

## SYNTHESIS NOTE

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### INTRODUCTION

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The conference entitled “Linking Economic Growth and Social Development in Lebanon” was held between January 11-13, 2000. It addressed a wide range of topics relevant to the state of the economy and social conditions in Lebanon. During the ten sessions, local and international experts made about fifty presentations on a variety of topics such as budgetary analysis, the national debt, social development, labor markets, and globalization.

This document is a synthesis of the papers presented at the conference, and the comments of the discussants. Section I addresses the current socio-economic situation in Lebanon. Section II outlines both general and specific recommendations presented by the participants. Section III presents concluding remarks.

### I. A DIAGNOSIS OF THE CURRENT SITUATION:

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#### **The macro-economic situation: neither growth nor austerity**

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The introductory discussion about the macro-economic situation in Lebanon focused on four main

issues: The current recession and its causes; the large size of the public sector; the post-war macro-economic reality; and the dearth of reliable economic data.

According to some experts, the government’s expansionary policy during the early 1990’s is partially to blame for the recent economic crisis. This policy led to an increase in the domestic debt and a widening of the balance-of-payments deficit. The subsequent deflation and rise of interest rates eventually lead to yearly drop in economic growth rates, in the process leading to stagnation in the economy.

An alternative explanation for the current economic recession is what is known as the ‘Dutch disease’ hypothesis. In theory, this states that high capital inflows<sup>1</sup> lead to an increase in the price of non-tradable goods and services – for example, construction and transportation – in turn increasing the real exchange rate<sup>2</sup>. The appreciation in the real exchange rate, reflected by the increase in the price of non-tradables, shifts investment toward non-tradable sectors and away from the tradable (productive) sectors. Ultimately, this negatively affects economic growth rates and reduces a country’s export potential.

The increasing dominance on economic activity of a wasteful public sector – estimated in Lebanon at 50%<sup>3</sup> of GDP – has aggravated economic inefficien-

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<sup>1</sup> In the case of Lebanon, capital inflows intensified during the wartime period and continued in the 1990’s.

<sup>2</sup> Real exchange rate = Price of non tradable / Price of tradable.

<sup>3</sup> This figure is reached by Marwan Iskander when the public sector is considered to include Middle East Airlines (MEA), Electricité du Liban, Intra Investment Company and the Central Bank.

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cies. The Central Bank continuously covers the losses of the national carrier, Middle East Airlines, and the government subsidizes tobacco, sugar beat, and wheat. The surplus of public-sector employees who were hired because of political intervention during the war, has led to an alternative form of indirect and fiscally-unjustified state inflation.

In the post-war era, some of the participants remarked, there was neither significant growth nor fiscal austerity. In fact, their calculations revealed that the average growth rate amounted to a mere 1.5% between 1993 and 1998, compared to the official rate of 6-7%. The effective exchange rate steadily appreciated as of the early 1990's and real inflation rates more than doubled after 1993.<sup>4</sup>

Lastly, credible economic analysis requires sufficient and reliable data. Economic data for Lebanon – trade figures, monetary series, price indices, and some budgetary information – is collected by the Central Bank, the Central Administration of Statistics (CAS), and the Ministry of Finance. However, the figures are inconsistent and in some instances not reproducible. The inconsistency in the data is due to a lack of clarity and errors in defining certain economic variables. For instance, the balance of payments is often confused with balance of accounts, and the GDP deflator with the price index.

### Fiscal constraints and the public sector

The Lebanese economy is faced with severe fiscal constraints at a time when the economy needs fiscal stimulus and the public sector needs more skilled personnel. The 1999 budget showed that 52% of current expenditures<sup>5</sup> went toward servicing the debt, and 32% towards paying out salaries and pensions. This left the government with about 16% of current expenditures to allocate for other non-capital government expenditures. The deficit for the same year was estimated at about 43%, and the growth rate was close to zero.

Lebanon also faces external imbalances, social disparities across regions, high levels of poverty, and a

high unemployment rate. There is much wasteful spending, and in some instances outright theft. However, in most cases there is simply a lack of planning.

