعد ذلك، إضافة إلى استقرار سعر الصرف الذي ظهر من خلال هبوط تدريجي في معدل الدولار، على تأمين القاعدة الأساسية للسياسة النقدية التوسعية التي اعتمدها مصرف لبنان ضمن سلسلة من الإجراءات التحفيزية في شكل قروض مدعومة.

v. ما زالت تداعيات الحرب في سوريا تشكل تحديات أساسية على المدى القصير، على الرغم من بعض الهدوء النسبي الذي شوهد مؤخراً والذي قد ينكسر في أي لحظة لشدة التوتر الأوضاع. كما أن عدم اليقين في ما يخص السياسة التقييدية للمصرف الاحتياطي الفيدرالي الأميركي قد أدى إلى بعض الغموض في سياسة لبنان النقدية لهذا العام؛ فعلى الرغم من موقف مصرف لبنان الذي يميل إلى السياسة التوسعية من خلال إطلاق الحزم التحفيزية المتلاحقة، فإذا ما فرض المصرف الاحتياطي الفيدرالي الأميركي تقييدات محددة، سوف يكون لبنان بالتالي ملزماً بالسير في نفس الاتجاه للحفاظ على هامش الودائع المسجلة بالدولار الأميركي والليرة اللبنانية. وقد يؤثر ذلك سلباً على القروض الموجهة إلى القطاع الخاص ويؤدي إلى ارتفاع خدمة الدين العالية أصلاً في لبنان، بحيث سوف يتم تعاقد الديون الجديدة بفوائد أعلى، نظراً للاحتياجات التمويلية الكبيرة في الوقت الحاضر.

vi. تدهور نظام الحوكمة في لبنان ما بعد الحرب الأهلية إلى حد الفشل فخاب الوطن والمواطن (تحليل خاص رقم ١). تزايدت ممارسات الرشوة والمحسوبيات والوساطة في القطاع العام، وقد فشلت تلك الإدارات في تقديم الخدمات

RÉSUMÉ

I. Les échecs systématiques en matière de gouvernance dans un contexte de chocs majeurs et de corruption endémique pourraient entraîner une rupture. La paralysie politique larvée en place depuis plus d'un an et demi a fait que les trois composantes du pouvoir sont soit inefficaces, soit souffrantes d'une vacance à leur tête. Plus encore, l'effondrement des services publics, tels que l'électricité, l'approvisionnement en eau et la crise, visuellement accablante, des ordures amoncelées dans les rues, a été à l'origine d'importantes manifestations. Dans le même temps, le Liban continue de faire face à d'importants défis découlant de la guerre en Syrie, notamment l'accueil de la plus large communauté de réfugiés syriens (en pourcentage de la population libanaise).

II. En dépit du dysfonctionnement politique, l'amélioration des conditions de sécurité dans le pays a favorisé une reprise modeste de l'activité économique en 2015. La croissance a été favorisée par une redynamisation du secteur touristique et par l'accroissement des prêts privés en partie dû à la Banque du Liban (BdL) et à ses mesures de relance économique à hauteur d'un milliard de dollars pour 2015. Le flux annuel de touristes a augmenté de 16,6 pour cent au cours des huit premiers mois de 2015, comparé à une simple hausse de 0,7 pour cent durant la période correspondante en 2014. Sur un autre plan, le secteur immobilier a agi comme un frein sur la croissance dans la mesure où l'octroi de permis de construire et la livraison de ciment ont régressé respectivement de 18,8 pour cent et de 16,7 pour cent au cours des sept premiers mois de 2015. De manière générale, nous prévoyons une croissance de 2 pour cent pour 2015, pratiquement le même taux qu'en 2014.

III. La baisse des prix du pétrole n'a eu, jusqu'à présent, que des effets positifs sur

l'économie libanaise grâce aux économies générées et à la réduction des déficits internes et externes du pays. Au niveau financier, la réduction des transferts à Électricité du Liban (EdL) — une société publique — en plus d'un examen accru des dépenses par l'actuel Ministère des Finances, devraient contribuer à maintenir un excédent primaire en 2015, et ce, malgré une petite augmentation prévue (de 0,6 points de pourcentage (pp)) du déficit budgétaire de 7,2 pour cent du PIB. Cette augmentation est essentiellement le fait du manque de certaines recettes ponctuelles qui avaient fait grimper les recettes en 2014. Au niveau externe, la baisse des prix du pétrole, ainsi qu'une importante contraction des importations, devraient réduire de 5 pp le déficit du compte courant, qui restera néanmoins élevé à 21 pour cent du PIB. Cela a été toutefois compensé par une diminution des apports de capitaux affectant la position des avoirs extérieurs nets du secteur financier. Néanmoins, les réserves de la BdL en devises devraient augmenter de 34,5 milliards de dollars d'ici la fin de 2015 dans la mesure où les banques commerciales continuent à rapatrier leurs actifs étrangers à la recherche de rendements plus élevés.

IV. Un écart de production négatif combiné à la baisse des prix des produits de base ont provoqué une chute des prix. La croissance du PIB réel demeure en dessous de la croissance moyenne de 4,4 pour cent de 1993 à 2014. En outre, le taux d'inflation a chuté de 2,7 pour cent en 2013 à une prévision de 0,2 pour cent en 2015. Ce taux devrait rester modéré sur le moyen terme. Ces facteurs, combinés à la stabilité du taux de change — qui se traduit par une diminution graduelle du taux de dollarisation — a fourni la base d'une politique monétaire expansionniste comme en témoigne la série de programmes de relance de la BdL sous forme de prêts subventionnés.

V. L'impact de la guerre en Syrie sur le Liban demeure l'un des principaux défis à court terme, malgré le récent répit, qui ne peut cependant pas être garanti en raison d'une grave instabilité. En outre, l'incertitude au sujet de la normalisation des taux de la Banque Fédérale Américaine complique la politique monétaire au Liban. La politique expansionniste suivie par la BdL serait impactée à terme lorsque la Fed commencera sa politique de normalisation des taux compte tenu de la nécessité de maintenir une marge entre les dépôts en dollars et en livres au Liban. Cela aura un effet négatif sur les prêts au secteur privé et relèvera le service de la dette publique au Liban.

VI. Le système de gouvernance du Liban durant la période d'après-guerre civile s'est détérioré au point que l'Etat n'a plus la capacité de décentement servir le pays et ses citoyens (Dossier No 1). Le secteur public est devenu de plus en plus régi et capturé par la corruption et le népotisme, et se trouve incapable d'assurer les services publics de base ou de répondre aux besoins les plus urgents des citoyens. Cette ineptitude est illustrée par l'inefficacité ou la vacance au niveau de la tête des trois postes les plus élevés de la fonction publique et surtout par le blocage de l'élection présidentielle. Depuis l'été, une série de mouvements de protestation et des mesures de désobéissance civile, déclenchés par la crise des déchets, ont vu le jour, visant la classe politique et mettant en cause sa corruption et son incompétence. Cette situation ne peut durer sans avoir d'importantes répercussion négative. Néanmoins sans d'importantes réformes politiques et économiques, il est à craindre que les troubles socio-économiques ne s'accroissent.

VII. Le Système de santé au Liban est constitué d'un amalgame complexe d'institutions publiques et privées, qui offrent des services de santé à la population (Dossier No 2). Les principaux défis comprennent : (i) une faiblesse du budget public consacré à la santé; (ii) un budget élevé consacré par les ménages aux dépenses de santé (iii) une allocation disproportionnée des ressources sur les traitements coûteux; et (iv) l'émergence de nouvelles épidémiologies associés à l'afflux sans précédent de réfugiés syriens, ce qui a une

incidence importante sur les prestations du secteur de la santé et son financement. Malgré les défis et les longues périodes d'instabilité, le Ministère de la Santé Publique a mis sur pied plusieurs réformes qui ont été couronnées de succès et qui ont contribué à la résilience du système face à la crise.

RECENT ECONOMIC AND POLICY DEVELOPMENTS

1. **Endemic corruption, the collapse of government services and the annulment of the democratic process have given way to widespread popular discontent.** Creeping political paralysis has rendered the three branches of government either vacant or effectively idle. As the presidential vacancy enters its 18th month, discord within the Cabinet of Ministers (CoM) over its own *modus operandi* has paralyzed the executive branch. Moreover, disagreements over the legislative agenda have induced a prolonged boycott of parliament, which extended its own mandate in 2013, abrogating the only national plebiscite. The breakdown in the political process is augmented with a breakdown of government services; after failures to deliver reliable electricity and water, a visually powerful garbage crisis left piles of it uncollected on the streets. This has triggered a series of protests and civil disobedience measures targeting the ruling political class with emphasis on corruption and incompetence. Amid the political deadlock and popular disenchantment, a new round of national dialogue between the main political parties kicked off on September 9 to discuss the main domestic points of contention (i.e. presidential and parliamentary elections, the *modus operandi* of the current government etc.).

2. **Notwithstanding the political dysfunctionality, improved security conditions and the P5+1 nuclear agreement have reinforced a sense of stability.** Early this spring, Hezbollah launched a successful campaign that led to the ejection of Al Nusra and ISIS militants from large areas around the Syrian-Lebanon border region from where they propelled terrorist operations inside Lebanon. Furthermore, the successful conclusion of the P5+1 nuclear negotiations has had strong reverberations in Lebanon; while political reactions have expectedly reflected conflicting geopolitical stances, there is a prevailing sense that this

agreement can offer a much-needed contribution to tension-relief in the region.

3. **The influx of Syrian refugees abates but they still account for almost a quarter of Lebanon's pre-Syrian conflict population.** Following a large increase in the number of Syrian refugees entering Lebanon in 2013 (i.e., 675,742 or 15 percent of the Lebanese population), the Lebanese government began imposing stricter conditions on the influx of refugees on October 2014, further tightening the enforcement of these new policies in January 2015. This effectively resulted in siphoning off the influx of refugees. According to the UNHCR, as of August 25, 2015,¹ the number of registered Syrian refugees was 1.1 million, which represents 24.5 percent of the total Lebanese population. This continues to mark the highest refugee-to-population ratio compared to all countries in the world.

Output and Demand

4. **Despite a near-complete absence of economic policy and reforms in the face of seismic shocks, periphery sectors have helped maintain positive, albeit tepid, growth in real GDP since 2011.²** While traditional drivers—real estate, construction, finance and tourism—have

¹ As of 6 May 2015, UNHCR Lebanon has temporarily suspended new registration as per Government of Lebanon's instructions. Accordingly, individuals awaiting to be registered are no longer included.

² National accounts data since 2011 are World Bank staff estimates based on our coincident economic indicator (for details, see Matta, S. (2014) "New Coincident and Leading Indicators for the Lebanese Economy," World Bank Policy Research Working Paper No. 6950), pending final GDP estimates from CAS for 2011 to 2014.

suffered heavily from the regional turmoil, support for the economy has originated from other sources, including, Syria-related economic activity in Lebanon,³ private consumption, pharmaceuticals⁴ and ICT sectors; the percentage of individuals using the internet jumped from 52 percent in 2011 to 74.7 percent in 2014, while fixed broadband subscriptions almost trebled to reach over 1.1 million persons, and mobile-cellular telephone subscriptions expanded by 127 percent over the same period.⁵ Nonetheless, this remains insufficient to regain pre-crisis growth rates or even reach potential output. To examine the slack in growth, we undertook an exercise to estimate potential output for Lebanon. The results, which are presented in Box 1, illustrate that by end-2014, output and, possibly, cumulative output, were both below potential.

5. **Since 2005, the Lebanese economy has mostly been driven by shocks rather than by global or regional growth developments.** We explore drivers of the business cycle in Lebanon by considering the relationship of the output gap with a number of regions as well as with the EMBIG Lebanon-composite spread.⁶ The EMBIG spread captures the effect of shocks, which heavily impact market sentiment (Figure 1), such that a positive spread indicates that Lebanon idiosyncratic risk exceeds emerging market risk. We observe that from the post-war period until 2005, real GDP growth

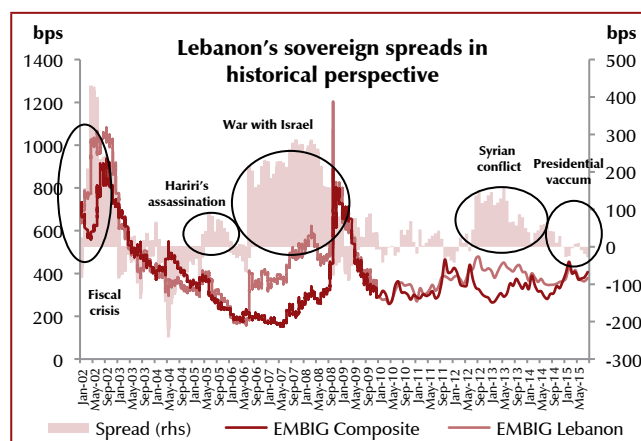


FIGURE 1. EMBIG spread reflects idiosyncratic country risks.

Source: JP Morgan and WB staff calculations

TABLE 1. Correlation coefficients between the output gap and:

	1998-2014	1998-2005	2005-2014
Arab region	-0.52	-0.53	-0.53
MENA region	-0.55	-0.58	-0.53
GCC region	0.02	0.14	-0.42
EU	-0.29	-0.34	-0.49
OECD	-0.19	-0.19	-0.38
USA	0.07	0.24	-0.35
Globe	-0.22	-0.23	-0.38
Lebanon-EMBI Spread	0.07	-0.71	-0.46

Source: Lebanese authorities and WB staff calculations

for each of the Gulf- Cooperation Council (GCC) region and the USA positively impacted growth in Lebanon, whereas shocks that increased country risk (EMBIG spread) did so negatively, as one would have expected (Table 1).⁷ Since 2005, however, none of the regions impart a positive effect on Lebanon's economy, whereas the EMBIG spread continues to exert a negative effect.⁸ This dominated impact of shocks on the country's growth reflects the severe security and political upheavals that the country has been going through since 2005.

⁷ The results show that from 1990 until 2005, the coefficients for the correlations that include the GCC region and the USA are positive at 0.14 and 0.24, respectively, while that for EMBIG spread is -0.71. The other regions generate negative correlation coefficients, which is counterintuitive.

⁸ The correlation coefficient for the EMBIG-spread for the 2005-2015 period was -0.46. All regions generate negative correlation coefficients, which is counterintuitive.

³ Positive economic impact and contribution of Syrian nationals in consequence of the war in Syria has been expounded on in the Spring 2015 issue of the LEM.

⁴ According to Société Générale de Banque au Liban, in its EcoNews, No. 36, publication in September 2015, pharmaceutical output and capacity have increased significantly over the past five years following a series of new investments in the industry geared mainly towards export markets.

⁵ Source: International Telecommunication Union (ITU).

⁶ We correlated the percent standard deviation of actual output from potential output with each of the real GDP growth rates for the Arab region, the Middle East and Northern Africa region, the Gulf Corporation Council (GCC), the OECD, the European Union, the USA and the globe (all World Bank Group countries) for the time period 1990-2014. We also correlate the difference between actual and potential output with the EMBIG Lebanon-composite spread. The results (Table 1) indicate that for the time period 1990-2014, the coefficients for the correlations are either of a sign that is inconsistent with our understanding (Arab, MENA, EU, OECD and Globe regions) or are unexpectedly low in magnitude (GCC and the US). Based on that, we disaggregated the time period into pre- and post-2005 periods.

BOX 1. Measuring the Output Gap for Lebanon.

The output gap is an economic measure of the difference between the actual output of an economy and its potential output, such that if it is positive the economy is running at above potential. Due to uncertainties surrounding output gap estimation techniques and due to data limitations for which Lebanon is known, two alternative estimation techniques are employed: The Hodrick-Prescott (HP) filter and a Production Function (PF) model. The HP filter is a de-trending statistical method, which we employ using three standard smoothing parameters. To minimize the end-point bias that the HP filter is normally susceptible to, the sample period is extended through 2017 using World Bank staff projections. Output gap is also estimated using a PF model, which is a structural method incorporating economic theory that relates output to total factor productivity and production inputs. The output gap for Lebanon is estimated using the sample periods of 1988-2017 and 1990-2017 for the HP and the PF methodologies, respectively.

