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Prosperity for Lebanon: An Action Plan*

The first chapter of the Economic and Social Program was the last to be written in this book's precursor, "Emerging Lebanon, Towards an Economic and Social Vision." In a sense, it integrated the other papers by setting up the conditions for their realization. The failure of the Lebanese economy goes beyond the last few years or decades of turmoil, and pertains to a systemic weak productivity that Toufic Gaspard has thoroughly demonstrated in his book "A Political Economy of Lebanon, 1948-2002: The Limits of Laissez-faire", and summarized in the analytical part of the following study.

To achieve sustainable growth, Lebanon must first tackle the weak productivity of the economy that characterized it since independence. The way to face the challenge is to address some of the fundamental causes of the problem, which involves the adoption of a radically different policy orientation than in the past. This can be accomplished by bringing into the economic mainstream most of the Lebanese people and regions that have been left since independence at the margins of economic, social and political life.

In today's Lebanon, outside the continuing political turmoil that the region and Lebanon are suffering from, the key to an economic and political "unification" of the country, and to a higher path of sustained economic growth, are "Education" and "Communication". These nationwide development projects will enhance labor skills and productivity, bring substantial investments to the regions outside the center, and expand the national market for years to come. But perhaps the main contribution of such a new orientation in economic policy would be the enhancement of economic and social interaction among the Lebanese, which would much contribute to their political unification.

In parallel, there is a large consensus on the necessity to reform Lebanon's public administration. In the context of this economic Action Plan, two basic reforms are required rather than a full-fledged reform of all public institutions, which may be an illusory objective, at least in the near future. The two basic reforms deal with the judiciary and the size of the public sector.

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Furthermore, the Action Plan essentially aims for sustained economic development in the long term. If recovery is delayed, it is doubtful that it will be possible to address the critical factors and achieve sustainable growth. The favorable expectations induced by the overhaul of the education and communication infrastructure cannot alone reverse the adverse economic trend, though they can strongly support recovery. The enduring situation of recession, a high and increasing public sector debt, and of scarcity of credit to the private sector requires a resumption of demand to support efficient scales of production and raise productivity. This issue is addressed in the following chapter.

It is necessary to keep in mind that sustained economic development cannot neglect industrialization especially that it is in the context of industry rather than services that we nowadays find the new dynamic technologies. And an industrial policy that supports a modern and productive industrial sector is needed.

Lebanon is too small to have a proper and distinct environment policy. Our natural resources will be much better protected if Lebanon effectively adhered to international or regional programs that aim at the protection of earth and life.

The last four decades since 1975 have been particularly damaging for Lebanon. Fifteen years of an intermittent but destructive war during 1975-1990 have ravaged the economy and wrought havoc on all aspects of society and the polity. The peace that followed failed to fulfill most of the economic and political expectations. In fact, the following twenty five years until 2015 have been distinguished by restricted sovereignty and freedoms, much corruption, modest economic growth accompanied by few employment opportunities, and an unprecedented increase in public sector indebtedness.

The Lebanese economy has become weak and unproductive. It is also burdened by a public sector debt that is among the highest in the world in relation to GDP. Such an economy cannot reinvigorate growth, generate many employment opportunities, or support social and political stability. The Lebanese economy was unable to produce that kind of performance even in its heyday prior to 1975 when public sector debt was practically nil, the Government's finances in balance, and the balance of payments almost continuously in surplus. It then becomes evident that the deteriorated real and financial condition of the economy today, and the weakened institutional structures, make it virtually impossible to expect the resumption of strong economic growth and development. Lebanon desperately needs radical actions to transform its economy into one that can bring economic prosperity for most of its people for generations to come. The issue is not merely one of economic prosperity, but also of political viability.

It is true that economic progress in Lebanon has been, and will probably be more so in the future, intimately linked to political developments in the country. Indeed, it would be difficult if not impossible to envisage economic prosperity for Lebanon without it being driven and sustained by a political authority that sees the economic transformation and development of the country as one of its principal national tasks. Specifically, the Lebanese confessional political system, with its constant need to accommodate political balances, and its associated rules of distribution of political and administrative powers, is unlikely to be compatible with a sustained drive for a radical economic change.

It is our belief, however, and it is a central idea of this paper, that if the Action Plan that is detailed below is successfully implemented in the next few years, it will by itself weaken existing political constraints and create a momentum for a more productive and democratic society. The idea is that a strong economic growth, which is accompanied by better job and income opportunities than has been the case since independence, would create a favorable basis for political reforms that establish the foundations of a prosperous and democratic republic.

