MANAGING GLOBAL INTEGRATION IN LEBANON

by MONA HADDAD
Senior Economist, ESCWA

The last decade saw an upswing in the pace of global economic integration: the ratio of world trade volumes to real GDP rose three times faster than in the previous decade; global foreign direct investment doubled as a share of world GDP to reach nearly $200 billion in the 1990s; more and more services are transacted internationally. Globalization is altering the world economic landscape in fundamental ways. It is driven by a widespread push toward the liberalization of trade and capital markets, increasing internationalization of corporate production and distribution strategies, and technological change that is rapidly dismantling barriers to international trade and mobility of capital.

Globalization has profound implications for developing countries. It creates important new opportunities—wider markets for trade, larger private capital inflows, improved access to technology. The new opportunities are accompanied by tough new challenges of economic management. Global integration requires adopting and maintaining a liberal trade and investment regime. In trade, competition is increasingly stiff. In finance, international capital market integration and the potential volatility that comes with it are making macroeconomic management in developing countries more complex. With financial markets so highly integrated, problems are transmitted rapidly from one country to another, with detrimental effects on exchange rates, output, and employment.

In this new global economic environment, Lebanon has to quickly position itself through increased and faster integration to avoid being marginalized. Despite being traditionally an open economy, Lebanon seems unsure about how and how fast to further integrate with the rest of the world. Recent developments (such as the Euro-Med and WTO initiatives) show its commitment to greater trade integration, but some protectionist trends point to the reverse. Prospects for increased competitiveness and exports may well come initially from within the region. This paper asks three questions: How globalized is Lebanon? Can globalization start within the region? What is the enabling environment for a well-managed globalization? Although globalization entails several dimensions, including global production, financial markets, labor movement, and technology transfer, this paper focuses only on trade.

How globalized is Lebanon?

A positive association has been established across countries between an outward-oriented trade strategy and enhanced allocative and technical efficiency, growth, and employment. Continued opening of Lebanon's trade would be an important pre-requisite for attaining high-quality, sustainable growth. But how open and competitive is Lebanon?
Despite being a more open economy than the average for developing countries, Lebanon is about average in terms of competitiveness. During 1991-95,

Lebanon's trade to GDP ratio, an openness indicator, was over 100 percent (Table 1) – higher than in most industrial and developing countries. However, this indicator is significantly influenced by the structure of trade – Lebanon's imports are about 10 times greater than its exports – and does not necessarily reflect competitiveness in global markets.

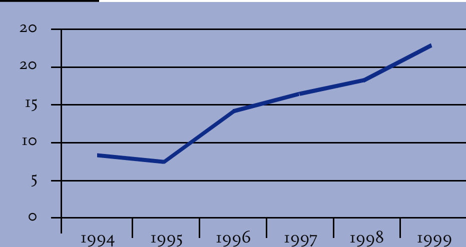
The ratio of manufacture exports to total exports – a good indicator of a country's competitiveness in foreign markets, technological progress, and production diversification – was around 70 percent for Lebanon in 1997, just above the 65 percent average for developing countries but lower than the nearly 80 percent average for Asian countries. Another indicator of competitiveness, per capita exports, is slightly lower for Lebanon ($330 in 1996) than the average for developing countries ($381).

An important feature of Lebanon's trade integration is that most of its imports are from the EU while most of its exports are to the Middle East region. In 1997, over 50 percent of its exports went to the region while the EU accounted for only 17 percent of its exports. Its main trading partners within the region are Saudi Arabia (33% of the regional trade), UAE (21%), and Syria (13%).

Trade restrictions in Lebanon are still quite high compared to other developing countries and they are increasing (Figures 1 and 2). In 1996, the weighted average tariff was about 24 percent, compared with 21 percent average for developing countries, 9 percent for Central Europe, 14 percent for Latin America, and 7 percent for Israel. Moreover, the unweighted average tariff has been on the rise – from about 7 percent in 1994 to over 20 percent in 1999.