For most periods, the estimation methods yield different output gap, both in levels and cumulative; nevertheless, the trajectories generated by the four methodologies are highly correlated. An immediate observation is that there exists a large variation in growth rates, with actual output sharply surpassing potential in boom periods and significantly below during recessions. This is consistent with volatile economic and security conditions in the country, which has been subject to a high frequency of large shocks. In the early nineties, and following the end of the civil war, Lebanon witnessed a reconstruction program, which generated robust growth rates. This was followed by a prolonged slack in economic activity, such that by 1999, the positive output gap that had persisted during the nineties reverted to zero. The enduring economic slack, however, led to an increasingly negative cumulative gap, until 2007, when a high growth period ensued until 2010.

The regional turmoil starting in 2011 was felt strongly in Lebanon, causing sluggish economy activity. All methods indicate that the large positive output gap that existed in 2010 starts narrowing in 2011 and closes by 2014 (Figure 2). In fact, the output gap even turned slightly negative in 2014 with estimates from the different methods ranging from -0.51 percent to -1.02 percent of potential output. The very large negative cumulative output gap that existed over the period 2000-2008 has significantly narrowed and virtually closed by end-2014 (Figure 3). Estimates of the cumulative output gap over the period 2000-2014 range from -2,749 to 1,084 billion LBP, with an average of -725 billion LBP across the four estimation methods.

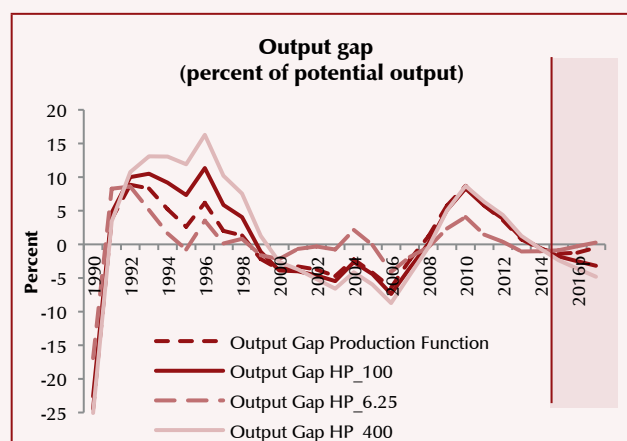


FIGURE 2. By 2014, the output gap turned negative ...

Source: Lebanese authorities and WB staff calculations

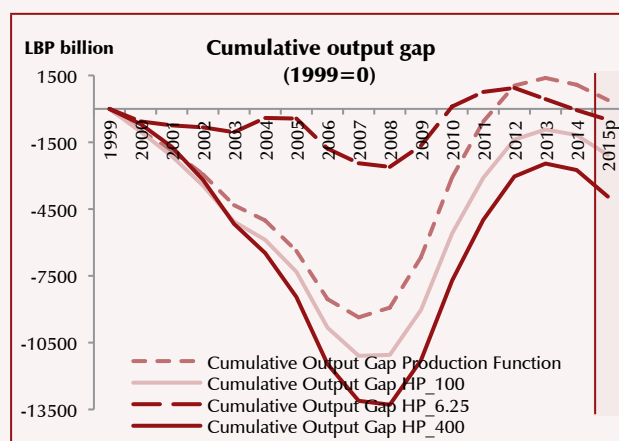


FIGURE 3. ... while the cumulative output gap is falling again.

Source: Lebanese authorities and WB staff calculations

6. **In 2015, improved security conditions and periphery sectors have helped stabilize growth, which nonetheless remains sluggish.** Real GDP growth for H1 2015 registered around 2.3 percent⁹ and is expected to be around 2 percent for the year, similar to 2014 (Figure 4). Traditional drivers

⁹ This is a World Bank staff estimate based on our coincident economic indicator.

of Lebanon's economy have surprised on the high and the low. The tourism sector regained impetus in 2015, albeit from low levels, with tourist arrivals increasing by 16.6 percent, year-on-year (yoy), in the first eight months of 2015, compared to a mere increase of 0.7 percent during the corresponding period in 2014 (Figure 5). Hotel occupancy rate also rose by 6.6 percentage points, yoy, for the first eight

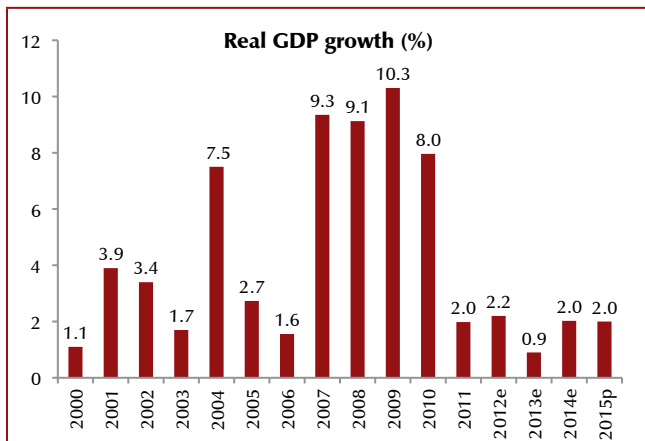


FIGURE 4. Real GDP growth sluggish but stable in 2015.

Source: Lebanese authorities and WB staff calculations

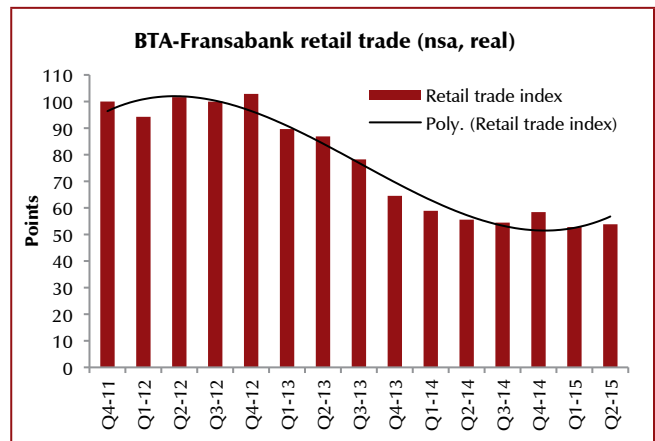


FIGURE 6. Retail trade stabilizes.

Source: BTA-Fransabank

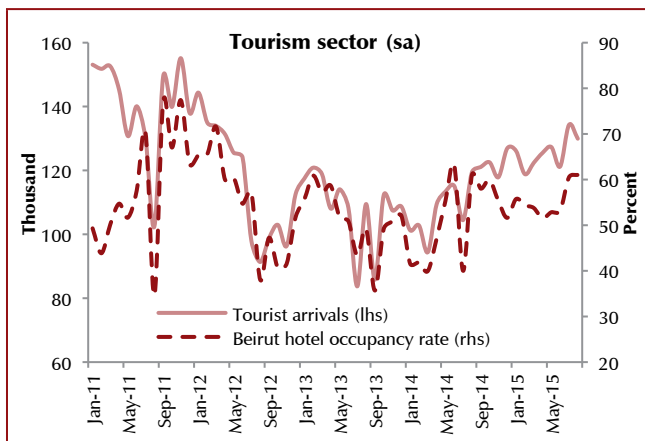


FIGURE 5. Tourism rebounds in Lebanon, but remains below pre-crisis levels.

Source: Lebanese authorities and WB staff calculations

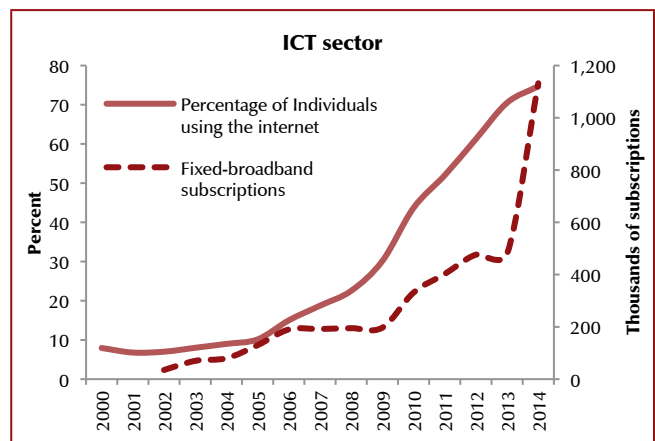


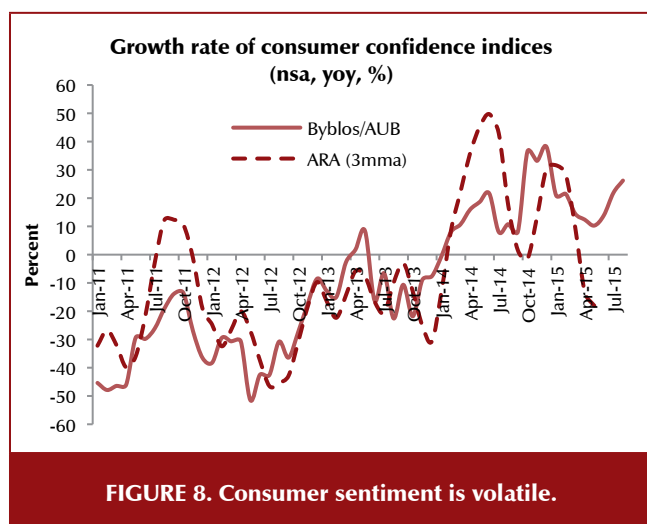
FIGURE 7. The ICT sector experiences robust growth.

Source: International Telecommunication Union

months of 2015 to reach 61 percent in August 2015. Moreover, after falling sharply since end-2012, the retail index appears to have stabilized (Figure 6); the loss of higher purchasing power consumers (i.e. gulf tourists) has been partially replaced by the large contingency of displaced people (i.e. Syrians, Iraqis). On the other hand, evidence point to a sharp decline in the real estate sector, another traditional driver of the economy; construction permits and cement deliveries both underwent yoy respective contractions of 18.8 percent and 16.7 percent during the first seven months of 2015, compared to respective expansions of 11.3 percent and 0.6 percent during the same period in 2014. Periphery sectors have maintained much needed support to the economy. An 18.2 percent growth (yoy) in exports of chemicals for the period January-July 2015, one of few export categories to have

experienced any growth during that period, suggests that the local pharmaceutical industry continues to be a positive contributor to GDP. Prospects are encouraging for the industry as it stands to benefit from reforms initiated by the Ministry of Health that allows the substitution of cheaper generic drugs for brand-name drugs in prescriptions. The ICT sector also appears to be sustaining relatively well, with potential for further growth driven by demand from those displaced to Lebanon as they gradually integrate into the economy (Figure 7).

7. From the demand side, private consumption and the external sector drive growth in 2015. Improved security conditions and lower oil prices helped partially offset the negative impact on consumer sentiment caused by the deteriorating political climate. The three-

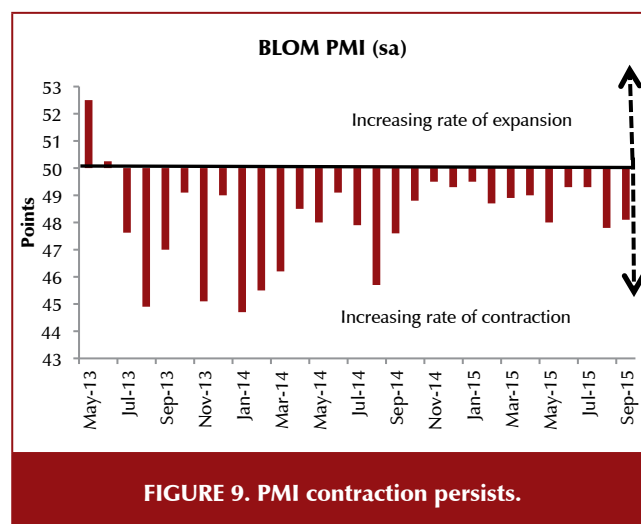


Source: ARA Marketing Research and Consultancy and BdL

month-moving average for the Byblos/AUB consumer confidence index¹⁰ rose by 50.2 percent in the first eight months of 2015, compared to the corresponding period in 2014 (Figure 8), but remains volatile. Moreover, private lending toward consumption and real estate purchases continues to expand, albeit at a decelerated rate, motivated by a BdL stimulus package in 2015; commercial banks' claims on residents grew by 6 percent (yoy) in August 2015, compared to 9.7 percent in August 2014. Anecdotal evidence suggests that private demand is also supported by Syrian investment and consumption, concentrated in the informal sector; as the Syrian turmoil endures, Syrians in Lebanon are gradually shifting their economic role from being mainly consumers reliant on handouts to becoming income earners, albeit for many, confined within the informal sector. This includes establishing micro and small businesses that sell goods (including those originating in Syria) at lower prices targeting the Syrian community (ILO, 2014¹¹). However, Lebanese businesses, which are not able to compete at those prices are negatively impacted. The external sector has also been a positive contributor to real GDP growth due to falling merchandize imports and a tourism-led increase in exports of services that more

¹⁰ The Byblos Bank/AUB CCI comprises two sub-indices: the Byblos Bank/AUB Present Situation Index and the Byblos Bank/AUB Expectations Index. The former represents consumers' opinion about current economic conditions, while the latter reflects consumers' outlook about the future of the economy.

¹¹ International Labor Organization, 2014, *Assessment of the Impact of Syrian Refugees in Lebanon and Their Employment Profile*.



Source: BLOM Bank

than offset a contraction in merchandize exports. This resulted in a narrowing of the trade deficit in goods and services. Public investment, on the other hand, is expected to lag in 2015 due to the political paralysis and increased scrutiny on outlays by the Ministry of Finance. Investment as a whole remains weak, albeit slightly improved from 2014; the BLOM purchasing managers' index (PMI)¹² averaged 48.7 during the first nine months of 2015, which, while in a state of contraction, is still progress from the corresponding period in 2014 where it averaged 47 (Figure 9).

Labor Markets

8. **Given their protracted presence, Syrian nationals have *de facto* become part of the labor market.** With around half of the working age Syrian refugees economically active (ILO, 2014),¹³ by

¹² The PMI is an indicator that is based on a monthly survey of business conditions in the Lebanese private sector. It is a composite index calculated as a weighted average of five individual sub-components: New Orders (30 percent), Output (25 percent), Employment (20 percent), Suppliers' Delivery Times (15 percent) and Stocks of Purchases (10 percent). A value of the PMI above 50.0 signals an improvement in business conditions from the previous month, while a drop in the PMI below the 50.0 threshold indicates a slowdown in business activity (BLOM Bank, 2013).

¹³ The study surveyed the employment profile of refugees and the impact of their economic participation on the host communities' livelihoods. Data was collected from 400 households, which included a total of 2,004 individuals.

end-2014 the labor supply in Lebanon is estimated to have expanded by 50 percent (IMF, 2014¹⁴). The majority of Syrian refugees are low- to semi-skilled workers, engaged primarily in construction, agriculture, and personal and domestic services, concentrated in the informal sector. It is unclear to what extent low-skilled refugees are competing with Lebanese nationals since Syrians were heavily represented in Lebanon's low-skilled labor sector even prior to the crisis, in addition to other nationals (e.g. Bangladesh, Ethiopia, Philippines); as such, it is more likely that low-skilled foreign labor in Lebanon, including other Syrians who were present here before 2011, will bear the brunt of the competition from refugees. This can explain the lack of significant tensions between the refugees and host communities, considering the sheer number of refugees. Lebanese employers and business owners, on the other hand, earn an unequivocal benefit from the availability of less costly labor (ILO, 2014). These findings are consistent with evidence of *de facto* (but rarely *de jure*) labor market inclusion witnessed in similar protracted refugee presence in host countries (e.g., World Bank, 2011¹⁵). They also confirm the simulations undertaken in the World Bank (2013)¹⁶-led report: namely that the Syrian conflict and the massive influx of refugees into Lebanon would generate both winners and losers among Lebanese (and refugees); those having good human or physical capital are not strongly impacted and might even benefit (e.g., landlords or retail store owners in regions with high refugee influx), while those with limited such capital would be worse off (e.g., lower wages, less jobs).

9. **Lebanon's inability to generate sufficient jobs has acute socio-demographic implications.** Real estate, construction, finance and tourism have

been the traditional drivers of economic activity.¹⁷ Since these sectors either are not labor intensive, or attract lower skilled and cheaper foreign labor, growth observed in Lebanon does not adequately generate employment for Lebanese nationals. In fact, the long-run employment-growth elasticity is estimated to be 0.2 (World Bank, 2012¹⁸), much lower than an estimated MENA average of 0.5 (IMF, 2014). Furthermore, during the 2005–09 period, Lebanon created only 3,800 jobs per year (one for every six new entrants to the labor market), while some 22,000 new Lebanese entrants are expected each year until 2019 (excluding the Syrian refugees) – World Bank (2012). The unemployment rate in 2011, still yet unaffected by regional hostilities, stood at 11 percent, slightly exceeding the MENA average of 10 percent, and reflecting insufficient job opportunities. While no data exist yet, unemployment is estimated to have worsened significantly since then (World Bank, 2013). This structural labor market weakness is changing the socio-demographic fabric of the country: educated Lebanese have sought employment in countries with a demand for high skilled labor, creating a large diaspora; meanwhile, non-Lebanese dominate the unskilled labor market, pricing out the nationals.