Today, such an approach is feasible. Indeed, Lebanon currently is at a crossroads, with most of its people and social and political forces apparently ready to accept and shoulder major changes following decades of war and political and economic decline. In other words, there exists today a historical, and perhaps unique, opportunity for Lebanon to put its economy on a new sustainable path of robust economic growth and development, which would reinforce social cohesion and lay the foundations of a democratic political system. This paper proposes an Action Plan with the central objective of embarking the Lebanese economy on this new path.

The proposed actions have two dimensions, a long-term and a short-term one. Long-term measures are intended to correct the structural deficiencies of the economy in order to put it on a higher and more solid path of economic growth; the benefits of the long-term measures will be felt quickly and will accumulate over a long period, but these should be implemented as soon as possible. Short-term measures are intended to deal with the immediate problems of weak economic growth and mounting public sector debt. Obviously, the two sets of measures will be mutually reinforcing in their impact.

Before presenting the details of the Action Plan, the performance and fundamental problems of the Lebanese economy need to be assessed. Section II below first presents a comprehensive evaluation of economic performance since after the end of the war in 1990, which offers a clear view of the present economic situation and its recent past. Section III follows with a more systematic evaluation of the essential structural problems of the Lebanese economy, those problems that need to be addressed by the economic reforms or the proposed long-term measures. Section IV then sets out the objectives of the Action Plan and presents its details, in its long-term and short-term dimensions. A final section concludes with summary remarks.

Economic performance: a systemic failure

Lebanon's post-war economic performance has been disappointing, far below the strong resurgence in economic activity and growth that was predicted and expected soon after the end of the war. This performance revealed the structural rigidities of the economy, and its weakness was accentuated by the fact that the post-war initial conditions were quite favorable to a strong revival in economic activity. Normal economic activity had in fact resumed from a low level of output, and with a relatively low level of government debt (see Table 1 below). Moreover, the nominal exchange rate was soon stabilized and continued on an appreciating trend since October 1992, while government spending strongly expanded during 1993-2015.

We present an evaluation of Lebanon's post-war economic performance, both overall and in all the major sectors of the economy during the period 1993-2015. We show that weak economic performance was pervasive in all sectors of the economy, which points to a systemic rather than circumstantial economic failure.

1. Growth and employment: Table 1 below summarizes the evolution of the gross domestic product (GDP) during 1992-2015.

The employment record has been equally poor. The most recent professional manpower surveys indicate unemployment rates of 8.5% in 1997 and 11.5% in 2001, and between 9% and 14% in 2007[2].

(2) See République Libanaise (2008, 1998) and Kasparian (2003), respectively. Kasparian's survey is based on Lebanese residents only.

Table 1: GDP Level and Growth, 1992-2015

		1992	2000	2005	2010	2015
GDP- current prices	$ billions	6.1	17.2	21.5	38.4	50.7
GDP p.c. -current prices	$	2,000	4,400	5,400	9,100	10,000
GDP -constant 1997 prices	LL billions	18.2	25.3	30.1	43.4	47.6
GDP growth 1993-2015	% p.a.	4.3%				
GDP p.c. growth 1993-2015	% p.a.	2.4%				
Exchange rate-aver. annual	LL/$	1,713	1,508	1,508	1,508	1,508

Sources: Compiled from Ministry of Finance (www.finance.gov.lb) and Central Administration of Statistics (www.cas.gov.lb) publications

BDL's share in government debt at end November 2015, and its debt to domestic banks in foreign currencies are estimates.
Notes: GDP is Gross domestic Product. "GDP p.c." is GDP per capita. In $, it is rounded to the nearest 100. GDP and population numbers for 2015 are unofficial estimates.
GDP growth during the twenty three-year period was an annual average of 4.3% (compared to more than 6% during 1964-74), and 2.4% on a per capita basis, reflecting in part the appreciation of the Lebanese Lira vis-à-vis the US dollar. These are modest growth rates at best, especially when set against the favorable economic environment mentioned above.

However, these figures underestimate the true unemployment situation owing, in particular, to the reluctance of many respondents in manpower surveys to acknowledge their unemployment status because of the social stigma that is perceived to be attached to that status. Moreover, many of the employed are occasional or temporary labor (about 36% of all those employed in the private sector in 1997)[3], underscoring the condition of large underemployment in Lebanon. The unemployment rate clearly would have clearly been higher without the emigration outlet for labor.

The improvement in the people's standard of living, including the provision of employment opportunities, truly is the main standard by which governments are judged in the economic and political domains. In this regard, the post-war record of Lebanese governments has been anything but a success.

Deficits and debts: Government without accountability: Throughout the post-independence period, and even until the early 1990s, Lebanese governments have remarkably succeeded in maintaining fiscal restraint. Government debt was almost nil

(3) See Gaspard (2004), Table 5.9.

in 1975, and budget deficits were few in the preceding thirty years. As Table 2 below shows, government debt still was at a relatively low level at end 1992.