This protectionist trend, partly caused by budgetary necessities, is in contradiction with Lebanon's recent commitment to pursue greater trade liberalization, as reflected by its entry in negotiations for joining the Euro-Mediterranean Free Trade Agreement and its application to join the WTO with which it currently has observer status.

Figure 1 Protection is increasing in Lebanon (average tariff)



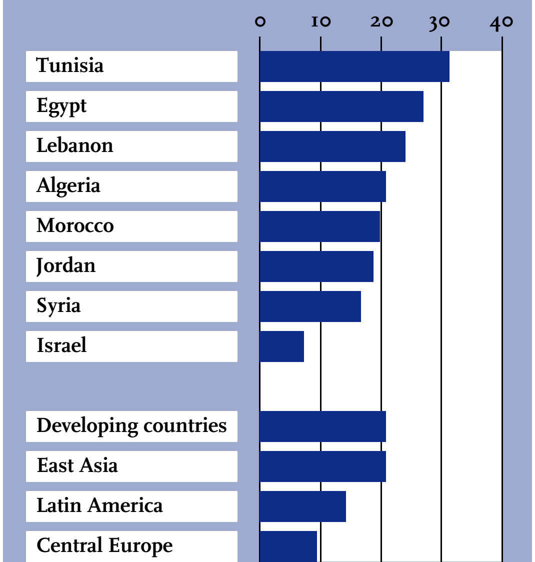
Source: Customs Administration, Lebanon
Note: average tariff is for the first month of each year

Table 1 Openness and competitiveness indicators

	Trade/GDP Average 1991-95	Manufacturing exports/total exports, 1997	Per capita exports US$, 1996
Lebanon	104	73	330
Jordan	127	50	1 034
Egypt	72	42	153
Tunisia	87	--	629
Israel	77	--	3 615
Developing countries	55	65	381
Asia	72	78	362
Latin America	29	--	420

Source: IMF World Economic Outlook, IFS, ESCWA economic survey
Note: share of manufacturing export and per capita export for Developing countries, Asia, and Latin America are for 1995

Figure 2 Weighted average tariff (1996)



Source: Alonso-Gamo, et.al., 1997

Can globalization start in our own backyard?

Given its characteristics and endowments, Lebanon occupies an intermediate place in the ladder of comparative advantage and is being squeezed from above and below. On the one hand, the more advanced developing countries (such as in East Asia) have gone upscale in their production structure towards more skilled and capital intensive activities. On the other hand, large and unskilled labor-abundant countries (such as China, India, and Bangladesh) are integrating fast into the world economy, putting strong pressures on low-skill intensive manufactures. The Central European countries are geographically closer to one of Lebanon's main trading partner, the EU, and are on track for accession to the EU thus gaining a competitive edge.

This raises the question of how will Lebanon fare in a more competitive environment and what trade strategy should it follow to boost its exports. The answer may partly lie in exploiting the unfulfilled potential of intra-industry trade with Arab countries as a first step towards globalization. Intra-industry trade (IIT), or trade in similar goods which a country undertakes, is indicative of the level of industrial advancement and of the implied potential to compete with industrialized economies in a more open trade setting. In the trade literature, the amount of intra-industry trade is often taken as a measure of the diversity, degree of specialization, and degree of technical sophistication of its industrial sector.

Disaggregated trade data for Lebanon were not available at the time of this study, so the following analysis relies on information from other countries of the region which can be revealing (see Havrylyshyn and Kunzel, 1997). Overall, the Arab region, like Lebanon, does not have a highly advanced industrial base, with an average IIT index of 16 percent for the period 1992-94 (Table 3). This IIT level falls well below those recorded in industrial countries, in particular the EU, which have an average IIT index of 88 percent. IIT levels for Arab countries are also lower when compared to other regions, such as NAFTA and APEC, or even in relation to Mercosur which has comparable per capita income levels. However, the Arab region does show positive signs of rapidly increasing IIT levels over the past decade.