Fiscal Policy

10. **In 2015, Lebanon is expected to undergo a slight deterioration in the overall fiscal balance, while maintaining a primary surplus.** The overall fiscal deficit is forecast to widen slightly to 7.2 percent of GDP, compared to 6.6 of GDP in 2014 (Figure 10). This small relapse is led by the primary balance (i.e., excluding interest payments), which is projected to shrink by 0.6 pp to reach 2 percent of GDP, albeit remaining in surplus for the second year in a row since 2011 (Table 6). The declining primary

¹⁴ IMF (2014), *Article IV Consultation and Selected Issues*, July, Washington DC.

¹⁵ World Bank (2011), *"The Impacts of Refugees on Neighboring Countries: A Development Challenge,"* Background note for the 2011 World Development Report on Conflict and Development, Washington DC.

¹⁶ World Bank (2013) *"Lebanon: Economic and Social Impact Assessment of the Syrian Conflict"*, Washington DC.

¹⁷ The real estate sector, in particular, has accounted for anywhere between 50 and 70 percent of total gross fixed capital formation since 1997.

¹⁸ World Bank (2012), *"Republic of Lebanon—Good Jobs Needed: The Role of Macro, Investment, Education, Labor and Social Protection Policies"*, December, Washington DC.

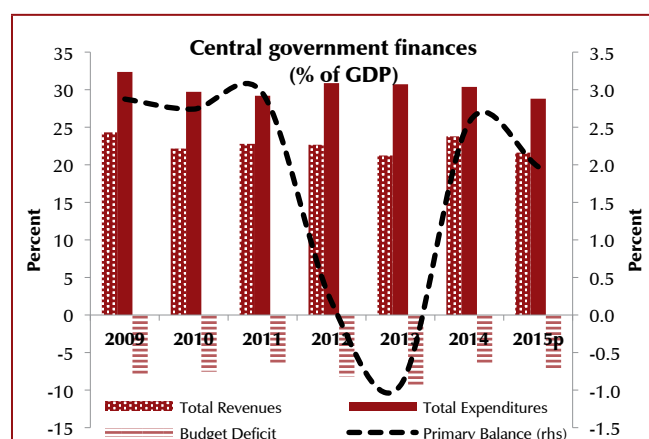


FIGURE 10. Fiscal deficit widens in 2014...

Source: MoF and WB staff calculations

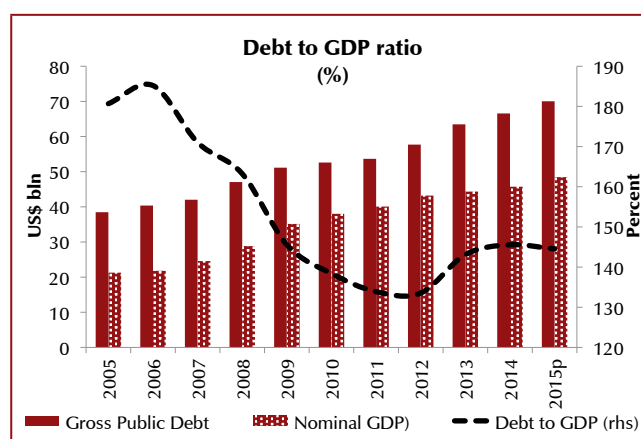


FIGURE 11. ... debt- to-GDP, however, falls.

Source: BdL, CAS and WB staff calculations

surplus is driven by a fall in revenue collection, specifically, non-tax revenues; a projected 2.2 pp decline in total revenues to 21.6 percent of GDP in 2015 is driven by a contraction in both telecom transfers and treasury revenues; the fall in the former is due to the lack of one-off measures, which in 2014 include the collection of telecom arrears that helped improve the fiscal balance. The slowdown in economic activity has induced a general decline in total revenues to below the 10-year average of 23.4 percent of GDP. On the expenditures side, primary spending is forecast to fall by 1.5 pp to reach 27.2 percent of GDP in 2015. This is principally due to lower oil prices, which is expected to decrease transfers to Electricité du Liban (EdL), the state-owned power company, from around 4.6 percent of GDP in 2014 to around 2 percent of GDP in 2015.

11. **A primary surplus for the second year running is expected to help temper the debt-to-GDP ratio, which has been rising since 2013.** Total public debt is projected to reach 144.5 percent of GDP (US\$70 bln) by end-2015, compared to 145.6 percent of GDP at end-2014 (Figure 11) (Table 6). Despite this minor improvement, which is due to a larger growth rate for nominal GDP than for debt,¹⁹ the trend, based on current policies and real GDP growth rates, is unsustainable and is expected to notably worsen once global dollar interest rates start normalizing (a pace which is expected to start with a tightening of policy rates by the U.S. Federal Reserve

¹⁹ In fact, in absolute terms, the increase in debt is expected to be larger in 2015 than in 2014.

Board). The government continues to primarily finance the fiscal deficit by issuing Treasury bills and Eurobonds. In February 2015, the government raised US\$ 2.2 billion through a dual-tranche Eurobond issuance,²⁰ while subsequent issues are being prepared for this year for around \$1.3 billion. Moreover, in August 28, the cabinet authorized the Ministry of Finance to swap \$750 million in Eurobonds that mature in January 2016. The stock of debt outstanding remains mostly in local currency, whereby, as of August 2015, 62 percent of gross public debt is denominated in LBP.

12. **Longstanding structural bottlenecks in public finance are important manifestations of the endemic corruption and political malfunction, impeding the development of the country.** Since 2005, budgets have not been ratified by parliament due to discord over accountability over previous fiscal accounts. Moreover, none of the post-war budgets were voted within constitutional time and the last officially closed fiscal accounts are those of 2003, although those from 1993 till 2003 need major adjustments. Spending has been conducted largely through treasury advances and ad-hoc measures in times of pressures. This leaves fiscal policy without an anchor. Even prior to 2005, fiscal policy has been missing a medium-term perspective. The lack of proper oversight and extra-budgetary

²⁰ Despite it being one of the largest issues by the government and occurring during a period of regional turmoil, it was oversubscribed. The issue consisted of two tranches: US\$ 800 million for a maturity of 10 years at 6.2 percent and, significantly, US\$ 1.4 billion for a 15-year maturity at 6.65 percent.

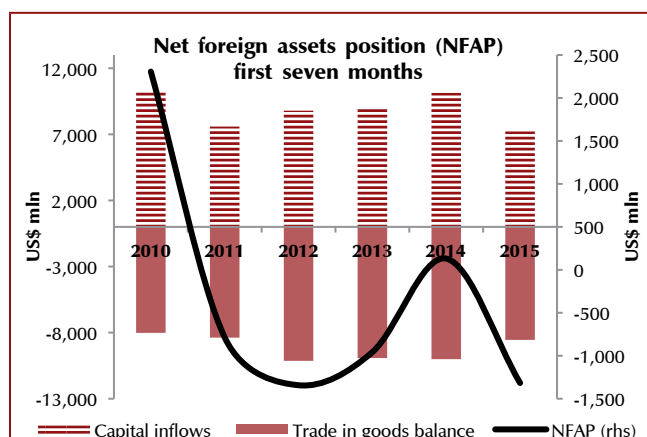


FIGURE 12. Despite a regression in capital inflows...

Source: BdL and WB staff calculations

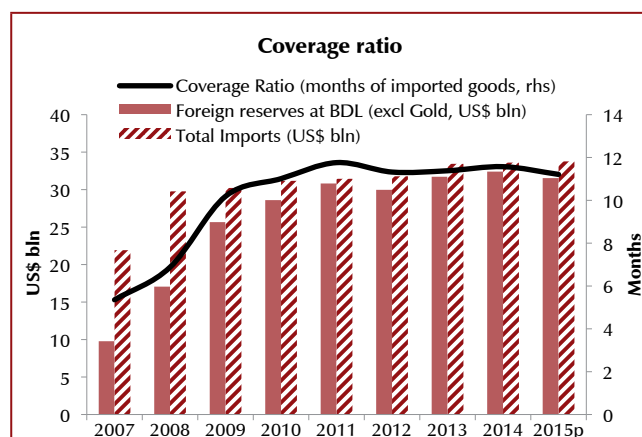


FIGURE 13. ... BdL to increase its stock of foreign reserves.

Source: BdL, Lebanese Customs and WB staff calculations

entities that receive significant government funding help entrench a culture of non-transparency and encourage corruption in fiscal affairs.

External Sector

13. Lebanon's current account balance is expected to improve in 2015 but remains structurally weak. The current account deficit is forecast to decrease by over 5 pp of GDP in 2015, reaching 21 percent of GDP;²¹ a deficit that remains among the largest in the world, exposing the country to significant refinancing risks. The improvement is a result of a 6 pp projected decline in total imports to around 64 percent of GDP, compared to an average of 80.5 percent of GDP over the previous decade. This is entirely due to a large contraction in merchandise imports, encompassing a broad range of goods and driven by lower commodity prices, especially fuel products,²² and the depreciation of the euro; in 2014, the Euro region was the origin for around a third of Lebanon's total imports, in value, but a destination for only around 9 percent

of the country's exports. Meanwhile, exporters of merchandize goods were severely afflicted by the closure of the few remaining routes via Syria, through which they were still able to reach the GCC market.²³ While this applies to a broad range of goods, exports of chemical products experienced a significant improvement, possibly a reflection of the rare success concentrated in the pharmaceutical industry. Nonetheless, we are still expecting total exports to increase slightly in 2015, led by services, Lebanon's primary export,²⁴ as the tourism sector experiences a bit of a revival. Remittances in 2015 is forecast to recover to 4.2 percent of GDP, compared to 3.7 percent of GDP in 2014, but will remain lower than the previous decade's average of 6.1 percent of GDP due to sluggish global conditions.

14. Lebanon is structurally and heavily dependent on capital inflows to finance its current account deficit.²⁵ Since 2012, leading sectors towards which the majority of foreign capital has traditionally gravitated have suffered a significant decline in activity, becoming a less attractive destination for FDI (e.g., real estate, tourism). However, net FDI in 2014 (the latest

²¹ BoP revisions by authorities are frequent and substantial. Recent revisions have included a substantial increase in historical numbers for the current account deficit. For example, in a previous BoP issue, the current account deficit in 2012 and 2013 had hovered around 8 percent of GDP.

²² Latest World Bank staff projections predict that the average composite energy price will fall by 39 percent in 2015 compared to 2014.

²³ On 10 August 2015, the Government agreed to subsidize the cost of exporting goods to Arab countries through the sea, over a period of 7 months. The total subsidy amount was set at US\$14 million.

²⁴ In 2014, exports of services in value was three times that of merchandise exports.

²⁵ The current account deficit has averaged 17.2 percent of GDP during the past ten years.

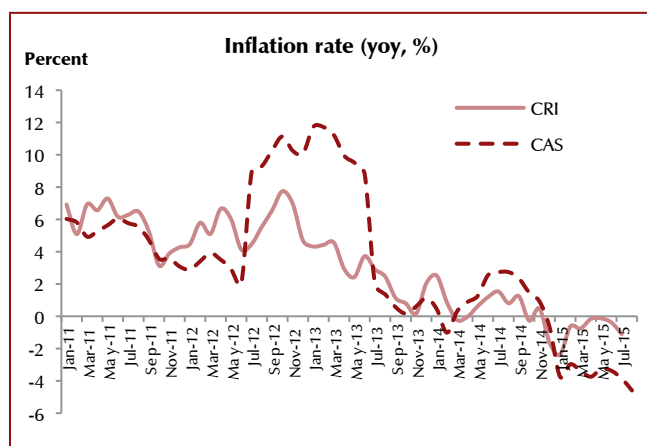


FIGURE 14. Inflation abates in 2015.

Source: CRI and CAS

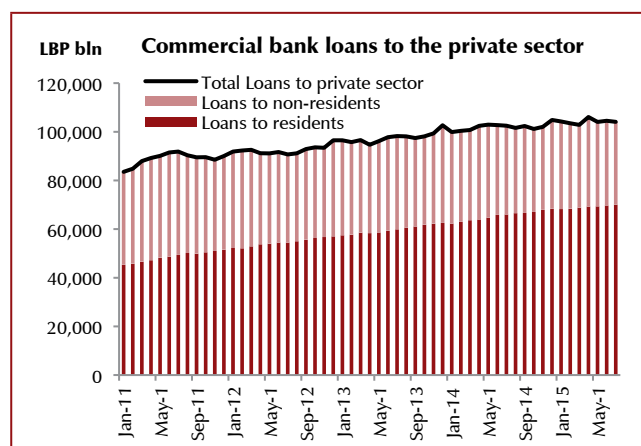


FIGURE 15. Lending to the private sector continues to respond to Bdl's stimulus package.

Source: Bdl and WB staff calculations

available full-year data) grew by 22.4 percent to US\$ 1.2 billion, equivalent to 2.6 percent of GDP, and the first such increase since 2010. Nevertheless, it remains well below pre-crisis levels, where between 2000 and 2010, FDI averaged 9.5 percent of GDP. We project a slight increase in 2015 to 2.7 percent of GDP. The presence of Syrian refugees has partially compensated for the overall loss of inflows since 2010; the longer the Syrians are displaced from their country, the more likely they will seek more medium-term adjustments to their financial situation. This involves investments and other inflows to their host country, in the form of FDI and short-term flows. Additionally, international aid targeting Syrian refugees provides additional support to the balance of payments.²⁶ This effect is also reinforced by the wide spread between domestic and international interest rates that reached an average of 417 basis points (bps) during January-July 2015.²⁷

15. Lower capital inflows weakens the net foreign asset position, but gross foreign

²⁶ Inflows to Lebanon have also included international aid targeting Syrian refugees, albeit via various international organizations and not through the government, which continues to appeal for assistance. A United Nations Development Program (UNDP) study assesses the impact on the Lebanese economy of international humanitarian aid delivered via UN agencies to the Syrian refugees in Lebanon. It estimates that this aid, estimated at over a billion dollars between 2012 and 2014, has a multiplier effect that added 1.3 pp to 2014 GDP growth.

²⁷ This is the interest rate differential between the 3-month Lebanese T-bill and the 3-month LIBOR.

reserves remain robust. The cumulative change in total net foreign assets recorded negative US\$ 1.6 billion during the first eight months of 2015, compared to negative US\$ 433 million during the corresponding period in 2014 (Figure 12). This deterioration was the result of a sharp drop in total capital inflows, which, at US\$ 6.9 billion for the year to August, is a 39.5 percent (yoy) decrease, despite the rise in tourism inflows. We expect this trend to moderate in the second half of 2015 for an overall decline in capital inflows of 20 percent in 2015. In spite of the worsening net foreign asset position, the stock of gross foreign reserves held at the central bank is projected reach US\$ 34.5 bln (equivalent to 13.4 months of imported goods and services) by end-2015, increasing by almost 7 percent compared to end-2014 (Figure 13). To some extent, this reflects repatriation of commercial banks' foreign assets in search of higher yield.

Monetary Policy, Banking and Prices

16. Amid lackluster economic activity and falling oil prices, Lebanon's inflation rate is expected to reach its lowest level in over a decade. Headline CPI inflation is forecast to average 0.2 percent in 2015, undergoing a one pp decline

relative to 2014 (Figure 14).²⁸ The declining inflation rate in 2015 reflects the continued negative output gap (Figure 3) as well as favorable external prices (mostly declining global energy and food prices, and also an appreciating effective exchange rate given the country's peg to the dollar). Moreover, with the influx of Syrian refugees sharply lower in 2015 than in 2014, supply side factors that previously pushed inflation upwards (e.g., the sudden and massive increase in housing demand), is likely to have waned off. The slowdown in inflation is translating into tepid growth in money supply (M3, including non-resident deposits), which we project to be 6 percent in 2015, unchanged from a year earlier.