Table 2: Government debt, 1992-2015 (At end period, in $ billions and in %)

	1992	2000	2005	2010	2015
Government Gross Debt	3.0	25.2	38.5	52.6	70.4
o/w to BDL	5%	5%	25%	17%	25%
o/w in foreign currencies	12%	29%	50%	39%	39%
Gross Debt/GDP	50%	146%	179%	137%	139%
BDL foreign reserves	4.5	8.3	14.6	41.6	41.6
Foreign currencies	1.4	5.7	9.8	28.6	31.8
Gold	3.1	2.5	4.7	13.0	9.8
BDL debt to domestic banks	…	3.5	18.0	37.0	69.7
o/w in foreign currencies	…	3.1	11.9	18.8	34.0

Sources: Compiled from Ministry of Finance (www.finance.gov.lb) and Banque du Liban (BDL) (www.bdl.gov.lb) publications

Notes: 2015 Debt and Memo data are for end November. BDL debt to domestic banks is net of LL legal reserve requirements. BDL's share in government debt at end November 2015, and its debt to domestic banks in foreign currencies are estimates.

However, the true debt situation of official Lebanon is reflected in the debt of the public sector, which is defined here as the consolidated accounts of the government and the central bank BDL, excluding other public enterprises, which have relatively negligible debt. In other words, to obtain public sector debt, we first consolidate the debts of government and BDL (by simply subtracting from government debt its indebtedness to BDL) and then we add the debt of BDL to others[4]. The reason for focusing on BDL is that its debt to domestic banks has dramatically increased since end 2000, as Table 2 indicates, reaching more than $71 billion by end 2015. BDL has recently become very active in the debt market by borrowing, mainly from domestic banks, in order to bolster its foreign reserves in actual and prospective defense of the fixed exchange rate of the Lira. It has in the process incurred significant losses (that should in principle be added to the announced fiscal deficit) as a result of borrowing from banks at significantly higher rates than the yield on its foreign assets.

(4) For methodological underpinnings of this calculation, see Blejer and Cheasty (1992), IMF (2001), and Mackenzie and Stella (1996).

We estimate consolidated public sector debt to have increased from $3 billion at end 1992 to more than $110 billion at end 2015. In any event, whether in absolute or GDP terms, consolidated public sector debt has been continuously and significantly rising, and its foreign-currency part also has notably risen to about 55% of the total debt. Moreover, more than 80% of the debt currently is to domestic banks, thus undermining their financial situation and that of the whole economy (more on that in section IV below).

The main problem with this debt situation, however, does not lie in the level of the debt but in its origin. By themselves, deficits and debts need not be economically harmful. On the contrary, they may be necessary, especially following a war period. The criterion that makes debt appropriate is the extent to which its proceeds are usefully applied to raise the productivity of the economy, which would raise living standards and also allow the reimbursement of the debt in the future. But this is not what happened, as Table 3 shows.

Table 3: Government cumulative expenditures, 1993-2014 (in $ billions and in %)

Category	**Expenditures**	**%**
Interest on debt	60.5	33.6%
Wages & Salaries	56.0	31.1%
Capital expenditures	16.4	9.1%
Transfers to EDL	16.7	9.3%
Other	30.6	17.0%
Total	**180.2**	**100.0%**

1. Sources: Compiled from Ministry of Finance (www.finance.gov.lb) and Banque du Liban (www.bdl.gov.lb) publications

2. Notes: Figures are for consolidated general government, including Treasury operations and annex budgets, whose allocation among expenditure categories is estimated. Wages and salaries include pensions and end-of-service payments. "Other" includes various transfers to public and private institutions, and purchases of merchandise and services.

In fact, total investment expenditure during 1993-2014 was merely 9% of total spending, not all of it spent on reconstruction projects. It is difficult to reconcile these figures with the repeated claim that most of the government debt has been due to spending on reconstruction.

The failure of fiscal policy and the continuously rising public sector debt have been accompanied by an increasing fiscal burden on the Lebanese people. The fiscal burden, as illustrated by total government revenue, has almost doubled in terms of GDP, rising from 12% in 1992 to 22% of GDP in 2014, a substantial increase at a time when economic activity has been only moderately growing.

If anything, these developments indicate that the adverse debt dynamics have taken hold of the fiscal situation and the economy, and that only radical, i.e. substantial and sustained, effective reforms can break the vicious circle.

The monetary environment: Against growth. Since 1993, the Lebanese economy has been marked by an appreciating and then fixed-exchange-rate policy, and by relatively high interest rates, which both turned out to be very inimical to economic activity and growth.