Prior to the Hoss government's recent five-year fiscal adjustment plan, which outlines for fiscal austerity measures, the Hariri government prepared a document – which was approved by the president and parliament – projecting a phased reduction of 50,000 employees in the public sector over a five-year period. The objective was to reduce the number of unproductive civil servants. Yet neither the past nor present government has acted upon this document. One of the reasons why the state has been reluctant to do so is the absence of a retraining-rehabilitation program that will allow discharged employees to acquire new skills, thus rendering them productive and useful in alternative sectors. The public sector remains in great need of skilled professionals, even though there is a surplus of civil servants. Nor are outside experts – hired to conduct specific studies – a panacea for ministries and other public bodies, since the duration of their contract is limited. The optimal solution would be to integrate experts into the civil service, even if that means paying higher overall salaries.

### The national debt and privatization

In the 1999 budget, the largest item on the expenditure list is debt servicing. Most of the debt is domestic, though the foreign component has been increasing in the last few years - from 16 % at the end of 1994 to 28% at the end of 1999. One of the strategies used by the Hariri government was to take advantage of the interest rate differential – borrowing at cheaper rates externally – so as to swap part of the domestic debt for external loans. The major difference between an external and internal debt is that the first entails a resource transfer from a country to the outside world, while a domestic debt involves an internal reallocation of resources between holders of debt instruments and taxpayers. In the case of

<sup>4</sup> Source: Charbel Nahhas.

<sup>5</sup> Or 25% of total (current + capital) expenditures.

Lebanon, it is Lebanese investors living abroad who own part of the foreign debt, effectively rendering it indirectly domestic.

The interest rate differential justifies, to a certain extent, the debt-substitution policy and the restructuring of the national debt. However, indicators<sup>6</sup> that measure currency vulnerability and the possibility of debt default reveal that if Lebanon continues to increase its foreign debt, the Lebanese economy could face both outcomes. A debt-substitution policy is risky, and its impact may outweigh the gains resulting from the interest rate differential. One expert argued that in the extreme case when most of a debt is external, the potential savings from a lower interest rate could be outweighed by a currency depreciation, a reduction in consumption, and an economic recession.

In light of such fiscal constraints, the privatization of state assets is a possible solution. However, to many experts of the World Bank and the International Monetary Fund (IMF), the primary objective of privatization is to improve efficiency and productivity, not to insure the reduction of the debt and the deficit. The macro-economic benefits of privatization should also include an increase in capital inflows, the broadening of domestic capital markets, and the acquisition of new technology.

Experience shows that if privatization is not accompanied by state efforts to establish a proper regulatory framework, the privatization process tends to create private monopolies from public monopolies. Absent an appropriate regulatory system, economies,

in the long-run face market inefficiencies due to the newly created monopolies, even if they might initially benefit from an positive fiscal shock.

The macro-economic conditions under which the sale of public assets occurs are also vital. The investor interested in buying state assets will be more risk-averse if there is no framework to regulate privatized sectors, and if there are adverse macro-economic conditions. Purchasers of privatized bodies who foresee a high risk and less stability in a post-privatized environment will devalue the marketed sector or firm and lower the price they are willing to offer. In other words, the failure of the state to ensure a proper and stable macro-economic environment may well reduce the initial fiscal gain from the privatization process.

### Income inequality and the erosion of the purchasing power

There are essentially four reasons for the erosion of the purchasing power of Lebanon's middle class. Overall the average purchasing power of households in 1999 is 20.9% of what it was in 1974 and the mean income dropped from 1.5 million Lebanese Pound (L£) in 1997 to L£1.2 m in 1999. Currently, 80% of families receive 50% of the national income, the next 10% of households receive 15%, and the richest 10% receive 35% of income.<sup>7</sup>

Firstly, the depreciation of the Lebanese pound in the 1980's reduced purchasing power and led to a hyperinflation.