17. Exchange rate stability, a negative output gap and low and decelerating inflation prompted the central bank, Banque du Liban (BdL), to continue its expansionary monetary policy. The dollarization rate—a key gauge of confidence in Lebanon—registered 65 percent by August 2015, a decrease of 93 bps from mid-2014. Simultaneously, real GDP growth continues to lag behind the 1993-2014 average rate of 4.4 percent; as shown in Box 1, a negative output gap has opened up in 2014. These, along with low inflation, allowed the BdL to launch a stimulus package in 2015 for the third year running,²⁹ amounting to US\$ one billion, in the form of subsidized loans. These packages have been vital for buttressing the real estate sector by boosting domestic demand after demand from Lebanese expatriates and foreign buyers dropped sharply.

²⁸ Inflation data in Lebanon have been problematic. Due to interruption in official CPI inflation data (Central Administration of Statistics (CAS) did not collect any price data between January and May 2013), we used the CRI CPI index instead, which does not include rents and only collects price data for the Greater Beirut area. Even prior to the interruption, the Central Administration of Statistics' CPI inflation did not reflect periodic measurement of rent inflation. In December 2013, CAS released a rebased inflation time series using a new methodology to better capture rents.

²⁹ Stimulus packages were launched by the BdL in 2013 and 2014 in the amounts of US\$ 1.46 billion and US\$ 800 million, respectively, and these have proved successful. While the real estate sector benefited the most from the subsidized loans, start-ups and venture capital (relatively nascent in Lebanon) are also responding favorably to BdL's subsidized loans. The BdL is expected to continue acting as a lender of last resort subject to exchange rate stability.

18. To maintain the peg, BdL ensures that banks offer attractive dollar spreads to finance the current account. Under sustained severe fiscal needs and a banking sector balance sheet that is over three times GDP, the BdL ensures that banks keep attracting foreign deposits and that the public sector gross financing needs are met. For the former, BdL introduced new certificate of deposits for the 15Y, 20Y and 30Y tenors, lengthening the maturity structure, as well as various subsidized refinancing schemes. For the latter, BdL bids on the TBs primary market and acts as a buyer on the secondary sovereign debt market. The resulting banking-sovereign feedback loop is therefore adding a financial burden on BdL.

19. In 2015, lending to the resident private sector continues to expand, albeit, at a decelerated rate. The stock of commercial banks' credit to the private sector increased by a sluggish 3.7 percent (yoy) in August 2015, compared to 3.5 percent (yoy) in August 2014 (Figure 15). However, this comes with a couple of caveats. First, with an exceptionally low inflation rate, the change in real private lending is larger. Second, this conceals diverging dynamics; while claims on non-residents contracted by 0.8 percent (yoy) over the same period, those on residents grew by 6 percent. Part of the growth in credit to residents, which nonetheless signals a deceleration from 9.7 percent growth in August 2014, is related to the BdL's stimulus packages described above. The deceleration possibly reflects the impact of macroprudential measures introduced by the BdL to help contain the over-leveraging of the financial sector.³⁰ Moreover, lending remains below the 2008-2012 average rate of 16.5 percent, reflecting reduced economic activity and elevated risk aversion from the volatile security environment.

³⁰ To limit leverage risks on the consumer side and the fallout impact on banks, in 2014, BdL instructed banks to require a minimum down-payment of 25 percent for any car or housing loan and to limit the value of the loan such that the monthly installment does not exceeding 45 percent of family income (35 percent for a housing loan).

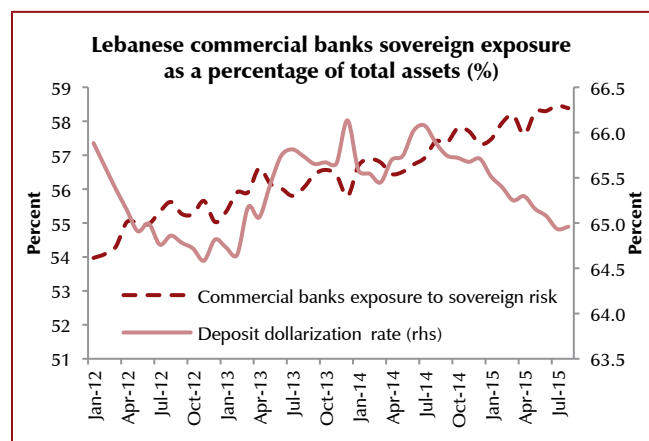


FIGURE 16. Lebanese banks' sovereign debt exposure increases in 2015...

Source: BdL and WB staff calculations

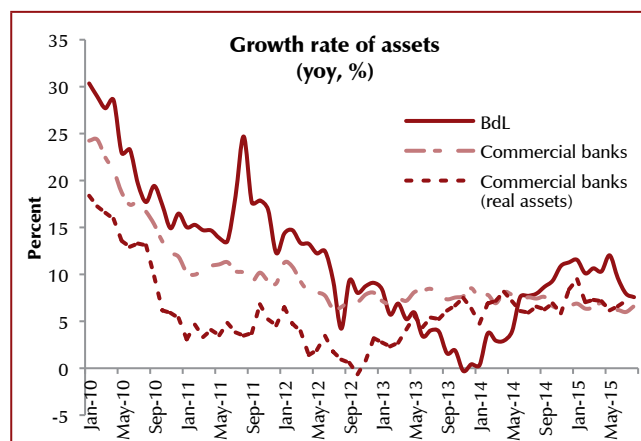


FIGURE 17. ... as did commercial banks' assets.

Source: BdL and WB staff calculations

Financial Markets

20. **Lebanon's banking sector is liquid, profitable and well regulated, but highly exposed to the public sector.** Banks are well capitalized and resilient owing to prudent investments and conservative regulation by BdL and the Banking Control Commission. In 2014 (latest available), the Tier one capital-to-risk-weighted-asset ratio was 12.8 percent, which was double what is required by Basel III. The liquid asset-to-total deposit ratio,³¹ an indicator of short-term liquidity, stood at 69.4 in July 2015, compared to 66.9 in July 2014. Moreover, banks' profits continue rising while non-performing loans (NPLs) are low and return on equity is in the double digits.³² Nonetheless, commercial banks are highly exposed to sovereign credit risk as they are a large investor in public debt.³³ In fact, Lebanese banks' sovereign debt exposure³⁴ increased slightly from 57.3 percent end-2014

to 58.4 percent at end-August 2015 (Figure 16). In an attempt toward diversification, banks expanded regionally, an effort that has been severely compromised by the recent regional upheaval.³⁵

21. **Deposit growth decelerates.** Commercial banks' balance sheet continued to grow, rising by 6.6 percent (yoy) in August 2015, compared to 7.4 percent in August 2014 (Figure 17). Once again, an exceptionally low inflation rate is distorting the trend as real assets³⁶ growth (yoy) was higher and not lower in July 2015 compared to a year earlier. Deposits constitute the principal funding source for commercial banks, with the deposit-to-total liabilities ratio at 87.6 percent by August 2015, compared to 88.1 percent a year earlier. Total private sector deposits at commercial banks grew by 5.7 percent (yoy) in August 2015, compared to 7.7 percent a year earlier; resident and non-resident private deposits increased by 5.1 percent (yoy) and 8.3 percent (yoy), respectively, undergoing respective declines of 1.8 pp and 2.7 pp from August 2014 (Figure 18). However, once inflation is accounted for, the yoy growth in real deposits exhibits is largely unchanged in July 2015, compared to a year earlier, and is generally higher than it has been since the beginning of the regional

³¹ Liquid assets consist of commercial banks' deposits with central bank, Treasury Bills in LL held by commercial banks and Eurobonds held by commercial banks.

³² There has been some deterioration in profitability and NPL ratios since the beginning of the Syrian crisis in 2011.

³³ Interest income, as obtained from BilanBanques, amounted to, respectively 64.09 percent, 65.31 percent and 64.06 percent of total consolidated banks' income in 2010, 2011 and 2012.

³⁴ The sovereign debt exposure is computed as a ratio of commercial banks' aggregate investment in Treasury bills, Eurobonds and deposits at BdL relative to total assets.

³⁵ Expansion of Lebanese commercial banks in Turkey continues, however, helping to increase profitability.

³⁶ To get real assets, we divided nominal assets by the CRI price index.

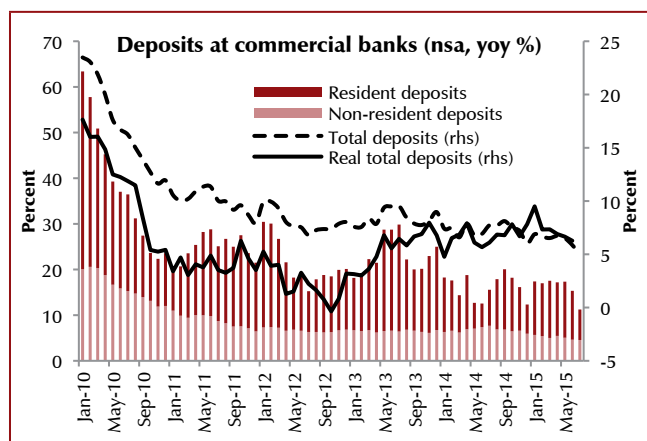


FIGURE 18. Real deposits at commercial banks continued to accelerate in 2015.

Source: BdL and WB staff calculations

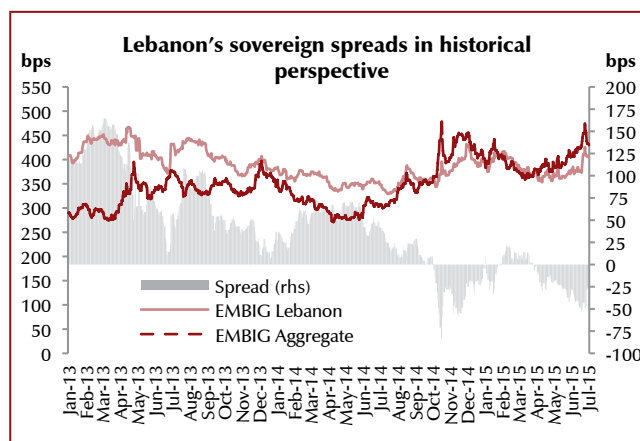


FIGURE 19. Global volatility translated into negative spread.

Source: JP Morgan and WB staff calculations

turmoil. Moreover, with global interest rates lingering at record lows, the Lebanese banking system continues to be an attractive destination for depositors. Non-resident deposit growth has been a vital factor in the stability of the banking sector, and in fact the whole economy. Attracted by interest rate spreads³⁷ it has been expanding at an average of 18 percent annually since 1993. However, a deceleration over this period signals the unsustainability of such a high rate; non-resident deposit growth declined from an annual average of 21.5 percent for the period 1993-2002, to 16.2 percent during 2003-2011. Since 2011, the regional turmoil has further exacerbated this trend to an average growth of 10.3 percent. Nonetheless, this remains sufficient to meet the country's financing needs.³⁸ Furthermore, these deposits, which are largely sourced from Lebanese expatriates, are resilient to shocks due to the diaspora's familiarity with the country's political and security volatilities. Additionally, the BdL has demonstrated its readiness to be the ultimate guarantor of the financial sector via its large foreign exchange reserves, intermediation

between antagonistic parties and good crisis management overall.³⁹

22. Spreads on Lebanese Eurobonds turned negative in 2015, whereas the stock market index fell slightly. The negative EMBIG spread likely reflects an improvement in overall security conditions along with a worsening of macroeconomic fundamentals in key emerging market economies (Figure 19). On the other hand, the Beirut Stock Exchange BLOM Index declined by 2 percent in the year to September, while market capitalization fell by 1.8 percent to reach US\$ 11 billion, equivalent to around 24 percent of 2014 GDP. It is unlikely that this decline is driven by the volatility in global equity markets, since the BSE has traditionally had weak global linkages. Average trading value during January-September 2015 also declined by 1.3 percent, compared to the corresponding period in 2014.

³⁷ The main interest rates that matter in this arrangement are the international dollar rate, a local rate on dollar deposits and a local rate on LBP deposits. A spread between the local and international dollar rates attracts deposits in dollar, while a spread between LBP and local dollar rates encourages deposits in local currency. Nonetheless, like much of the country, Lebanon's banking system is highly dollarized (65 percent dollarization rate).

³⁸ Source: IMF 2014 Article IV Consultation.

³⁹ For example, in 2011 the US accused the Lebanese Canadian Bank of money laundering, which caused a rattle in the Lebanese financial sector. BdL immediately declared that it has sufficient funds to back up the bank, rapidly negotiated a takeover by Societe Generale de Banque au Liban, and eventually agreed on a settlement with the US government.

PROSPECTS

23. **The regional turmoil, especially the war in Syria, poses serious security threats in Lebanon and the recent relative clam is not a guarantee of stability.** A key assumption underlying projections for the Lebanese economy regards the Syrian conflict and its spillovers. Current World Bank staff projections no longer assume that the end of the Syrian war occurs within the projection period of 2015-2017, but instead assume that current conditions hold, i.e., containment of the spillovers continues but does not prevent occasional security events from occurring. Relative to our Spring 2015 issue of the Lebanon Economic Monitor, real GDP growth for 2015 is projected to be 0.5 pp lower at 2 percent, reflecting a sharp contraction in the real estate sector and negative effects of the garbage crisis on tourism and private consumption during the critical months of summer. Over the medium term, we expect real GDP growth to be around 2.5 percent. The return to potential output critically hinges on a resolution of the conflict in Syria as well as a marked improvement in the security and political situations in Lebanon.

24. **Absent significant structural reforms on either revenue or spending, Lebanon's public finances are projected to remain structurally weak.** The primary surplus is expected to continue falling over the medium term, almost disappearing by 2017, due to higher primary spending; transfers to EdL will rise once again along with energy prices. Moreover, assuming political paralysis eases by 2016, we expect some limited public sector wage increases as well as higher transfers to municipalities. A projected increase in debt servicing due to pass through from higher global interest rates (i.e., US. Federal Reserve Board-related) will also raise current spending. As a result, the overall fiscal deficit is forecast to continue widening over the medium term.

25. **The conduct of monetary policy is likely to become more challenging due to conflicting objectives.** BdL, whose primary objective is to maintain the stability of the peg to the dollar, is expected to become confronted over the short to medium term with challenges to its expansionary policies (secondary objective) from a number of factors. First, expected normalization of global interest rates will ultimately require domestic interest rates to increase in order to maintain exchange rate stability. Second, the enthusiastic response to BdL initiatives (subsidized loans) has helped boost economic activity but, after several years of such lending, more attention will need to be paid to the issue of household leveraging and repayment capacity. The expanded use of macroprudential tools shows that BdL is vigilant to these risks. Hence, while monetary policy has been one of the few effective countercyclical policy tools during the ongoing period of sluggish growth, it will likely become less potent economic stimulant going forward.

26. **The breakdown in the political process and the severe deterioration in government services are fundamental challenges to the post-war system in Lebanon.** Current conditions are unsustainable, and without significant political and economic reforms, a widening and worsening of socio-economic unrest is not unfathomable. In fact, the demonstrations and activities directed at the political class that the country is witnessing is one such manifestation. It is thus imperative and urgent for policy-makers to address Lebanon's longstanding and worsening structural bottlenecks. Lebanon continues to be beset by structural bottlenecks, including in infrastructure such as electricity, water, waste treatment, transportation and telecommunications. These bottlenecks are becoming even more binding as shown by a

worsening of Lebanon's international ranking among key investment climate assessments (e.g., the World Bank's Doing Business indicators or the World Economic Forum's Global Competitiveness Index). Policy inaction is not just putting on hold Lebanon's development, it is dragging it backwards.

SPECIAL FOCUS

I. ELITE CAPTURE AND THE HOLLOWING OF THE STATE: AN OVERARCHING CONSTRAINT TO LEBANON'S DEVELOPMENT⁴⁰

Lebanon's post-war governance endures systemic failures. Institutionalized confessionalism intended as protection for the mosaic of communities in a country that lacks a demographic majority has developed into pervasive elite capture and patronage system. This elite commands the main economic resources, generating large rents and dividing the spoils of a dysfunctional state. In the process, the public sector has become increasingly governed by bribery and nepotism practices, failing to deliver basic public services and incapable of resolving the most urgent needs. This has culminated in the comprehensive breakdown in the political process, with the three branches of government either vacant or effectively idle, and the only national plebiscite abrogated. This has triggered a series of protests and civil disobedience measures targeting the ruling political class with emphasis on corruption and incompetence. Current conditions are unsustainable, and without significant political and economic reforms, a widening and worsening of socio-economic unrest is not unfathomable.