A successful fixed-exchange-rate policy usually holds a requirement and an expectation. The requirement is a restrained fiscal policy, and the expectation is that real interest rates would fall to relatively low levels so that they become in line, i.e. not exceed for long, the growth rate of the economy, namely real GDP growth. Contrary to expectations, government spending expanded while output growth was modest, and interest rates, in nominal or real terms, have remained at high levels. This situation has exacerbated the debt burden and dynamics, and further hampered economic activity and growth.

For instance, in the last five years 2011-2015, the bank lending rate to the private sector averaged a real interest rate of more than 5% when the average real growth rate was less than 2%, noting that real interest rates should usually be close to growth rate levels, particularly when considered over a relatively long period.

In addition, as Table 3 above indicates, government has paid during 1993-2014 more than $60 billion as interest cost on debt. Importantly, this sum represents about the third of all government spending during the period, and a little less than four times all government spending on capital expenditure. It also represents more than 11% of GDP, a remarkable number when for most countries interest cost of government debt amounts to about 2% of GDP.

The balance of payments: Debt in, Capital out, government economic policy and indebtedness have rendered the balance of payments weak in performance and fragile in structure. Though merchandise exports currently amount at best to 10% of GDP, this should be compared to an average of 18% during the period prior to 1975. In parallel, and in contrast to the pre-war period, most factor and non-factor services, except for travel and transportation, now have a negative balance. And this is taking place in a "services" economy.

On the other hand, owing to a continuously strong positive capital account, the overall balance of payments has often remained in surplus. In fact, practically since independence until 2010, most years witnessed a balance of payment surplus, and there never were deficits for more than two consecutive years. Unfortunately, this pattern has recently changed in a major way since the balance of payments has been in continuous deficit during the last five years since 2011. This means that, on balance and in each year during the 2011-2015 period, more funds have been leaving Lebanon than entering it.

What is wrong with the Lebanese economy?

Lebanon's weak performance on practically all economic fronts since the end of the war, and despite many favorable conditions, is indicative of structural problems in the economy. We need to identify these structural problems since a long-term solution, to be effective, will have to address the fundamental rather than cyclical or temporary problems.

Above all, it is important to realize that Lebanon's structural problems are endemic since they have existed since independence and are not merely war sequels. There is in fact a widespread view, even belief, particularly among officials and that was noted in "Horizon 2000 for Reconstruction and Development"[5], that by re-establishing the conditions prevailing in Lebanon prior to 1975 (essentially peace and some reconstruction, especially in Beirut) then Lebanon would regain its golden prosperity, and grow to its old vigor.

However, this belief regarding Lebanon's prosperity prior to 1975 is again more of an illusion than a fact. The illusion was supported, and reality masked, by Lebanon's strong financial performance and by macroeconomic stability, which manifested itself by the absence of public sector debt, a continuous surplus in the

(5) See Republic of Lebanon (1994).

balance of payments, and a strong currency. Yet, despite these unusually favorable economic conditions during the post-independence period until 1975, economic growth in Lebanon was equal to the average rate achieved in the developing world by and large, and even less than in most Middle Eastern countries. Moreover, the Lebanese economy has throughout its modern history failed to generate enough job opportunities to many skilled and less skilled workers who had to seek jobs overseas, particularly in the Arab Gulf countries.

Economic growth and development, which comes with a sustained increase in productivity, is usually accompanied by a significant change in the structure of output or GDP. But it is a remarkable characteristic of the Lebanese economy that its structure has little changed in the last half century, as Table 4 shows, which clearly points to the absence of structural change in the economy during this long period. Other than the standard decline in the share of agriculture, the only other noticeable change has been the significant increase since the early 1990s in the share of public administration, whose effective contribution to output and productivity is clearly doubtful.

Table 4: The structure of output by economic activity, 1950-2013 (in % of GDP)

	1950	**1973**	**1997**	**2013**
Agriculture	20	9	7	5
Industry	14	16	13	12
Services	59	68	69	72
Public administration	7	7	11	11
Total	**100**	**100**	**100**	**100**

Sources: Gaspard, 2004; Republic of Lebanon, 2005, and Central Administration of Statistics www.cas.gov.lb

Notes: Industry consists of mining, manufacturing, energy and water. Construction is included in services.

The Lebanese economy's fundamental structural problem is its weak productivity. Today, twenty five years after the end of the war in 1990, it produces an output per capita (at constant prices) that is only slightly higher than what it was four decades earlier in 1974. Notwithstanding errors of estimation and quality improvement in output, the evidence is still striking with regards to the weak productivity of the Lebanese economy and its workforce, whether at present or in the past.

Raising the productivity of the Lebanese worker will be crucial for sustained economic growth and development, and would address three essential needs for the economic and political viability of Lebanon: (i) it would raise incomes and the standard of living while reducing the need to secure income support through "confessional" and political patronage; (ii) it would make feasible the financing of the basic components of the social contract, including education, health and retirement benefits; and (iii) it would alleviate the burden of the public sector debt and re-engage banks into financing the private rather than the public sector.