	Purchasing power change between 1992 and 1999	% of families		
	(1988 prices)	1974	1992	1999
High income	4.8%	19.5	10.3	8.8
Middle income	-8.4%	60.1	40.2	29.3
Low income	-4.6%	20.4	54.6	61.9

Source: Calculations of Ibrahim Maroun based upon studies made by the CAS Reach-Mass and Yves Schemel (St. Joseph University)

<sup>6</sup> Such as the debt service ratio (external debt payment to exports, payments include the interest as well as principal). The ratio of interest payments to exports is another indicator, both of which measure the likelihood of facing difficulties in repayment. The rate of external debt to international reserves measures the degree of absorption of foreign exchange reserves by the external debt. The higher the ratio, the more likely there will be debt rescheduling.

<sup>7</sup> The Gini coefficient, which measures income inequality with an income concentration index, shows that 1992 had the lowest inequality rate of 35% compared to 52.2% for 1988, 43.5% for 1997, and 43.3% for 1999. Some experts had reservations about the figures given that Lebanon still lacks national accounts, the sample used is not the same across the studies, and the assumptions and the sample behind each of these four unrelated studies are not known.

Secondly, the large inflow of foreign workers - 34% of the Lebanese labor force in the 1995-1996 period<sup>8</sup> – drove wages down, especially for medium – and low – skilled jobs taken by middle class workers.

Thirdly, the unfairness of the tax code meant that the majority of the tax burden fell on low- and middle-class households. The direct tax system is not progressive, while indirect taxes and fees generally hit fixed-income earners the most.

Finally, the forced displacement of a substantial portion of the population and the material destruction due to the war, contributed to eroding the purchasing power of middle class families and aggravating social inequalities in Lebanon.

### Balanced development

Before the war, economic growth in Lebanon was significant. However, the regional and social distribution of wealth was uneven. For instance, per capita annual income was \$803 in Beirut by the end of 1950's and \$151 in the South.<sup>9</sup> This tendency for unbalanced development continued throughout the war years and into the post-war period.

Public spending during the 1940s and 1950s was channeled mostly towards infrastructure and was mainly spent in Beirut and in the northern suburbs of the capital. In the 1960s, there was a reduction in

the gap between regions with regard to the provision of social services. However, the gap between sectors widened – more particularly that between the services sector (which expanded) on the one hand, and the industrial and agriculture sectors on the other. The disparity in sectoral growth led to the eventual centralization of economic activity in certain areas, most notably Beirut.

In these years, the state allocated money for basic infrastructure, such as roads and hospitals to all the regions, but this effort was not complemented by involvement of the private sector. Public works spending by the government did not induce private-sector investment as no economic incentives existed for private firms to relocate to less developed regions and contribute to their development. The state did not prepare a comprehensive blueprint linking economic sectors, because Lebanon's laissez-faire economic philosophy precluded central planning.

In 1978, at the height of the war, the state established the Council of Development and Reconstruction (CDR). Paradoxically, the breakdown of order made state involvement in reconstruction all the more pressing. The CDR introduced an eight-year reconstruction plan in 1978 that was not fully executed because of the escalation of the war. A nine-year plan in 1983 was also presented by the CDR, and for similar reasons, it was partially executed with only 35% of the planned monies actually spent.

Regions	Average Income per month USD (\$)	Unemployment (%)	Schooling 10-15 years (%)	Illiteracy (%)	Housing connected to water network (%)	Infant mortality (per 1000)
Beirut	1,379	7.5	96.1	8.7	95.1	19.6
Beirut suburbs	1,149	8.6	94.9	8.7	77.3	27.6
remaining Mount Lebanon	1,297	7.0	98.4	6.6	89.2	27.6
Beqaa	842	10.7	93.3	13.5	70.8	39.8
South	756	9.1	93.3	14.4	79.0	27.2
Nabatiyeh	726	9.6	96.8	14.8	90.4	-
North	823	10.6	90.0	16.7	67.6	48.1

Source: Central Administration of Statistics (CAS) 1998/ Mona Harb el-Kak

<sup>8</sup> Study by the U.S.E.K. University, Kaslik.

<sup>9</sup> Source: Wafa' Sharf el-dine.