Elite capture hidden behind the veil of confessional governance

27. **The 15-year long Lebanese civil war formally ended through the establishment of the 1989 Taif Agreement that institutionalized the confessional nature of the political system.** A complicated matrix of antagonistic interests in the Lebanese civil war involving international, regional and local players was finally successfully balanced in the 1989 Taif Agreement that adjusted and institutionalized a power-sharing formula among the different confessional communities in Lebanon. The Taif Agreement brought about a more equitable confessional distribution formula between Christian and Muslim (50/50) representation in the executive and legislative branches (previously these were 60/40 in favor of the Christian representation), while transferring much of the executive powers of the Maronite president to the Cabinet. In the process, however, it further entrenched confessionalism in the Lebanese governance system by constitutionalizing the sectarian ownership of the top three positions in the country: the President of the Republic (Maronite), the Prime Minister (Sunni), and the Speaker of Parliament (Shia).⁴¹ Although the accord stated that the abolition of political confessionalism was a national goal, and set out a mechanism to achieve this, 25 years later this system still prevails due to selective implementation of the accord.

28. **The post-war confessional governance system developed into a pervasive elite capture and patronage system.** By the end of the 15-

⁴⁰ This Special Focus draws to a large extent on the recent Lebanon Systematic Country Diagnostic (World Bank, 2015).

⁴¹ This distribution existed prior to the Taif Agreement as part of a National Accord and not the constitution.

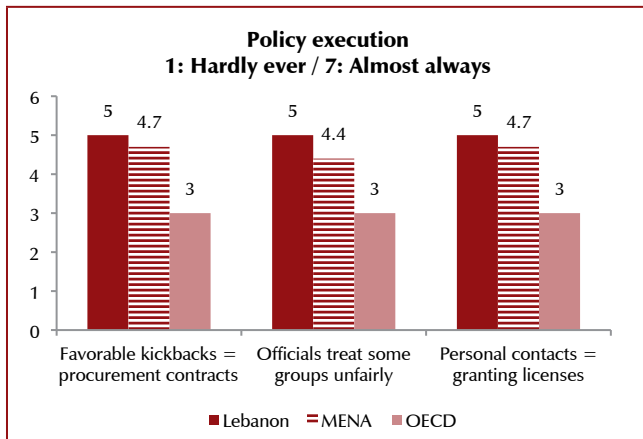


FIGURE 20. Bribery and nepotism are pervasive in policy execution in Lebanon.

Source: Quality of Government Expert Survey, 2010

year civil war, the Lebanese state was crippled and had lost its sovereign function. Furthermore, the nature of the confessional system encouraged constant competition over state resources. This led to the breeding of a new ruling class that became dominated by former warlords, militia members and oligarchs, who captured the public sector and used it as a source of redistribution and rent-seeking. Behind the veil of confessionalism, the political elite used the public sector to advance and protect the interests of their constituencies in order to secure their allegiance while political influence and wealth became concentrated in the hands of a few families. The latter was facilitated by the lack of regulation over conflicts of interest between the political and economic elite which has generated considerable political rent. For instance, many members of the ruling class are directly or indirectly tied to major players in the financial and real estate sectors, to major holding companies, and to companies that have monopolized a wide range of markets at the expense of the welfare of the Lebanese public (e.g., Chabaan, 2015⁴²).

29. The public sector has become increasingly governed by bribery and nepotism practices. According to surveys, public procurement contracts are most often awarded to the firms that provide the most favorable kickbacks to senior officials, while civil servants favor their personal contacts when granting licenses to start up private firms

⁴² Jad Chabaan (2015) "Mapping the Control of Lebanese Politicians over the Banking Sector," mimeo, AUB.

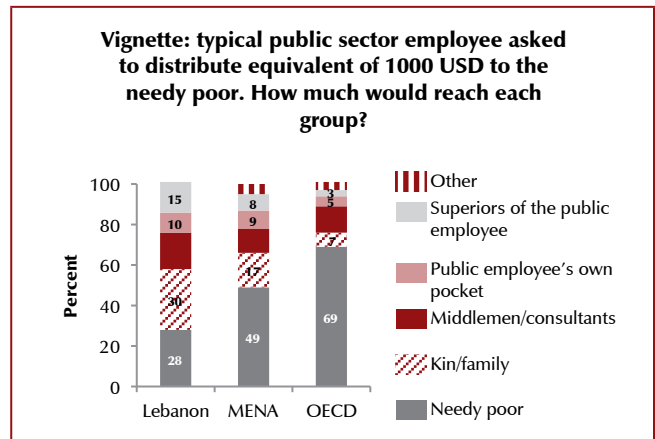


FIGURE 21. Public funds are diverted into the coffers of Lebanese politicians and civil servants.

Source: Quality of Government Expert Survey, 2010

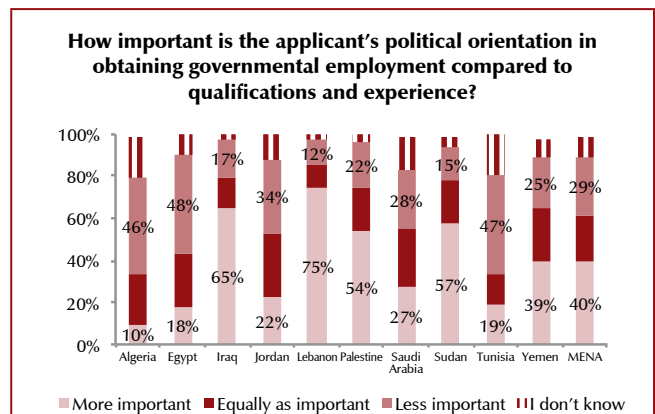
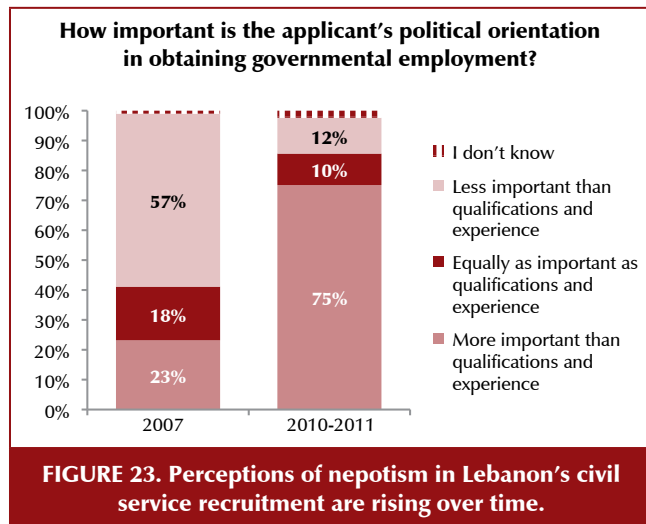


FIGURE 22. Nepotism in the Lebanese civil service recruitment is perceived as highest in MENA.

Source: Arab Barometer Survey, 2010-2011

(Figure 20). Public funds, including those intended for the most vulnerable segment of the population, are diverted into the coffers of the political elite and civil servants. For instance, only 28 percent of public funds intended for the poor reach that group while the rest are directly pocketed by civil servants, their superiors or kin (Figure 21). These practices are pervasive in all sectors to the extent that social and economic constitutional rights have become defined by clientalism and sectarian affiliations.

30. Power and resource allocations among the competing confessions have also extended into civil service appointments. Confessional considerations and nepotism, rather than merit, mostly determine recruitment into the public sector. In the 2010-2011 Arab Barometer Survey, 75 percent of Lebanese respondents reported that



Source: Arab Barometer Survey, 2007 and 2010-2011



Source: World Economic Forum, Global Competitiveness Index 2014/15

when it comes to obtaining public employment, an applicant's political orientation is more important than qualifications and skills (Figure 22). This share is not only the highest in the MENA region but has also markedly increased over time (Figure 23). The lack of a meritocratic recruitment process within the public sector has severely undermined the performance of the Lebanese public administration.

31. The capture of the state by sectarian and economic interests has undermined the autonomy and effectiveness of public institutions and generated a stalemate that has characterized the political landscape of post-war Lebanon. Public institutions emerged from the civil war in very dismal states. The redistributive and rent-seeking practices of the post-war governance system failed to build strong institutions and further exacerbated

their weaknesses, rendering them incapable of carrying out the most basic functions. Much-needed reforms in all sectors of the public sphere have never been implemented because the political and business elite have an incentive to preserve the status quo that enables them to generate large rents and divide the spoils of a dysfunctional state. At the same time, the governance formula introduced by the Taif Agreement with its requirement for broad consensus on every decision has resulted in a paralysis of decision-making since 2005.⁴³ As a result, the state was effectively hollowed out in the face of sectarian and economic interests.

Poor governance and weak institutions

32. Lebanon's poor governance and weak institutions constrain productivity and prosperity in the economy. A sound and fair institutional environment is a basic and fundamental driver of growth (see Easterly and Levine 1997; Acemoglu et al. 2001, 2002; Rodrik et al. 2002; and Sala-i-Martin and Subramanian 2003). The World Economic Forum's Global Competitiveness Index has identified institutions in Lebanon as the third factor constraining the level of prosperity of the economy, preceded by infrastructure and macroeconomic environment. Lebanon's governance structure and institutions are extremely weak with key constraints including, a lack of vision and planning to address short- and long-term challenges, inefficient and corrupt public institutions such as the judicial system, low capacity to deliver quality public services (as exemplified by the recent protests against the government's inability to deliver garbage services in the country), favoritism in the decisions of government officials, excessive bureaucracy and red tape, and weak accountability.

33. Lebanon fares poorly and well below world and regional averages on a wide range

⁴³ Prior to 2005, the Syrian military presence was the main power broker and decision maker in Lebanon.

of governance indicators. Public institutions in Lebanon are characterized by severe inefficiencies and widespread corruption that have become customary in the political and administrative landscapes. According to the Global Competitiveness Index, institutional quality in Lebanon is one of the worst in the world, ranked at 139 among the 144 countries included in the index. Lebanon ranks among the bottom 10 countries on 10 out of the 21 sub-indicators that capture the quality of institutions (Figure 24). Public trust in politicians has the lowest score and ranks last among the 144 countries. This is confirmed by polls of Lebanese citizens that have shown that the public at large has lost faith in the state that it perceives to be rife with corruption. In the 2013 Arab Barometer survey, more than half of the Lebanese respondents reported an absolute lack of trust in core public institutions (Figure 25). Not only are these shares alarmingly high, but they are also well above the averages in the MENA region. Moreover, in the 2013 Global Corruption Barometer survey, 93 percent of Lebanese respondents reported that corruption is a (serious) problem in the public sector while 77 percent reported that the government is (very) ineffective in the fight against corruption.

34. Lebanon's poor governance performance has significantly deteriorated over the past decade, from an already low starting level. The World Bank's Worldwide Governance Indicators show a substantial decline in the quality of governance in Lebanon particularly since 2005 (Figure 26). The control of corruption indicator, which measures the extent to which public office is used for private gain, has decreased from an already low score of -0.5 in 2005 to -0.9 in 2013. Similarly, over the same time period, the rule of law index has decreased from -0.3 to -0.8. Lebanon scored 31 out of 100 on the Corruption Perception Index in 2005, further dropping to 27 in 2014, indicating serious and deteriorating levels of corruption. Likewise, from 2012 to 2014, Lebanon's score on institutional quality in the Global Competitiveness Index dropped from 3.2 to 2.7, with the rank falling from 125/144 to 139/144.

35. The judicial system is corrupt, inefficient, ineffective and unfair. This is reflected in Lebanon's

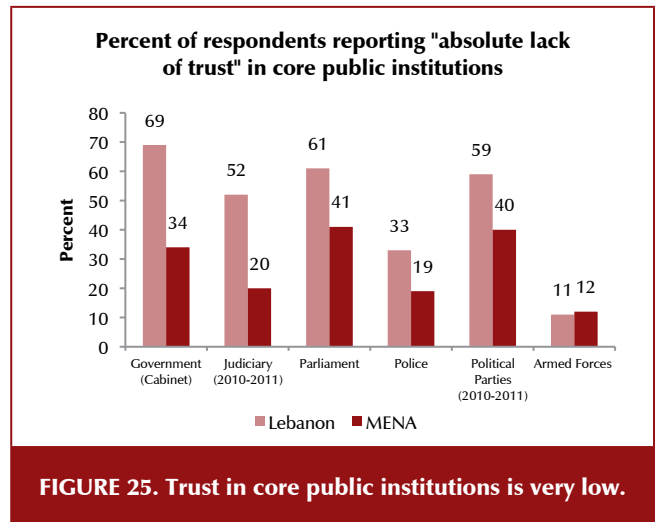


FIGURE 25. Trust in core public institutions is very low.

Source: Arab Barometer Survey, 2010-2011 and 2012-2014

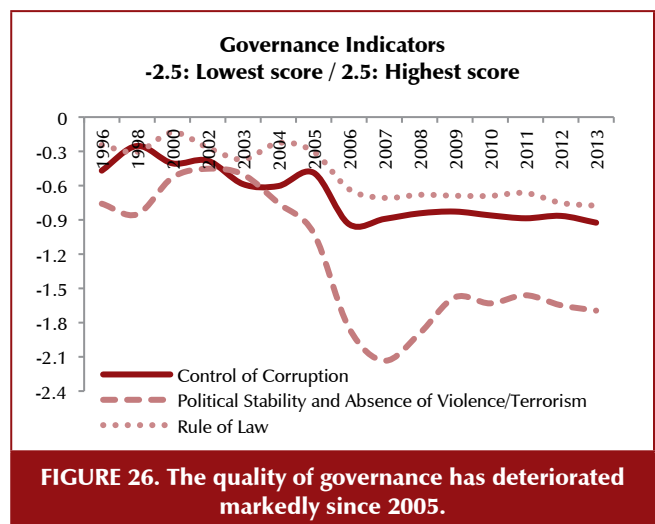
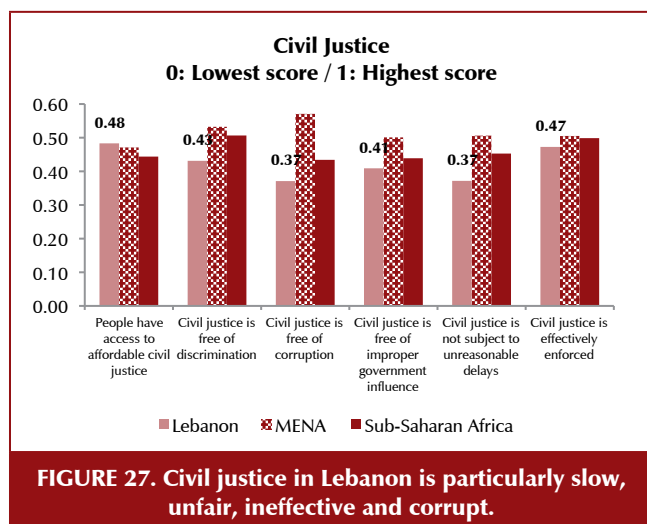


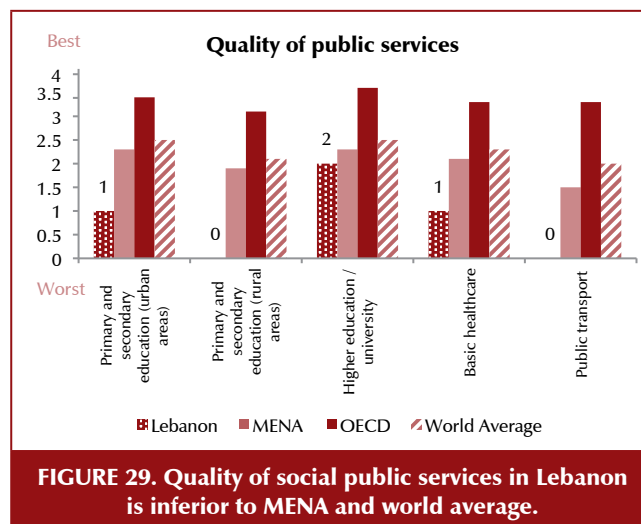
FIGURE 26. The quality of governance has deteriorated markedly since 2005.