We identify three major causes, not totally independent one from the other, that explain Lebanon's predicament of weak productivity:

- Low skill and education levels
- Underdeveloped public institutions
- Underdeveloped regions

1- Low skill and education levels: Table 5 below shows the education level of Lebanese employed workers according to official national surveys conducted in 1970, 1997 and 2007.

Table 5: Employment structure by education and work status

(In % of total employment)

Education level	**1970**	**1997**	**2007**
Primary	80.0	45.2	33.6
Intermediate	9.4	21.1	23.3
Secondary	6.3	17.4	18.6
University	4.3	16.2	24.4
	100.0	**100.0**	**100.0**
Work status in private sector			
Waged in private sector	53	52	46
o/w Regular-waged	30	33	38

Sources: Compiled from Republic of Lebanon, 2008, 1998b, 1972

Work skills, and hence productivity, are largely determined by the level of education. By 1970, only about 11% of the workforce in Lebanon had at least a secondary education. By 2007, that ratio jumped to 43%. In fact, the quality of overall education in Lebanon has markedly declined during the war years 1975-1990 and afterwards, particularly in government schools. The overall deterioration in the quality of education at schools and universities is manifest and documented. The fact that worker productivity today, illustrated by GDP at constant prices divided by the number of the employed, is still less than it was just prior to 1975 confirms this assessment.

The low skill and productivity levels are not only the product of an inadequate education level but also, in a primary way, the result of an underdeveloped market economy or its private institutions. The number of waged workers, as opposed to independent or self-employed workers, in the private sector has remained at practically the same level of half of total employment, as Table 5 indicates. Moreover, only about a third of all the employed in the Lebanese economy are regularly waged, the other waged workers being occasional or seasonally employed labor. This type of labor employment constitutes a structural weakness of the economy and is detrimental to the accumulation of experience and learning in business enterprises, and hence is unfavorable to labor productivity.

2- Underdeveloped public institutions: The institutions of public administration in Lebanon are underdeveloped and incompatible with a modern productive economy. The notion of public service and support to private institutions, in facilitating their activities and development, is not in practice in Lebanon. For most citizens and enterprises, dealing with the public administration, including the judiciary, is taxing, costly and of an uncertain outcome. The problem is that Lebanon's public institutions not only do not support economic growth (a legacy of a long tradition of laissez-faire) but have also become obstacles to growth and development. The absence of structural change that is reflected by the stability of the GDP structure by economic activity, as shown in Table 4 above, points to the institutional rigidity of the Lebanese system. And institutional rigidity is not compatible with dynamic growth and development.

Moreover, the public administration in Lebanon is unduly costly. Its size has significantly increased, as Table 4 indicates, bearing in mind that the value added by the public administration is mostly composed of wages and salaries. More important, employment in the public sector has become governed, and much more so than in the past, by strictly confessional and political considerations. In addition, average wages are often higher than corresponding wages in many sectors of the economy. It is then no wonder to witness the attraction of work in the public sector, where the pay is higher on average than in the private sector, and work is less demanding or responsible.

Underdeveloped public institutions, the judiciary in particular, may inhibit investment and growth in a direct and tangible manner. Private investment seeks, above all, to reduce uncertainty, and hence the risk associated with any contemplated investment project. The fact that the judicial process is lengthy, and that the rule of law may have little bearing on its outcome, substantially increase the uncertainty, risk and cost of investment in Lebanon. The result is that investors expect significantly higher profits to compensate for the higher risks and costs, the outcome being less investment and slower economic growth than in a situation with a more efficient and transparent public administration.

3- Underdeveloped regions: Since independence, economic development in Lebanon has been characterized by a much skewed distribution of income and wealth, and by large economic disparities between the center (mostly Greater Beirut) and the periphery (the rest of the country). More seriously, however, the regional disparities have not only been economic in nature but also social and cultural. Already in the early 1960s, in the first national and comprehensive socio-economic survey ever undertaken in Lebanon by IRFED for the Lebanese authorities, it was noted that while income disparities were marked between urban and rural areas, the disparities were significantly more marked in schooling, and in the availability of cultural and general social facilities. To a large extent, that situation still prevails today.

The small size of Lebanon, which constitutes an advantage in terms of making easy the economic and social communication among its separate parts, presents nonetheless a picture of distant rather than close communities and unified markets. The size advantage has become an impediment. Today, much like in the past, most economic, political and cultural activities continue to be concentrated in Beirut and its surrounding areas of Mount Lebanon. For instance, Beirut and Mount Lebanon, which include about half the total population of Lebanon, witness a concentration of about 82% of all commercial bank deposits and benefit from more than 88% of total bank credit to this day.