In addition to having significantly lower IIT levels than other countries in global trade, Arab countries also have lower IIT levels in trade with the EU as opposed to intra-regional trade or trade with other developing countries. No single Arab country has higher IIT levels in trade with the EU than with other Arab countries or other developing countries. So Arab countries trade more among each other in similar goods than with the EU or the world at large. This suggests that Arab countries have more similar levels of industry specialization, and that they compete more effectively in the intra-regional setting than specifically with the EU. Thus intra-regional trade and trade with developing countries provide an opportunity for Arab countries to compete in IIT, and could be viewed as reinforcing the position that globalization and bilateral trade agreements between the Arab countries and the EU should be accompanied by regional liberalization. Similar conclusions can be applied to Lebanon.

Table 3 Intra-industry trade indices in manufactures, 1992-94

	Trade with:			
	World	Developing countries	European Union	Arab countries
Arab countries	16.1	20.5	12.8	21.1
Jordan	24.8	25.4	10.0	22.0
Egypt	17.2	25.0	11.3	27.8
Tunisia	30.1	38.0	24.3	26.8
Israel	58.4	32.2	42.5	19.0
Turkey	28.4	45.5	23.2	11.9
Industrial countries	87.8	--	--	--
APEC	90.3	--	--	--
Mercosur	51.9	--	--	--
NAFTA	77.3	--	--	--

Source: Havrylyshyn and Kunzel, 1997

Table 4 Protection against Lebanese exports, 1995

	Tariff rates	
	Simple average	Weighted average
European Union	4.6	3.9
United States	4.5	2.8
Japan	4.6	2.8
Egypt	42.2	31.0
Tunisia	33.2	24.8
Jordan	28.4	22.0
Algeria	22.9	16.4
Morocco	22.8	19.0
Syria	11.0	12.6

Source: Martin, 1996

This finding is reinforced by the current pattern of tariffs between Lebanon and its trading partners (Table 4). Protection against Lebanese exports is much higher within the region than with developed countries. Given the small share of Lebanese exports destined for the EU (and other developed countries) and the low EU tariffs currently applied to Lebanese products, it seems that Lebanon would benefit only marginally from the elimination of the EU tariffs under the Euro-Med agreement. On the other hand, regional countries import comparatively more Lebanese products, and they subject Lebanese exports to much higher protection than those of industrial countries. For this reason, Lebanese exports could greatly benefit from reciprocal trade liberalization with these countries (see Fedelino, 1999).

In raising the importance of trade liberalization within the region, the role of Saudi Arabia (and other Gulf countries) can be highlighted as it is currently the major regional trading partner of Lebanon (accounting for 20 percent of its exports in 1994, followed by the UAE) and potentially a crucial one for the future. With a per capita income over $6000 and an open trade regime, Saudi Arabia is the largest import market in the Arab region (and one of the top fifteen importers in the world). The share of all Arab countries in total Saudi imports was only 6 percent in 1994. The small industrial base in the Arab countries, including Lebanon, and the types of commodities that Saudi Arabia needs for its development (high-end products, machinery, software, etc.) are the main factors responsible for the low share of Arab exports to the Saudi market. Some of these products can be developed in Lebanon. Moreover, the number of Lebanese products exempt from tariff in Saudi Arabia is lower than other countries of the region and can further be increased (Table 5).

Table 5 Bilateral trade agreement between Saudi Arabia and other Arab countries

Bilateral trade agreement with	N° of commodities completely exempt from custom duty	N° of commodities subject to reduced rate of duty
Lebanon	124	29
Jordan	130	38
Morocco	535	0
Syria	121	0
Tunisia	311	0
Egypt	300	0

Source: The NCB Economist, 1996

Towards a well-managed globalization

In order to take advantage of the unparalleled opportunities offered by the current external environment, Lebanon needs to implement the appropriate policies for increased integration with world markets while minimizing the risks of globalization. Managing increased trade integration for Lebanon would require macroeconomic stability, continued trade liberalization, continued improvements in physical and institutional infrastructure, a safety net to cushion the adjustment costs during the transition period, and an enhanced education system to increase labor market responsiveness to new opportunities.