Lebanon's fifteen years of conflict aggravated the unevenness in regional development. The war, in relative terms, ameliorated the situation in some regions - including Mount Lebanon, the South, and the Bekaa - and impaired development in others such as North Lebanon (see table opposite page). During the war, some enterprises and businesses moved to the Bekaa and the South, while the North as a whole suffered from the migration of economic activity to Mount Lebanon or the city of Tripoli.

At the end of the war, the World Bank sponsored what was known as the National Emergency Reconstruction Plan (NERP). In 1994, an \$11bn plan (Parallel Plan for Reconstruction and Development - PPRD) was introduced to include the \$2.2bn allocated for the NERP and with the purpose of rehabilitating 19 basic sectors. The NERP mostly sought to rehabilitate existing infrastructure and urban services. It did call for a balanced dissemination of infrastructure, but failed to help regions which did not possess the infrastructure in the first place. It was fully executed for some sectors - for example power, postal services, Beirut airport, and roads - and only partially for others - for example the potable water network and solid waste treatment. To this day, there is a regional imbalance in economic development in Lebanon. Most economic plans have continued to focus economic activity in Beirut, while failing to push for the spreading of economic activity to all other parts of the country.

## Labor market

There are four major imbalances in Lebanon's labor market. These are the unequal composition of the labor force, the surplus of foreign workers, low real wages and high unemployment levels, and an alarming emigration rate.

Between 1970 and 1997, Lebanon's labor force increased by 138%. The increase did not bring about

a sufficient improvement in the gender balance and most created jobs were in the lower-skilled bracket and in the services sector, rather than in the industrial and agricultural sectors.

### The composition of the labor force (of the resident population)

	1970	1997
<b>Labor force</b>	572 thousands	1.36 million
<b>Women</b>	17.5%	21.6%
<b>Services sector</b>	55.8%	65.1%
<b>Agriculture sector</b>	19.0%	12.0%
<b>Industry + power</b>	17.8%	14.7%

Source: Central Administration of Statistics/ Albert Dagher paper

The labor force<sup>10</sup> is estimated in 1997 to be 1.36 million, some 34% of the residing population, which is estimated at close to four million people. The number of migrant workers - mainly Syrians, Egyptians, and South and Southeast Asians - peaked in 1993-95 at about 1.4 million, exceeding the Lebanese labor force. This excess was mainly driven by the booming construction sector. The inflow of workers mainly affected low-skilled and blue-collar Lebanese workers. High-skilled workers, in contrast, were in high demand but short supply. Recently, more and more medium-skilled employees have taken on low-skilled jobs, for a number of economic reasons. This reflects the fundamental disequilibrium in the Lebanese labor market.

With regard to wages, disparities increased and real wages decreased over the last two decades. For instance, real wages in 1992 were 30% of their nominal value in 1974.<sup>11</sup> Participants noted that the average monthly wage was \$1,100 before the war, compared to \$218 in 1997. At the same time, two out of three Lebanese laborers then earned less than L£500,000.<sup>12</sup> The problems do not end here. The real rate of unemployment is estimated at between 20-40%<sup>13</sup>, a large gap due to the lack of credible data.

<sup>10</sup> All labor market figures are drawn from the paper of Albert Dagher.

<sup>11</sup> 1974 prices.

<sup>12</sup> Slightly above \$300 in 1999 prices.

<sup>13</sup> Source: Nagib Isaa

Unemployment in Lebanon is mostly disguised and partial, and is under-evaluated given the high emigration rate.

The alarming emigration rate is another major factor adding to the problems of the Lebanese labor market. It is mostly young skilled male Lebanese who emigrate. Since 1992, some 690,000 Lebanese are thought to have emigrated. Indeed, some participants regarded this as a historical phenomenon. Some wondered whether Lebanon was able to absorb all the doctors, engineers, and nurses graduating every year. Many assumed not, and argued that migration seemed the natural outcome for this group. Not everyone agreed, however, that this was a positive phenomenon, since Lebanon has invested in these skilled professionals who end up working abroad, with little or no known beneficial impact on Lebanon.