Source: World Bank, Worldwide Governance Indicators 2015

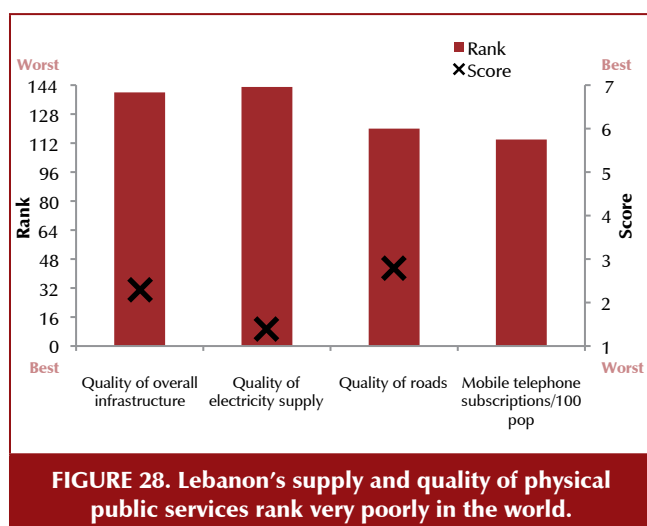
poor performance on a number of indicators on the strength of the judicial system. Out of 144 countries in the Global Competitiveness Index, Lebanon ranks 139 on the efficiency of legal framework in challenging regulations, 138 on judicial independence and 132 on the efficiency of legal framework in settling disputes (Figure 24). Like most other public sector positions, judicial appointments have become confessionally-driven, thus undermining the independence of the judiciary. The civil justice system is unfair and ineffective as evident from Figure 27 where Lebanon scores below MENA and Sub-Saharan Africa averages on civil justice equality, honesty, independence, timeliness and effective enforcement. Furthermore, the weak judicial system adversely impacts businesses by raising their transaction costs. Enforcing a contract,



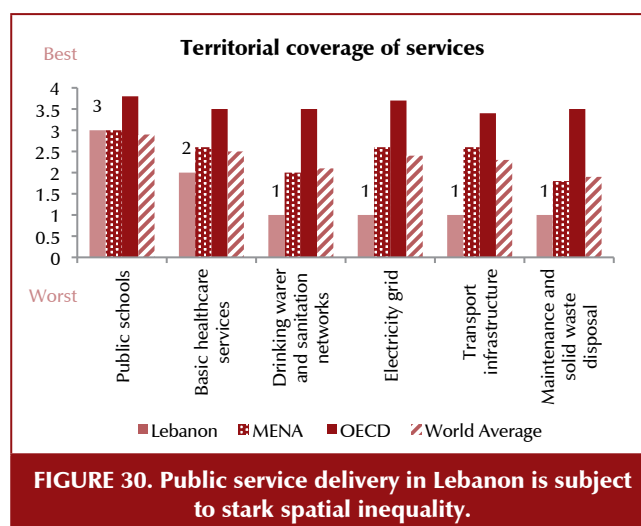
Source: World Justice Project, Rule of Law Index 2015



Source: Institutional Profiles Database, 2012



Source: World Economic Forum, Global Competitiveness Index 2014/15



Source: Institutional Profiles Database, 2012

for instance, necessitates 37 procedures, takes over 700 days and costs 30.8 percent of the value of the claim, most of which is associated with attorneys' costs (Doing Business, 2015). Polls of Lebanese citizens have also reflected weaknesses of the judicial system. For instance, in the 2013 Arab Barometer survey, 52 percent of respondents reported an absolute lack of trust in the judiciary (Figure 25).

36. The capacity of the public sector to provide sufficient, high-quality and evenly-distributed public services is severely impaired. During the civil war, the private sector and non-governmental organizations started providing social and infrastructural services in order to fill the gap generated by the weakened state. This state of affairs persists till the present day, such that public service delivery of goods and services

has become chronically dysfunctional. Shortages in supply and quality exist in almost all basic services such as electricity, water, sanitation, solid waste management (garbage collection), transportation and telecommunication. Moreover, performance in these sectors is much worse than in other countries in the MENA region and the rest of the world (Figure 28 and Figure 29). In addition to inadequate supply and quality, public service delivery is also subject to stark spatial inequality, often at the expense of rural and poor areas (Figure 30⁴⁴). As a result, less well-off citizens are disproportionately affected by the shortages in public services especially since they cannot afford the high costs imposed by private service providers.

⁴⁴ The latest available data from the Institutional Profiles Database is for the year 2012.

37. **The ongoing waste management/garbage disposal crisis exposes, in a very visible and odorous way, the cumulative failures of post-war governance.** A visually powerful garbage crisis that has left piles of it uncollected on the streets of Lebanon have galvanized sizable popular demonstrations. Garbage has been piling up since July 17, 2015 when the Naameh landfill, which served as the primary landfill for the country, was closed without an alternate site being designated due to opposition from local communities. A non-transparent tendering process was organized by the government for new waste management contracts across the country. On August 24, 2015, the Ministry of Environment announced the winners of the bids, most of whom were seen as having close ties to the political elite.⁴⁵ The perceived incessant corruption at the expense of quality of services triggered a series of protests and civil disobedience measures targeting the ruling political class with emphasis on corruption and incompetence. A surprised and shaken political elite quickly abandoned the waste management contracts and distanced themselves from the process. The waste management crisis illustrates and encapsulates the very features that have so negatively characterized the post-war political landscape: elite capture, corruption, dysfunctional public institutions and political impasse.

38. **Local governments in Lebanon are unable to adequately provide services to their residents let alone invest in much-needed local economic development.** This is reflected in the share of local government spending to central government primary spending that was only 6 percent in Lebanon in 2007 compared to an average of 20 percent in countries with unitary governments around the world (World Bank, 2007c). Despite the large responsibilities attributed to municipalities as per Article 49 of the Municipal Law (Decree-Law 118 of 1977), municipalities lack adequate financial and human resources. Transfers from the central government, distributed through the Independent

Municipal Fund (IMF), account for 70 percent of municipal revenue. The remaining 30 percent is collected through local taxes and fees. The IMF allocations are based on inequitable criteria and disbursements are most often irregular and delayed. In addition, municipalities have limited capacity to collect local taxes and fees and deal with non-compliance.

39. **Widespread corruption and rent-seeking have become institutionalized in the public procurement system.** Bribes and political connections play a very big role in contract awards, with the implication that in most instances contracts are not awarded to the most qualified applicants (Figure 20). The public procurement system relies on an outdated law from 1963 that is not comprehensive and does not regulate all aspects of the sector. Proper implementation of rules and guidelines is also not regularly enforced while a shortage in qualified personnel is obstructive. Furthermore, the lack of laws governing access to information, whistleblower protection and a procurement complaint mechanism has rendered the procurement process void of transparency and accountability.

40. **Despite the lack of leadership and a development vision for the country, rising poverty levels and unemployment, catastrophic public service delivery, massive diversion of public funds and widespread and unveiled rent-seeking, there has been limited accountability of elected officials and public servants.** This is partly due to the lack of transparency and participation in the decision-making process and the lack of key legislations, all of which erode accountability. Draft legislation for a freedom of information act, whistleblower protection, an anti-corruption agency, an Ombudsman's office and public procurement are either awaiting approval from the Council of Ministers or awaiting parliamentary debate and approval. Furthermore, regulations governing conflicts of interest and income and asset disclosure for public officials and servants are weak.

⁴⁵ This has been widely reported in the media, for example, in Al Akhbar newspaper in August 25, 2015 edition or in Mouawad, Jamil "Lebanon's Rubbish Crisis Is a Chance to Clean up the Polluted Political System." The Guardian. N.p., 2 Sept. 2015. Web.

Paralysis in decision-making

41. **The fragile political equilibrium of the confessional system reached its limits in 2005 when Syrian tutelage was removed and the Lebanese process had to proceed without a power broker.** Following the assassination of ex-Prime Minister Rafiq Hariri and the withdrawal of the Syrian forces from Lebanon, competition between political forces ensued and the whole political landscape was restructured. Political forces organized into two opposing coalitions that dominated the political landscape: March 8 and March 14. The political forces offered competing visions and strategy, alienating with opposing sides of the schism that has afflicted the region. As a result, consensus was barely reached and all decisions that furthered the interests of some groups but not others were blocked. In the absence of a power-broker to enforce these decisions, the policymaking process has come to a halt and institutional quality rapidly deteriorated across a wide range of indicators (Figure 26).

42. **The protracted political crisis has plunged the legislative and executive branches of the government into a complete impasse.** The country has suffered from a presidential vacuum twice in the past 10 years. In 2008, the presidency was vacant for 6 months and was only filled after a domestic violent episode erupted and subsequently an external power-broker (Qatar) intervened. Currently, the presidential seat has been vacant for the past 18 months (since May 2014). Parliament has failed in over 25 legislative sessions to elect a new president. Moreover, parliament does not regularly convene due to a lack of quorum and has barely produced any legislation in the past years. For instance, in 2007, not one single law was passed, while in 2013 only two laws were passed: the first extended parliamentary election deadlines and the second postponed them for 17 months and extended parliament's term. Parliament has also failed to approve a Public Budget Law since 2005, which meant that for the past 10 years budgetary receipts and payments have not been subject to oversight from parliament or the Court of

Audit. Lack of consensus between political factions has also left a large number of senior administrative civil service appointments vacant, further degrading the performance of state institutions. Despite the necessity and urgency of reforms in most public sectors, especially the deteriorating infrastructure, the lack of political consensus has left all of these challenges unaddressed. Furthermore, the absence of political consensus has left the country without a strategy to deal with a 25 percent increase in its population due to the massive influx of Syrian refugees.

43. **The nature of the confessional system of the post-war period created an environment where political stalemate was inevitable.** In order to protect the interests of the various confessional communities and to prevent the hegemony of one group over the others, the Taif Agreement gave the competing sectarian factions veto powers in the decision-making process thereby requiring broad consensus on practically all decisions. This created an unstable equilibrium that made the decision-making process long and challenging. Whenever consensus was not achieved, political forces resorted to an external power-broker (Syria up until 2005). The lack of resolution induced pent-up pressures that at times caused outbreaks of violence.

44. **The breakdown in the political process and the severe deterioration in government services are fundamental challenges to the post-war system in Lebanon.** Current conditions are unsustainable, and without significant political and economic reforms, a widening and worsening of socio-economic unrest is not unfathomable. The demonstrations and activities directed at the political class that the country is currently witnessing is one such manifestation. It is thus imperative and urgent for policy-makers to address Lebanon's longstanding and worsening structural bottlenecks (e.g., in infrastructure such as electricity, water, waste treatment, transportation and telecommunications). These bottlenecks are becoming even more binding as shown by a worsening of Lebanon's international ranking among key investment climate assessments. Policy inaction is not just putting on hold Lebanon's development, it is dragging it backwards.

II. LEBANON'S HEALTH SECTOR: MODEST REFORMS DESPITE THE CHALLENGES

This special focus provides an overview of the health sector in Lebanon and highlights both successes and challenges facing the system. Lebanon's trends in health outcomes, inputs and spending are analyzed over time and compared to a number of countries with similar levels of income and health spending, as well as to the averages for the Middle East and North Africa (MENA) region. Global comparisons are presented for each of these measures based on the latest available year of data (generally 2011). Key challenges are highlighted; (i) low public spending on health which hinders the Ministry of Public Health's (MoPH) ability to adequately respond to the health needs of low income groups; (ii) high household out-of-pocket spending on health subjecting low income groups to financial hardship; (iii) disproportionate allocation of resources on expensive curative care; and (iv) emerging epidemiologic and population trends associated with unprecedented influx of refugees having significant implications on the delivery and financing of the health sector. Despite the challenges and prolonged periods of instability, the MoPH embarked on several successful reforms that contributed to the resilience of the system in the face of the crisis.

Overview of the healthcare system

45. **Despite protracted periods of instability, Lebanon attained significant improvements in the health outcomes, performing better than MENA averages (Table 2).** Between 1990 and 2012, the infant mortality rate dropped from 27.4 deaths per

1,000 live births to 8 deaths, under-five mortality rate declined from 33.1 to 9.3 deaths per 1,000 live births,⁴⁶ and maternal mortality ratio dropped from 52 deaths per 100,000 live births to 16 per 100,000.⁴⁷ Life expectancy has also improved, rising from 66.6 years to 81.5 years, considerably higher than MENA average of 69 years. Nonetheless, there are regional disparities in health outcomes with Beqaa and the North having lower rates than national averages.

46. **Lebanon's healthcare system is a complex amalgam of public and private institutions, providing health services to the population, with the MoPH serving as the main steward.** In the public sector, a total of 28 public hospitals, with a bed capacity of 2550,⁴⁸ in addition to dispensaries and primary health centers (PHCCs) provide healthcare across the country. All public hospitals are financially and administratively autonomous with administration boards appointed by government decrees.

TABLE 2. Health outcomes indicators, Lebanon and MENA average, most recent years.

	Life expectancy at birth (years)			Newborns with low birth weight (%)	Children under weight (%)	Mortality rate per 1,000 Live births		
	Total	Male	Female			Neonatal	Infant	Under-5
Lebanon	81.5	79.6	83.2	11.5	NA	5.4	8.0	9.3
MENA Average	69.0	71.0	73.0	12.0	13.0	17.0	30.0	39.0

Source: WHO-EMRO, 2013

47. **The private sector is a dominating part of the Lebanese healthcare system.** The majority of hospitals (168) are private, both for-profit and not-for-profit, comprising 84 percent of hospital beds in the country. Private hospitals' bed occupancy rate is around 58 percent with an average length of stay of

⁴⁶ World Bank, 2013a, World Development Indicators, World Bank, Washington, DC.

⁴⁷ World Health Organization (WHO), Regional Health Observatory, URL http://www.who.int/gho/countries/lbn/country_profiles/en/

⁴⁸ Walid Ammar MD, Ph.D., Health Beyond Politics, 2009, World Health Organization Eastern Mediterranean Regional Office.

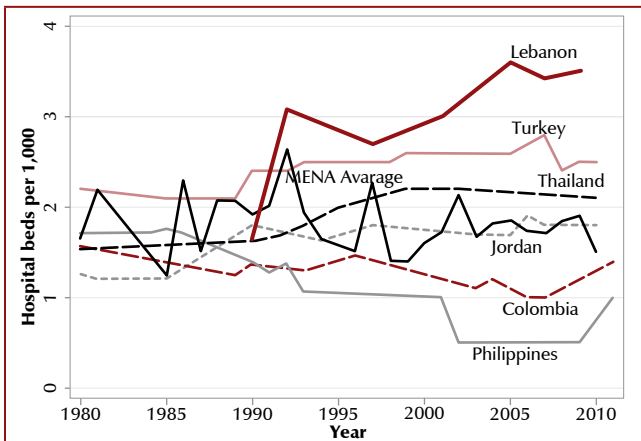


FIGURE 31. Hospital beds per 1000 population: Lebanon, MENA average, and other countries; 1980-2011.

Source: World Development Indicators and WHO NHA, 2013

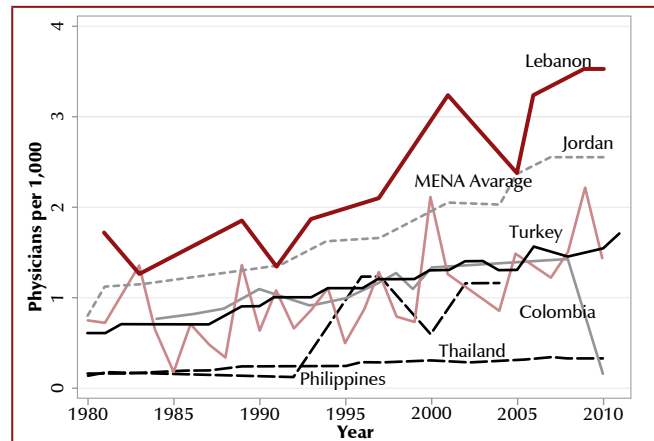


FIGURE 32. Physicians per 1000 population: Lebanon, MENA average, and other countries; 1980-2011.

Source: World Development Indicators and WHO NHA, 2013

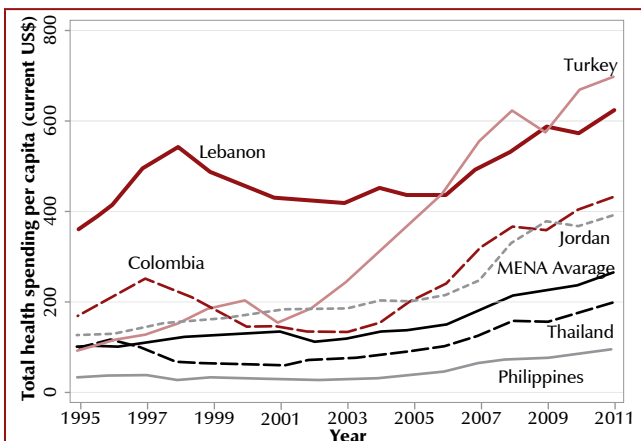


FIGURE 33. Total health spending per capita (current US\$): Lebanon, MENA average, and other countries; 1995-2011.