First, a well-managed globalization would require a stable macroeconomic environment with low inflation, low budget deficits, and strong external positions. In recent years, macroeconomic instability in Lebanon has been significantly reduced and inflation rates have fallen. However, efforts at further reducing the fiscal deficit need to continue. Such effort needs to delink itself from further reliance on trade revenue by exploring other revenue sources or further reductions in expenditures.

Second, greater trade openness strengthens the sustainability of a high growth path. The trade regime in Lebanon is increasingly protective in an ad hoc manner, without an obvious strategy. The trade regime needs to be further harmonized. Selective protection of sectors that have a potential to be competitive in the future could be provided, with a clear mandate to eliminate such protection after a few years. The process of accession to WTO will provide discipline in using trade restrictions. Recent initiatives for regional trade agreements, such as the Euro-Mediterranean partnership or the Great Arab Free Trade Area, offer the potential to step towards more multilateral trade liberalization. However, they need to remain compatible with further global integration.

Third, smooth business activities require adequate infrastructure—trade and investment liberalization are not sufficient for increased integration. To sustain growth, Lebanon needs to continue upgrading its infrastructure, especially in transport, tele-communications, and power. Private sector participation would be helpful, but would require improved regulatory regimes.

Fourth, institutional reforms to provide adequate institutions, legal framework, competition policies, corporate governance, and enforcement are an essential complement to macroeconomic adjustment and structural reforms. They improve transparency in the regulatory environment, which translates into a perception of lower risk and transaction costs.

Fifth, a safety net aimed at reducing adjustment costs and increased risks associated with globalization needs to be designed. There are short and medium term adjustment costs associated with globalization, due to losses incurred by resources idled as they are being reallocated from lower comparative advantage production to higher ones. The unemployed workers may not be readily absorbed in other expanding sectors, and this in turn reduces aggregate demand.

Sixth, the quality of education in Lebanon needs to improve so that its rapidly growing labor force becomes more internationally competitive. Although the share of university graduates in the labor force is relatively high in Lebanon, the quality of education has deteriorated in recent years. Investing in human capital would pay high dividends in terms of growth and welfare.

SUMMARY*

THE FOREIGN TRADE POLICY OF LEBANON IN THE GLOBALIZATION ERA

by Dr. ISKANDAR MOUKARBEL
Economic Consultant, Lebanese Association of Banks

Among the main characteristics of the Lebanese economy, beside being developing, small and open, is the fact that its exports, at least of goods, are very poor when compared not only to exports of the small industrial countries, but also to exports of the Arab non-oil producing countries of similar size. Two reasons can explain Lebanon's poor exporting performance. First, the Lebanese industrial and agricultural productions developed mainly to meet the domestic demand, where they enjoy a substantial protection, the level of which would vary according to the particular need of each individual activity. Second, since the end of 1992, Lebanon adopted an exchange-rate- based nominal anchor policy, which resulted in an increase of its real effective exchange rate by 68% during the period 1992-1999.

The Lebanese economy needs to grow at high rates for many successive years. Because of the small size of the domestic market, such a sustained rapid growth cannot take place except if the large investments required are export-oriented.

In an attempt to improve the Lebanese exporting capability through trade agreements, the Lebanese government has been acting in three directions:

Ü It filed an application for accession to the World Trade Organization. This accession , however, is not expected to have any noticeable impact on the Lebanese exports.

Ü Lebanon is negotiating an Association Agreement with the European Union, whose main aim is to create a reciprocal free trade area in industrial products between the two parties. This free trade area would inflict a heavy loss on the Lebanese economy stemming from trade diversion and the destruction of a large number of Lebanese domestic industries. In addition, the new free trade area will not improve the access of the Lebanese products into the European Union's countries, for two reasons. First, the Lebanese industrial products already enjoy a free access into the European Union countries on the basis of the 1977 agreement still in force. Second, because the European Union has included in the draft of the new association agreement a set of rules of origin similar to the ones included in 1977 agreement, which constitute in fact non- tariff barriers to trade that will limit drastically the Lebanese exports, as they have done up till now.