An economic action plan for lebanon

It is now time to present the details of an economic Action Plan that would address Lebanon's fundamental problems as outlined above.

Action Plan objectives: The objectives of the Action Plan are essentially two. First, Lebanon's economy needs to be put on a path of higher growth, which would allow it to grow over a long period (at least over two to three decades) at a sustained higher rate than it has been able to do in the past. To illustrate, it is our belief that if the actions detailed below are implemented, GDP growth would double its average rate since 1993 to a range of at least 7 to 8% a year over a period of ten to fifteen years. Assuming that the population would be growing at an annual rate of 2% at most, per capita GDP (or, roughly, the standard of living) then would also double in 12 to 14 years.

Concerning these growth objectives, it is important to note that a significantly higher growth rate than in the past is absolutely necessary for a tangible improvement in the standard of living, and is crucial as well in order for the economy to afford the basic elements of the social contract, including in particular education, health, and pension benefits.

The second objective of the Action Plan is developmental, which concerns a better distribution of income and wealth. This would, by itself, promote economic growth and provide as well a basis for social and political stability. In other words, though the modalities and main objectives of the Action Plan are mostly economic, they are at the same time, and in a fundamental manner, national and political in their orientation. The implementation of the Action Plan should create solid foundations for political consensus and stability.

To accomplish these objectives, the Action Plan seeks to remedy the structural weaknesses of the Lebanese economy; it also proposes economic policies that would support economic recovery in the short term.

Actions for long-term growth and development: The Action Plan should above all focus on measures that raise the productivity of the Lebanese economy in a sustained manner. In addition to the necessary reform of the public sector, we identify two central actions that would accomplish this objective over the long-term. These are:

- Provide a good-quality and low-cost public education to all, at least until the end of the secondary level.

- Establish a modern transport and communications network across Lebanon.
- Reform the public sector.

These actions directly address two of the fundamental reasons we identified above as explaining the state of low productivity in Lebanon, namely a low skill and education level, and the underdevelopment of Lebanese regions outside the center. Addressing the situation of underdeveloped public institutions is taken up later.

It should be noted at the outset that if the objective of these actions is to create a sustained long-term effect, they will also have a tangible short-term impact, at least through the considerable positive expectations they will generate regarding the economic and political future of Lebanon, and through the related capital inflows and investments they will generate. The short-term impact of these actions should not be under-estimated.

a) A good-quality public education to all: Providing a good-quality and low-cost public education to all, at least until the secondary level, would start the process of enhancing labor skills and economic productivity in Lebanon. The emphasis here is on good quality, particularly in languages, math and sciences. An important message that this action would also give is that all young Lebanese would be provided an equal opportunity for a good-quality minimal education at little cost. As such, this is not only an economic action but also an essential social and political measure that bears a message of national solidarity and equality of opportunity.

All currently advanced economies or newly industrializing countries, as in Southeast Asia, have had a good system of education play a central role in their rapid pace of economic development. The role of a good education, as human capital, in promoting economic development is well known in the economic literature. A good basic education, at least until the secondary level, is widely recognized as a critical factor in economic and human development. Studies have shown that its annual rate of return, whether private or social, usually is above 10%, which is a very good return on investment! Moreover, a good education bears important derivative economies, such as a better raising of children, better informed citizens, and better voting and system of political accountability.

Education reform should focus above all on the training of teachers in public schools and on correcting the serious misallocation of their numbers among schools and regions. Teachers in public schools, which include about half the students in Lebanon, often are under-trained or do not possess adequate qualifications in the basic subjects of languages, math and sciences. Fortunately, school buildings are not in shortage. Moreover, experts agree that providing professional training and upgrading the qualifications of teachers over a number of years is not a costly proposition.

All in all, and notwithstanding estimation errors concerning the cost of educational reform, the required investment does not appear to be large while its economic and social returns would be disproportionately high. The point here is that the financial costs of the reform are relatively minor, and that the main issue is that the Lebanese authorities should attach a primary importance to this fundamental reform, and quickly start implementing it to achieve a substantial and definitive raising of education standards in public schools. Private schools with deficient standards and performance would then naturally have to follow suit in terms of raising their own standards.

b) Establish a modern transport and communications network across Lebanon: The other critical action consists of the building of a modern road and telecommunications (phone and internet) network for rural Lebanon that would significantly ease travel and communication between rural and urban areas. The project would start with a fast modern railroad track along the coast of Lebanon. In parallel or shortly afterwards, the road would be linked to major road axes to be built or upgraded in rural Lebanon. In short, the aim is to create road and electronic highways, fast and inexpensive, which would lay the physical foundation for fast growth.