Source: World Development Indicators and WHO NHA, 2013

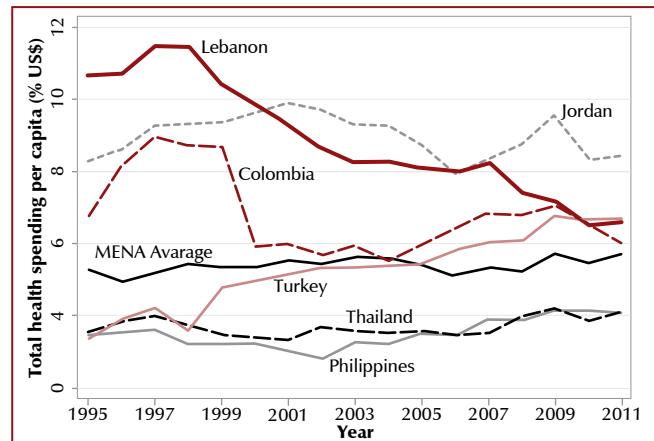


FIGURE 34. Total health spending as a share of GDP: Lebanon, MENA average, and other countries; 1995-2011

Source: World Development Indicators and WHO NHA, 2013

3 days.⁴⁹ The total hospital bed to population ratio is 3.5 beds per 100 population which is significantly higher than the MENA average of 1.5 beds and other countries with similar income levels (Figure 31).

48. **Lebanon has an imbalance in the supply of healthcare providers.** The number of physicians per capita has increased from 1.7 physicians per 1000 population in 1981 to 3.5 physicians per 1000 population in 2010, creating a surplus of physicians. While the ratio is more than twice as high as the MENA average and other countries with similar income levels, the rate at which it has increased is similar to other countries; the MENA average rose from 0.7 in 1980 to 1.4 physicians per 1000 population in 2011 (Figure 32). Yet Lebanon

faces imbalances in health human resources with significant shortage of nurses, and oversupply of pharmacists (18.6 per 10,000 compared to 5 per 10,000 in MENA) and dentists (12.7 per 10,000 compared to 3 per 10,000 in MENA).

49. **Half of the Lebanese citizens have insurance coverage (50.1 percent) under the three main insurance schemes - the National Social Security Fund (47.8 percent of insured), public schemes covering mainly public sector employees and the armed forces (30.8 percent of insured), private sector (16.3 percent of insured), and others (5.1 percent of insured).** For the uninsured who belong mainly to low income groups and the informal sector, the MoPH serves as a safety net and as an insurer-of-last resort, providing a generous package of hospital services

⁴⁹ Syndicate of Private Hospitals, Lebanon, July 2013

through contracted public and private hospitals, and covering 85 percent of the hospital expenses, and 100 percent of medication of chronic and high risk diseases. While secondary and tertiary care in Lebanon is covered, for the most part, through the various schemes available in the country, Lebanon still faces coverage gaps in terms of preventive care, primary and ambulatory healthcare, with the low income groups carrying the higher financial burden.

Spending trends

Total health spending

50. **Lebanon experienced a significant increase in total health expenditures (THE) in recent decades.** Per capita spending rose from US\$ 361 in 1995 to US\$ 621 in 2011 (720 per capita in international dollar), which is higher than MENA average of US\$ 220 (Figure 33). As a share of GDP, Lebanon's THE remains quite high despite falling from 10.7 percent in 1995 to 6.6 percent in 2011. This is comparable to other countries with similar income levels and almost 1 percent point higher than the MENA average of 5.7 (Figure 34).

51. **The composition of health spending in Lebanon differs quite drastically from other comparable countries, with the lion share of spending coming from private spending and out-of-pocket payments.** In 2011, private spending in Lebanon represented 74.5 percent of THE and 4.9 percent of GDP, while out-of-pocket (OOP) spending constituted 37.4 percent of THE, surpassing global averages. According to World Health Organization (WHO) criteria, countries with OOP shares between 15-20 percent of THE are able to ensure financial protection for their citizens. Given that Lebanon's OOP spending is higher than WHO macro criterion for financial protection suggests that further reforms need to be taken to ensure financial protection for the Lebanese.

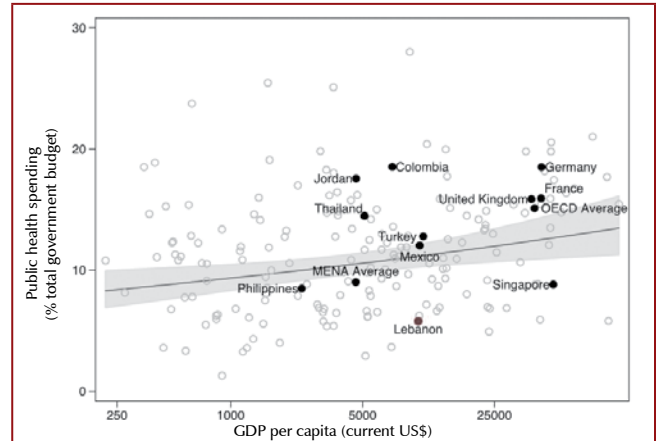


FIGURE 35. Public Health Expenditure as a Share of Total Government Expenditure versus Income Per Capita.

Source: World Development Indicators & WHO, 2013

Public health spending

52. **While THE per capita is higher than MENA average, public health spending per capita is quite low when compared to other countries with similar income.** In 2011, public spending on health represented 25.5 percent of THE (1.7 percent of GDP) and 5.8 percent of total government spending.⁵⁰ This is significantly lower than global averages (Figure 35). Similarly, MoPH allocations from the government budget (excluding debt) dropped by 41 percent from 5.9 percent of total government expenditures in 2005 to 3.4 percent in 2012.⁵¹ Given the relatively low levels of public health spending as a share of the total government budget, a strong argument could be made for the reprioritization of the health sector by the GoL against other needs.

53. **Elasticities of public health spending varies across time periods.** Table 3 displays the elasticities of public health spending relative to total government revenues and total government spending. Relative to total government revenues, public health spending increased 52 percent per year less rapidly than government revenues for the 1995-2011 period (elasticity of 0.38). Between 2006 and 2011, however, public health spending grew 5.8 percent per year faster than total government revenues. Relative to total government

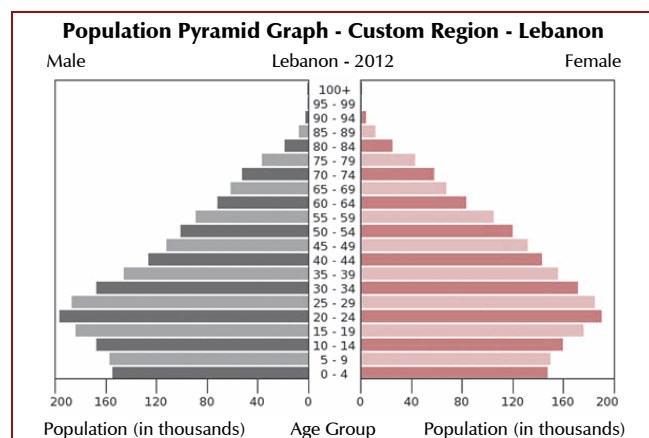
⁵⁰ This includes MoPH allocations, as well as health spending by the NSSF and the military.

⁵¹ Ministry of Public Health, 2012.

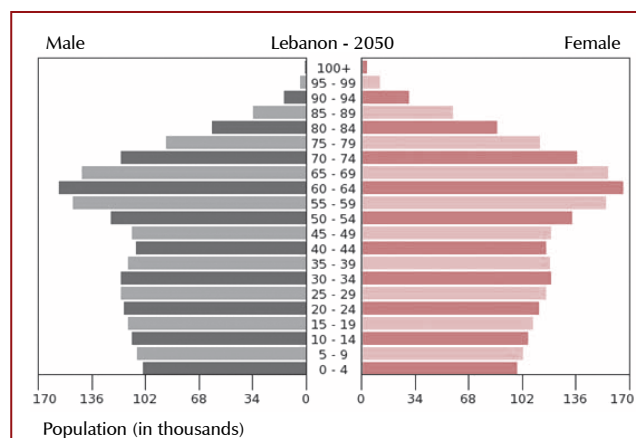
TABLE 3. Elasticities of public health spending relative to government revenues and spending, 1995-2011.

	1995-2011	1995-2005	2006-2011
Public health spending relative to revenues	0.4	0.2	1.1
Public health spending relative to expenditures	0.7	0.4	1.3

Sources: WDI, IMF WEO, and WHO, 2013

**FIGURE 36. Population pyramid, Lebanon, male and female, 2012.**

Source: UN Population database

**FIGURE 37. Population pyramid, Lebanon, male and female, projected 2050.**

Source: UN Population database

TABLE 4. Household out-of-pocket expenditure on health, 2011.

Health categories	Average of household's expenditures US\$	Average of individual's expenditures US\$	Share of total household expenditure percentage	Share of total health expenditure percentage
Health categories	2 446	603	7.8	100.0
Pharmaceutical Products	1 287	317	4.1	52.6
Other Medical Products	4	1	0.0	0.2
Therapeutic Appliances and Equipment	67	17	0.2	2.8
Medical services (medical examination)	211	52	0.7	8.6
Dental Services	106	26	0.3	4.3
Other medical services	194	48	0.6	7.9
Hospital Services	577	142	1.9	23.6
Health Insurance	98	24	0.3	7.9
Total	31 279	7 715	100.0	-

Source: Central Administration for Statistics (CAS)-Household Budget Survey (HBS) 2011-2012

expenditures, government health spending grew 21 percent per year less rapidly from 1995-2011 (elasticity of 0.688), but 33 percent per year faster than GDP between 2006 and 2011 (elasticity of 1.329). This suggests that Lebanon could increase public spending in order to improve financial risk protection for the population. It is thus important to analyze the available fiscal space to understand

whether this would be possible in the future.

54. **The limited fiscal space suggests that Lebanon will need to rely on efficiency enhancing reforms to improve health outcomes, such as those that strengthen incentives for cost effective medical care.** World Bank Staff projections of Lebanon's macroeconomic conditions indicate

that Lebanon's key fiscal indicators are projected to deteriorate slightly over the medium term; the overall fiscal deficit is forecast to widen from 6.6 percent of GDP in 2014, to 7.2 percent, 7.9 percent, 10.1 percent of GDP, in 2015, 2016 and 2017, respectively.

Main challenges

55. A growing and aging population, combined with a rise in non-communicable diseases (NCDs) and injuries will carry significant implications for health care financing and service delivery in the future. The bulge of currently young and healthy people will transition into a middle-aged and older cohort by 2050 (Figure 36 and Figure 37), which will increase demand for health care. Furthermore, epidemiological trends are shifting from communicable diseases to NCDs. Almost half of all deaths in Lebanon are due to cardiovascular diseases (45 percent), and one in five deaths are cancer related.⁵² The top five causes of morbidity – measured by disability adjusted life years (DALYs) – are all NCDs, namely ischemic heart disease, low back pain, major depressive disorders, stroke and diabetes.⁵³ These trends also suggest that Lebanon will have to reshape its health system to better address the prevention and treatment of NCDs.

56. The decline in government spending on health in the last decade is indicative of the lower prioritization of health within the government budget. Low public spending on health has negative implications on health outcomes especially among low income groups. The need to achieve fiscal consolidation, however, suggests that financial resources for healthcare are limited, and improving the efficiency of spending will thus be essential for improving health outcomes.

57. There is an over reliance on direct payment at the time people need care. Despite MoPH's successful efforts at reducing out-of-pocket (OOP) spending to 37.34 percent in 2012,⁵⁴ the burden continues to be shared disproportionately among households, leaving Lebanon below the broad World Health Organization (WHO) macro criterion for financial protection. The obligation to pay directly for services subjects a large proportion of the population to financial hardship and impoverishment. Lower income groups spend a higher percentage of their income (14 percent) on health than those with higher income (4.2 percent).⁵⁵ For uninsured households, OOP expenditure accounts for 7 percent of income, while households covered under public and private health insurance schemes spend 6 percent and 5.2 percent of their income, respectively. The single largest component of out-of-pocket payments for health is pharmaceuticals, which accounts for more than half of total household expenditures (52.59 percent) (Table 4). While further analysis is important to understand health seeking behavior in the country, these figures may suggest that Lebanese use pharmacies as an alternative to costly physician's visits.

58. Disproportionate allocation of resources favors expensive curative over cheaper preventative care. As the main public health financing agency in Lebanon, the MoPH plays a key role in resource allocation. The MoPH allocates the majority of its budget (62 percent) to reimburse contracted private hospitals for the care provided to the uninsured population, while contributions to non-governmental organizations (NGOs) that are the main providers of primary health care services have remained at a relatively low level of less than three percent of the total budget (Table 5). As such, the system is skewed towards high cost curative care compared to lower, cost effective preventive and primary health care.

59. Fragmentation of financing and service delivery systems is another challenge facing the

⁵² World Health Organization, Non Communicable Diseases Country Profiles, Lebanon, 2014, www.who.int/nmh/countries/lbn

⁵³ Institute of Health Metrics and Evaluation, 2013. GBD Profile Lebanon.

⁵⁴ Ministry of Health, National Health Accounts, 2012.

⁵⁵ World Bank, 2013b, Fairness and Accountability: Engaging in Health Systems in MENA. World Bank, Washington DC.

TABLE 5. Ministry of Public Health budget allocations for main categories, percentage share of total budget.

	2009	2010	2011	2012
Hospitalization in private sector	69.4	65.8	62.5	61.9
Public Hospitals	2.7	2.5	2.3	2.4
Medicines	15.0	18.7	20.8	21.8
Contributions to NGOs	2.9	2.6	2.4	2.4
Salaries and other employees' benefits	6.3	5.7	5.2	4.9
Other Expenses	3.2	3.8	3.7	5.0

Source: MoPH, 2013

health sector. Today, 20 percent of the insured population is covered by 70 private insurers, many of which are relatively small, while the other 80 percent are covered through multiple insurance schemes. On the public side, providers have different packages of subsidized services and varying reimbursement systems. From a governance perspective they fall under different ministries, making it politically difficult to obtain a coherent national policy framework. Fragmentation negatively impacts the health sector as it results in (i) adverse risk selection with the MoPH bearing the burden of the sick population, (ii) higher administrative costs at both the fund (MoPH, NSSF) and the provider level, (iii) different groups getting different packages, and (iv) weak purchasing power.

60. **Adding to these challenges is the influx of Syrian refugees and the dramatic increase in demand for health services.** The immediate impact of the rapid increase in patients over a short time period has primarily been met through existing structures, and an accelerated use and hence depletion of resources. Refugees are accessing services extended to Lebanese citizens, thus putting pressure on the delivery, quality of services and on public finances. The fiscal impact of the Syrian crisis on the health sector has been estimated to be US\$ 48-69 million in 2014. Overall healthcare costs needed to maintain the system to its pre-refugee access and quality levels was estimated at US\$ 216-306 in 2014.⁵⁶

Key health sector reforms: moving in the right direction

61. **Several reform initiatives have been implemented in the past decade focusing on increasing system efficiency, controlling cost and improving quality of care.** These reforms successfully contributed to improving health sector performance, building up resilience to cope with the country's prolonged periods of conflict and crisis.

62. **Reforms aimed to improve access via an increase in the physical infrastructure.** As part of MoPH reform efforts to improve the quality and access to primary health care services to low income groups, the MoPH established in the 1990s a network of primary health care centers consisting of 230 centers run mostly by NGOs and municipalities. Under this partnership, the MoPH contracts with the network for the provision of essential care to communities around the country, including maternal and child health, reproductive health, dental care and management of chronic illnesses. The MoPH provides in-kind support to these centers including essential drugs and vaccines, and in return the PHCCs charge nominal fees for their services. This partnership proved successful in providing quality low cost primary care services and free drugs, especially to low income Lebanese as the use of network centers increased by 73 percent between 2002 and 2012, from 32,6184 to 121,2000 visits, respectively.