Ü Lebanon has signed an arrangement aiming at the creation of a large free trade area between the Arab League countries gradually in ten years starting from 1998. Lebanon has also signed agreements with a number of Arab countries in order to shorten this implementation period. However, it is too early at this stage to say whether the new trade liberalization attempts between the Arab countries will succeed or not, since the previous attempts ended with failure.

The trade agreements reviewed are the only ones offered at present to Lebanon. They are all at the stage of negotiation or early implementation. In any case, these agreements will have by themselves a little effect in the development of the Lebanese exports. In order for Lebanon to take full advantage of those agreements, the Lebanese economy need to be restructured with the aim to decrease its production costs and improve its competitiveness.

References

1- **Luis Abughattas.** "Implications of the Agreement Establishing the World Trade Organization (WTO) for the Lebanese Economy: Issues Related to the Negotiations to accede to the WTO", *Final Report, 1995*, UNDP/UNCTAD.

2- **Balassa, B.** *The Theory of Economic Integration*. Homewood, Illinois: Irwin, 1961.

3- **De Melo, Jaime and Arvind Panagariya.** *The New Regionalism in Trade Policy*. World Bank. 1992.

* The original arabic paper will be found in the arabic section of this report on page 141.

4- **Joseph F. Francois, Bradley Mc Donald, and Hakan Nordstrom.** "Assessing the Uruguay Round" in: "The Uruguay Round and the Developing Economies". Edited by Will Martin and L. Alan Winter, *Discussion paper no 307* - The World Bank.

5- **Crissa, Abdessatar.** "Arab economic integration: current reality and future prospects" *The Economic Research Forum*, Working Paper (Cairo, June 1993).

6- **Richard Harmsen and Arvind Subramanian** "Economic Implications of the Uruguay Round" in *International Trade Policies, the Uruguay Round and Beyond*, Vol. II. Background papers, 1994 Internnational Monetary Fund.

7- **Lipsey, Richard.** "The theory of customs union: a general survey," *The Economic Journal*, vol. 70, No. 279 (1960).

8- **Moukarbel, Iskandar.** "The Proposed Free- Trade Agreement Between Lebanon and the European Union Countries ; Evaluation and Recommen-dations" in *The Proceedings of the Expert Group on the Impact of the Peace process on Selected Sectors*, June 1997, ESCWA.

9- **Moukarbel, Iskandar.** "Lebanon and the General Agreement on Trade in Services(GATS)". *Dossiers de l'ABL*, No 12, 1997, Association of Banks in Lebanon.

10- **Pohl, Geshard and Piritta Sorsa.** European Integration and the Developing World. *The World Bank, Policy and Research Series*, No. 21, 1992.

11- **Rutherford, Thomas F., E.E. Ruston and D. Tarr.** "Morocco's free-trade agreement with the EC", *World Bank Working Paper WPS 1173*, published in French in Revue d'Economie du Developpement, No. 2 (1994).

12- **Schiff, Maurice.** "Small is beautiful: preferential trade agreements and the impact of market size, market share, efficiency, and trade policy." World Bank, 1995

13- **Sekkat, Khalid.** "Regional integration among the Maghreb countries and free trade with the European Union." *Economic Research Forum, Working Paper* (Cairo, November 1994).

14- **United Nations Conference on Trade and Development.**
"The Outcome of the Uruguay Round: An initial Assessment", 1994, New York and Geneva.
"Trade and Development Report" 1994. The Secretariat of UNCTAD, New York and Geneva.

15- **Viner, Jacob.** "The customs union issue." *New York: Carnegie Endowment for International Peace*, 1950.

16- **World Trade Organization.** "Accession to the World Trade Organization". *Note by the Secretariat* 1995, Geneva.