The main purpose of this major action is not simply the raising of economic productivity through the improvement of road and communications traffic but a much more fundamental one of unifying (and hence expanding) the national market, and of stimulating investment in housing and related activities. People and businesses would then be willing to locate outside Beirut and the center of Lebanon, which would stimulate social and political interaction among Lebanese, which by itself is a very important national objective.

It is difficult to overestimate the substantial positive impact that such investments in infrastructure would have on economic activity for years to come. The investments would take advantage of the small size of the country and bring most of the population and areas of Lebanon to mainstream economic activity by facilitating transportation and communication in general. They would also provide incentives for people and businesses to reside outside Greater Beirut, thereby significantly reducing its high population density, drive up real estate prices in rural regions from their currently very low levels, and stimulate investments in these regions overall. The realization of such a project would not only alter in a fundamental way the economic landscape of Lebanon but also satisfy a greater political good by affording a better national integration among disparate rural communities.

If the full benefits of a significant improvement in human infrastructure or education typically take several years to be realized, the economic impact of an overhaul in physical infrastructure can be extensive and almost immediate. The two actions, briefly described above with their long-term benefits, would substantially raise positive expectations about the future of the Lebanese economy, increase private investment, stimulate the inflow of foreign capital, and reduce the cost of the financing of these projects.

The costs of the two actions will not be prohibitive, especially for education. The projects associated with these actions can be financed from domestic and foreign borrowing, foreign grants, and from the Lebanese State's budget (in a relatively minor way). The contribution of the private sector, including banks in particular, will be crucial: banks need to understand that by actively participating in the financing of these projects, they would be directly contributing to the growth that they will be benefiting from for years to come. Foreign assistance and grants would then be more forthcoming than usual to the extent that foreign donors are presented with a coherent economic development plan that the Lebanese authorities undertake to implement.

c) Reform the public sector: The reform of the public sector in Lebanon has always been a very sensitive issue in view of its direct link to the distribution of political and administrative power in the country. However, in the context of this economic Action Plan, two basic reforms are required rather than a full-fledged reform of all public administration, which may be an illusory objective, at least in the near future.

The two basic reforms deal with the judiciary and the size of the public sector. It is understood that the main problem with the judiciary is not in the nature of the laws but rather in their non-application. Specifically, many cases take years to be settled in court, and many more are perceived as not being adjudicated on the basis of their legal merit. This state of affairs introduces much uncertainty to the process of investment and significant artificial economic costs, with adverse implications on private investment and economic activity in general. An efficient judicial process, where judges are well trained and reasonably paid, and where cases are adjudicated within a predictable and short period, then becomes essential for an efficient and productive economy.

As Table 4 above shows, the size of the public sector, in terms of wages and salaries and in relation to GDP, has significantly increased compared to the pre-1975 period. The wage bill in the budget currently amounts to about $5 billion, or about 10% of GDP, and it is clear that the corresponding output that is in principle produced is much less than what is indicated by this expenditure amount. Containing current expenditure, especially interest cost (see below on this) and wages and salaries, which amount to more than two thirds of the total budget, becomes essential for fiscal reform. Regarding wages and salaries, the number of contractual staff will have to be drastically reduced over time while reducing the overall number of public employees through natural attrition.

These two reform measures are feasible. In fact, they were already prevailing prior to 1975, when the judiciary was a reasonably efficient body, public sector staff limited in number, and the budget was rarely in deficit. So these measures are not unrealistic.

3. Actions for short-term recovery: The actions detailed above, though long-term in their full impact on the economy, need to be initiated as soon as possible and would thereby create in the short-term significant positive expectations about the future of the economy. However, these immediate positive effects are not sufficient and need to be supported by short-term actions that address weaknesses in the Lebanese economy that, if left without remedy, may undermine or at least weaken economic recovery and the impact of the long-term measures.

We focus on two short-term measures that would significantly support economic recovery out of the current recession. They are:

- The refinancing of public sector debt at lower interest rates and longer terms.
- The rescheduling of doubtful private sector debts to banks.

The two measures are related and they both deal with commercial banks, specifically with the asset side of their balance sheet.

a) Refinance public sector debt at lower interest rates and longer terms: At 140% of GDP (the figure is about 217% for the consolidated public sector), government debt is high by any standard (see Table 2 above). However, the major problem associated with public sector debt is that it is mostly held by domestic commercial banks and that these holdings represent more than half the total balance sheet of banks. Consider, in this regard, Table 6 below that shows the allocation of banks' assets between the public and the private sectors.

Table 6: The structure of commercial banks' assets

(At end period; in % of consolidated balance sheet, unless otherwise indicated)

	1974	**1992**	**2005**	**2015**
Claims on Public Sector	13	25	56	59
Claims on Government	-	21	26	21
Claims on BDL	13	4	30	38
Claims on Private Sector	47	33	21	26
Foreign Assets	32	40	19	12
Other	8	2	4	3
Total Balance Sheet	**100**	**100**	**100**	**100**
in $ billions	5.4	8.0	68.5	183.2
in % of GDP	151	140	319	362

Source: Compiled from Banque du Liban (www.bdl.gov.lb)

Note: 2015 data are for end November.