⁵⁶ Lebanon Economic and Social Impact Assessment of the Syrian Conflict, World Bank and the United Nations, September 2013.

63. **Reforms also targeted the Quality of Care.** In 2000, the MoPH introduced the hospital accreditation program aimed at improving the quality of care. A similar program was initiated in 2009 for primary health care centers. The accreditation system forms a critical cornerstone of MoPH's regulatory role. As a major payer of health care in Lebanon, the MoPH only contracts with accredited hospitals and primary health care centers. This provides strong incentives to both private and public hospitals and centers to enhance their quality, and the ministry to monitor performance and regulate provider payment.

64. **There have been attempts to better scrutinize hospital contracting.** In 2009, the MoPH embarked on an important reform initiative aimed at improving hospital payment mechanisms and reducing expenditures. A new set of reimbursement rates were established based on key performance indicators (KPIs) consisting of case mix indices and accreditation results. Accordingly, contracted hospitals are reclassified and their rates re-adjusted based on more realistic measures. The system is supported with an automated billing system, utilization review and auditing mechanisms, which allow the MoPH to better monitor performance and expedite billing processes. The payment system became effective in early 2015, hence more time is needed to assess its impact on government hospital spending.

65. **Expanding coverage has also been a primary objective of the reforms.** Recognizing the need to reduce out-of-pocket spending and improve financial protection of the population, the MoPH set a new strategy in 2013 aimed at expanding health coverage to the uninsured. The strategy has been put into practice in 2015 through the Universal Health Coverage (UHC) program, targeting first poor households who are identified by the National Poverty Targeting Program as living below the poverty line.⁵⁷ Under this program, beneficiaries are

provided with a subsidized package of essential health services, including preventive and case management services such as reproductive, maternal and child health services, screening tests and medications, management of chronic illnesses such as diabetes and hypertension. The program is targeting 150,000 by 2016, and aims to add another by 2018. Services are provided through 75 contracted network centers distributed throughout the country. The successful introduction of this program would lay the ground for expanding coverage to other groups in the future, namely the informal sector. It will also set the sector on the right path of shifting care to lower cost-effective setting, such as preventive and primary care, and to activities that benefit lower income groups.

66. **Price controls and Pharmaceutical measures.** With pharmaceuticals taking up more than half of households' spending on health and 22 percent of MoPH spending, the MoPH recently launched several measures to contain the escalating cost of drugs. Changes in drug prices are now reported by pharmaceutical companies within one month, compared to six months in the past, thus resulting in faster turn-around in reducing the cost of drugs in the market. A new generic drug policy as well as price cuts on high-cost drugs in the range of 15 percent have also been implemented. While cost savings in the pharmaceutical sector have already been reported lately, more time and further analysis are needed to assess the real impact of these measures on cost reduction.

Final note

67. **Against this background, reprioritizing government budget, giving health precedence, is essential for reforming the health sector in the country.** This is especially so in light of the government's strategy to reach out to low income groups with expanded coverage and improved services. However, considering the current economic and political environment and the limited fiscal space, the MoPH is rightly aiming at promoting

⁵⁷ The National Poverty Targeting Program (NPTP) was established by the Ministry of Social Affairs in 2011 as the first poverty-targeted social assistance program for the poorest and most vulnerable Lebanese families. To date, approximately 93,000 households have been identified as eligible to benefit from the NPTP social assistance package, with the poorest 5,076 households also benefiting from the e-card food voucher.

efficiency of spending and eliminating waste. Primary health care reforms through the UHC program, if well implemented, can shift the composition of spending toward prevention of diseases, helping to contain costs in the future.

68. Fast tracking pharmaceutical reforms is also key, given the financial and fiscal importance medicines have in the overall funding of services. Implementing cost control through the use of generic drugs is a good first step in that direction.

69. Careful planning is crucial for moving the UHC program to the second stage of implementation, which may include expanding service coverage as well as population coverage to reach the informal sector. This will entail expanding prepayment schemes, increasing the efficiency of revenue collection and encouraging risk pooling and coordination. As such, extensive policy analysis and key policy questions will have to be addressed who should pay and how much, what type of fund is most appropriate (public, private) and whether contribution should be made mandatory. Strengthening the public health insurance system through the harmonization of public pooling arrangements (e.g.; MoPH, NSSF) will also need to be considered and carefully examined.

DATA APPENDIX

TABLE 6. Lebanon: Selected Economic Indicators, 2012-2017.

	2012	2013	2014	2015	2016	2017
	Est.	Est.	Est.		Proj.	
<i>(annual percentage change, unless otherwise specified)</i>						
Real sector						
Real GDP	2.2	0.9	2.0	2.0	2.5	2.5
Real GDP per Capita	1.2	-0.1	1.0	1.0	1.5	1.6
Agriculture (share of GDP)	4.5	4.8	5.2	5.0	5.0	4.9
Industry (share of GDP)	21.5	22.1	22.8	22.4	22.6	22.6
Services (share of GDP)	74.0	73.2	72.0	72.6	72.4	72.5
Money and prices						
CPI Inflation (p.a)	5.7	2.7	1.2	0.2	2.5	2.8
Money (M3, including non-resident deposits)	8.1	9.0	6.0	6.0	6.0	6.0
<i>(percent of GDP, unless otherwise specified)</i>						
Investment & saving						
Gross Capital Formation	29.4	30.4	30.8	28.1	26.9	24.0
o/w private	27.8	28.5	29.2	26.5	25.3	22.4
Gross National Savings	6.7	3.8	4.1	7.1	4.9	3.9
o/w private	9.8	15.7	15.2	12.6	11.2	12.4
Central Government Finance						
Revenue (including grants)	22.7	21.2	23.8	21.6	21.8	22.0
o/w. tax revenues	15.6	15.1	15.1	15.3	15.6	15.6
Total expenditure and net lending	30.9	30.7	30.4	28.8	29.7	32.0
Current	29.3	28.8	28.8	27.2	28.1	30.5
o/w Interest Payment	8.4	8.5	9.2	9.2	9.5	10.4
Capital & Net Lending (excl. foreign financed)	1.6	1.9	1.6	1.6	1.6	1.6
Overall balance (deficit -)	-8.2	-9.5	-6.6	-7.2	-7.9	-10.1
Primary Balance (deficit -)	0.2	-0.9	2.6	2.0	1.6	0.3
External sector						
Current Account Balance	-22.7	-26.6	-26.7	-21.1	-21.9	-20.2
o/w Export (GNFS)	46.6	45.7	40.0	39.4	41.7	43.5
o/w Import (GNFS)	73.5	75.4	70.2	63.8	66.7	67.0
Remittances	4.8	5.5	3.7	4.2	4.2	4.2
Trade Balance (GNFS)	-27.0	-29.7	-30.2	-24.4	-25.0	-23.6
Gross Reserves (months of imports GNFS) /1 /2	11.3	11.4	12.1	13.4	13.0	13.1
Total Public Debt						
Total Debt Stock (in million US\$)	57,684	63,489	66,576	70,043	75,226	80,867
Debt-to-GDP ratio (percent)	133.5	143.1	145.6	144.5	150.4	155.6
Memorandum Items:						
Nominal GDP (in billion LBP)	65,132	66,861	68,939	73,057	75,396	78,357
GDP (in million US\$)	43,205	44,352	45,731	48,462	50,014	51,978

Source: Government data, and World Bank staff estimates and projections

/1 Gross Reserves (months of imports GNFS) = (Imports of Goods & Services / Gross Res. excl. Gold)*12

/2 Total Imports using the BOP data from the Quarterly Bulletin of BDL

SELECTED SPECIAL FOCUS FROM RECENT LEBANON ECONOMIC MONITORS

SPRING 2015 LEM: THE ECONOMY OF NEW DRIVERS AND OLD DRAGS

The Trade Impact of the Syrian conflict on Lebanon (Special Focus 1): We explore the trade effect of the Syrian war on Lebanon up until the second half of 2014. A dissection of the data reveals that, so far, the war seems to have affected neither merchandise nor services exports at the aggregate level. At the same time the relative stability of merchandise imports is likely a result of increased demand due to refugee inflow being offset by higher transit costs through Syria as well as depressed Syrian production. A gravity-type trade model confirms these findings, suggesting also that Lebanese trade seems to have been less negatively affected by the Syrian war than other Syria's neighbors. An empirical analysis using micro level exporter data substantiates this finding. While Lebanese exporters to Syria have suffered from a drop in demand in the Syrian market (but less so than their Jordanian counterparts), other Lebanese exporters have started to export to Syria to fill the gap in Syrian production. Further econometric analysis suggests that Syrian refugees in Lebanon provide important impetus to Lebanese services exports.

Challenges in the Lebanese Energy Sector (Special Focus 2): The Lebanese electricity sector has been underperforming and in crisis for several decades, requiring urgent action to avoid further deterioration of the quality of electricity delivery. The macroeconomic impact has been massive; accruing debt on investments in and transfers to Electricité du Liban's (EdL) amounts to 40 percent of Lebanon's

gross public debt and is escalating rapidly as transfers now account for over half of the fiscal deficit. Some of the measures needed to improve EdL's financial situation are well known, such as increased investment, tariff reforms and corporatization of EdL. Political and confessional obstacles, however, have so far hindered any progress.

Water in Lebanon – Coupling Infrastructure with Institutional Reform (Special Focus 3): Despite the relative availability of water resources, the Lebanese water sector has not achieved suitable levels of service provision and is not in line with the level of economic development reached by the country. The cost of inaction in the water sector is estimated at about 1.8 percent of GDP, or 2.8 percent of GDP if the cost of environmental degradation is included. Several factors have led to this situation and require sustained attention. These include: (i) low continuity of water supply due to small storage capacity, large amount of water lost to the sea, growing demand for water and deficiency of the existing water networks; (ii) unfinished reform agenda that contributed to institutional uncertainty and fragmentation of functions particularly relating to wastewater and irrigation; (iii) an irrigation sector that is characterized by inadequate water storage capacity, lack of proper maintenance and a heavy reliance on subsidies; and (iv) regional water establishments (RWE) that severely lack management and financial autonomy and are impeded by limited inter-agency coordination and weak central government oversight. Moving forward, the Government must

FALL 2014 LEM: DOWNSIDE RISKS MATERIALIZE

Towards an Effective Social Safety Net in Lebanon (Special Focus): Lebanon's social safety nets (SSNs) fail to protect poor and vulnerable Lebanese as it consists of a multitude of small and poorly targeted programs that suffer from low coverage, high leakage, and limited benefit levels, while large budgetary resources are expended on universal subsidies which are pro-rich and crowd out other social spending. With poverty incidence elevated and broadly unchanged for the past 25 years, Lebanese citizens revealed in a World Bank (2014d) survey of country stakeholders that social protection ranked second in their development priorities. International experience reveals that carefully designed SSNs can help prevent shocks from pushing vulnerable households into poverty, help tackle the problem of spatial pockets of poverty in slums and rural areas, and also can help break the cycle of intergenerational poverty. With these objectives in mind, in 2011 the Ministry of Social Affairs embarked on a modernization of Lebanon's SSN system, starting with the introduction of the National Poverty Targeting Program. The NPTP is the first means-tested targeting social assistance program in Lebanon. With the Syrian crisis pushing vulnerable households into poverty, the NPTP has been scaled up to cover more beneficiaries as part of a three year emergency project to help mitigate the impact of the Syrian crisis on Lebanese households. Most recently, the institutionalization of the NPTP into a permanent program with an annual budgetary allocation has been proposed by members of Parliament, which if approved would constitute a significant positive step forward in the effectiveness of Lebanon's SSN system.

SPRING 2014 LEM: A SLUGGISH ECONOMY IN A HIGHLY VOLATILE ENVIRONMENT

A Sovereign Wealth Fund for Lebanon: Issues and Preliminary Recommendations (Special Focus 1): As Lebanon contemplates prospects of sizeable hydrocarbon discoveries, the country is in the process of designing an institutional framework to manage these resources. One such issue is the establishment of a Sovereign Wealth Fund (SWF), as required by the 2010 Hydrocarbon Law. This Special Focus provides an overview of the various types of SWFs that have been established across countries, draws lessons from these experiences, highlights some pitfalls, and presents preliminary recommendations for Lebanon as it moves towards establishing its SWF. Key among these recommendations is that the Lebanese SWF's design should include (i) integration with the budget system, (ii) some (limited) flexibility in operational rules, (iii) no (or limited) earmarking but no extra-budgetary spending, (iv) coherence with country investment strategy, and (v) transparency and accountability.

New Coincident and Leading Indicators for the Lebanese Economy (Special Focus 2): Weak economic statistics in Lebanon impede economic analysis and decision making. To remedy this, World Bank staff developed two indicators of economic activity for Lebanon: a coincident indicator (WB-CI) and a leading indicator (WB-LI). These indicators, which are based on an expanded NBER-Conference Board methodology, reveal promising statistical properties that should make them valuable coincident and leading (one-year ahead) indicators for the Lebanese economy. Based on these indicators, GDP growth for 2012 and 2013 is estimated to be, respectively, 2.2 and 0.9 percent while growth in 2014 is predicted to reach 1.5 percent. Aside from having a high degree of accuracy, both indicators are of relatively high (monthly) frequency and are available with a relatively small time lag (2-3 months), which make

them ideally suited for economic analysts, investors, and policy makers alike. In contrast to the BdL-CI, the WB-CI points to a deceleration in economic activity during the first ten months of 2013, which, if sustained over a few more months, would warrant a different monetary policy stance than the one based on the BdL-CI. This monetary policy example highlights the critical importance of having accurate, high frequency, and timely economic indicators.

SELECTED RECENT WORLD BANK PUBLICATIONS ON LEBANON

(for an exhaustive list, please go to: go.worldbank.org/5N4AMNJXV0)

Title	Publication Date	Document Type
Lebanon economic monitor, April 2015 : the economy of new drivers and old drags	2015/04/2015	Working Paper
Lebanon - Urban Transport Development Project: procurement plan (English)	2015/02/2015	Procurement Plan
MENA Quarterly Economic Brief, January 2015: Plunging Oil Prices	2015/01/29	Brief
Economic effects of the Syrian war and the spread of the Islamic state on the Levant	2014/12/01	Policy Research Working Paper
Lebanon Economic Monitor: Fall 2014 (English)	2014/10/31	Brief
New coincident and leading indicators for the Lebanese economy (English)	2014/06/01	Policy Research Working Paper
Lebanon Economic Monitor: Spring 2014 (English)	2014/04/30	Brief
Lebanon Economic Monitor: Fall 2013 (English)	2013/10/31	Brief
Lebanon - Economic and social impact assessment of the Syrian conflict (English)	2013/09/20	Board Paper
Lebanon Economic Monitor: Spring 2013 (English)	2013/06/25	Brief
Lebanon - Economic and labor force impact of the change in the wage structure of the public sector (English)	2013/06/01	Policy Note
Supporting innovation in SMEs in Lebanon through a public/private equity fund : the iSME fund (English)	2013/02/01	Brief
Doing business 2013: Lebanon - smarter regulations for small and medium-size enterprises : comparing business regulations for domestic firms in 185 economies (English)	2012/10/23	Working Paper
Lebanon - Economic monitoring note (English)	2012/09/01	Brief
Doing business in a more transparent world 2012 - economic profile: Lebanon - comparing regulation for domestic firms in 183 economies (English)	2012/01/01	Working Paper
PPIAF assistance in Lebanon (English)	2011/07/01	Brief
Lebanon - Large scale solar water heater market development program in Lebanon (English)	2011/06/01	Working Paper
Lebanon - Thermal standards for buildings: Review and implementation plan (English)	2011/06/01	Working Paper
Lebanon - Prototype Carbon Fund (PCF) Trust Fund Grant for Nahr Al-Barid Project: grant completion report (English)	2010/12/31	Working Paper
Status of Projects in Execution (SOPE) - FY10: Middle East and North Africa region - Lebanon (English)	2010/10/03	Annual Report
Lebanon - Statistical capacity building with the Central Administration of Statistics: report on gender statistics (English)	2010/08/28	Working Paper
Development horizons (English)	2010/04/01	Newsletter
Doing business 2011: Lebanon - making a difference for entrepreneurs : comparing business regulation in 183 economies (English)	2010/01/01	Annual Report
Lebanon - World trade indicators 2009 (Vol. 1 of 2) : Trade brief (English)	2009/12/01	Brief
Lebanon - World trade indicators 2009 (Vol. 2 of 2): Trade at a glance (English)	2009/12/01	Brief



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