According to Table 6, by end 2015 about 60% of bank assets are claims on the public sector whereas only 26% are claims on the private sector, down from around half the assets prior to 1975. This indicates that the Lebanese economy has been going through a process of bank disintermediation where the private sector has become a minor client of banks and where the banks' condition and profitability have become strongly linked to the financial condition of the public sector. Such a situation clearly presents serious risks to banks and to the economy at large.

Public sector debt in LL, which basically consists of LL-TBs issued by the Ministry of Finance and LL-CDs issued by Banque du Liban, should be refinanced by banks at lower interest rates, with a spread or margin over the 12-month LIBOR within the range 1%-2%, against an actual average spread of more than 5%. Of course, reducing interest rates on public sector debt should go hand in hand with public sector reform and the gradual reduction of government budget deficits over a number of years. The impact of this refinancing will be significant on the fiscal situation, and on banks and the economy overall.

Banks will not incur losses from this refinancing, only lower spreads that should have prevailed in the first place since the early 1990s. Lower interest rates on LL-TBs and LL-CDs issued by BDL will make lending to the private sector more attractive to banks, and to the private sector as well. Importantly, the announcement of the long-term measures cited above and the new "developmental" outlook of the authorities will most likely induce large capital inflows, which will support the exchange rate and make lower interest rates a viable new monetary anchor.

Clearly, the refinancing of public sector debt at lower interest rates, and the resulting lower interest bill on the budget, will be feasible in direct relation to the credibility of the long-term measures and their early implementation. Banks will subsequently start assuming to a greater degree their traditional intermediary role by lending more to the private sector, thereby participating, as they should, in the reinvigoration of economic growth.

b) Reschedule doubtful private sector debts to banks: With a continuously weak economic growth since 2011 and the persistent political uncertainty in Lebanon and the region, we expect more bank loans to the private sector to become non-performing or doubtful, and the overwhelming number of the borrowers in this category is small and medium enterprises. These enterprises, and in fact many enterprises in the private sector, suffer from a shortage in working capital funds, let alone funds for new investment.

Falling interest rates, following the implementation of the measures described above, will certainly stimulate new borrowing and investment, especially in the new positive environment that would result from the announcement and initiation of reforms. Rescheduling doubtful debts with the support of Banque du Liban will reinforce the positive environment and sustain the economic recovery that is needed in the short term before the impact of the long-term measures is fully felt.

Concluding remarks

Economic action plans for Lebanon have usually underlined the high level of government (rather than public sector) debt as the main economic problem facing the country today. They have also focused on privatization and general administrative reform as key solutions to Lebanon's predicament. For all, the hope has always been that these reforms will succeed in recapturing the presumed strong economic performance that was believed to have occurred before 1975.

But Lebanon only enjoyed a strong financial, and not economic or developmental, performance prior to 1975. And its performance on practically all fronts has been weak, or modest at best, since after the end of the war in 1990. The inexorably rising public sector debt and modest growth record to date are nothing but symptoms of deeper structural problems that have endured since independence but that have intensified and become more apparent after the war, exacerbated by political discord and widespread corruption. These problems are low productivity and underdeveloped institutions, associated with extensive underdevelopment outside the center of the country or of Beirut in particular.

The cause of the problem usually points to its solution. Raising the productivity of labor through a long-term program of raising education standards in all schools in Lebanon, particularly in public or government schools, is the *sine qua non* condition for sustained economic growth and higher standards of living. Markets alone do not ensure this outcome; they need the assistance of government. Moreover, linking together through a modern road and communications network the geographically close but economically and socially distant regions in small Lebanon will provide not only a massive economic boost but also underline the rebirth of a unified and modern Lebanon. Again, this is a task for both government and the private sector.

However, Lebanese governments that for the last twenty five years, have been incapable of simply ensuring regular electricity supply to citizens throughout the country, though at a cost that is among the highest in the world, are hardly likely to be capable of implementing a structural reform program as described above, let alone to have a genuine developmental outlook that is necessary for sustained reforms. The private sector, also, should think beyond the short-term by contributing to the financing of the long-term projects, in which it has itself a long-term interest since these projects will put the economy on a higher level of economic growth and development.

These are times when drastic change is possible. The Action Plan has to be initiated by a genuinely reform-minded government. If the actions described above are implemented, then perhaps the ensuing economic change will drive the political reforms that are necessary for the establishment of a modern and productive society where most citizens, rather than the few, can contribute to its development and share in its benefits.

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