### Social public spending

Even though Lebanon has gone through a war, basic social indicators since the mid 1970s have improved. Internationally, post-war Lebanon has among the highest levels of spending on education and health, at 20% of GDP. In spite of this, the results are not satisfactory with a double-digit illiteracy rate, no health coverage for over 50% of the population, expensive health services, and other problems.

Substantial disparities continue to persist between regions and across the social sectors, particularly in terms of education and health. The cost of providing social services is very high. This has been exacerbated by the fact that the state has not developed a comprehensive social policy. State agencies providing social services often have overlapping roles, and most of these institutions are lacking when it comes to the efficient management of public spending.

#### (a) Education

A major deficiency in the education sector is its weak link to the labor market. Some participants argued that higher education institutions have failed

to produce the needed economists, administrators, and technicians needed by the market. Young students are not exposed early on to those careers that may best meet their capacities and interests. Traditional Lebanese society and the existing education system offer little of the flexibility needed to strengthen the linkage between educational institutions and the labor market. And in those cases where the system provides a qualified candidate for a vacant job, it is often less qualified candidates with the right connections who get the job.

Public spending on education is relatively high. However its impact is unsatisfactory. Overall, Lebanon allocates 9.3% of GDP to education, compared to an average of 5.2% for OECD countries.<sup>14</sup> Households are responsible for most of the education budget, as the state spends less than half of national spending on education, and covers only one-third of enrolled students.

In 1998, about L£1.9m was spent on average on each student in a public school. This rate is somewhat comparable to the cost of education in a private school – where L£2.2m is spent on average per student per year. However the quality differential of the education provided between private and public establishments remains wide. The state also subsidizes so-called ‘free schools’, and provides education allowances to families of public servants.

Regarding the quality of education, Lebanon’s appropriate ministries cannot ensure a certain standard of quality at the national level when they fail to do so in public schools. Private schools, left to their own devices, have failed to create a network amongst them to establish quality criteria. The government has tried to take a pro-active role. A new curriculum was introduced to revive and improve the level of the primary and secondary education system. School instructors have been trained according to the new curriculum, but the training is still introductory in nature. It is too early to judge the effectiveness of the new curriculum, though some experts have been critical.

Participants pointed to the fact that private universities are offered an operating license based upon a one-time criteria review. In other words, higher edu-

<sup>14</sup> Average rate for the 1990’s.

cation institutions are left unchecked once established. For example, only the Lebanese University requires its faculty to be holders of doctoral degrees. Less than 50% of faculty members in private universities hold such a degree. Research is also neglected in most universities, and when the motivation is mainly promotion.

Lebanon has yet to provide basic education for all: 44% of children between the ages of three and five, 4% of those between the ages of six and eleven, and 12.7% of those between the ages of twelve and fifteen do not receive a basic education. The majority of those children reside in North Lebanon. Illiteracy is estimated at 13.6% for the total population, and the figure is increasing for women. About 9% of the active population are believed to be illiterate, 12% just read and write, and 25.5% have completed basic education. As for farmers and blue-collar workers, 32% of this group are illiterate.<sup>15</sup>

## (b) Health

There are two main types of health care systems. In liberal economic systems, it is the market that determines the price of goods or services, such as health care or the price of drugs, according to a limited level of state regulation. The American system is a good example of the latter, but is considered to be the most expensive system, as it absorbs 14% of GDP. Health Maintenance Organizations (HMOs) and Preferred Providers Organizations (PPO) have been somewhat successful in reducing prices without sacrificing the quality of care.

Centralized health care systems, on the other hand, place caps on spending and provide universal coverage. A good example is the United Kingdom's health system. Centralized systems are sometimes criticized because they provide lower-quality health service.

The Lebanese health system is mainly liberal, and does not ensure universal coverage. In contrast, however, certain companies have the exclusive right to import drugs, driving prices up and contradicting the principles of a free market. As a result, spending

on drugs consumed in 1997 between 30-40% of the national health budget. The health system is also costly, as physicians are accustomed to over-utilizing sophisticated and expensive technology.

A number of structural imbalances exist in the health sector. There are about 15,000 hospital beds, when Lebanon requires just 9,000. There are 12,000 registered doctors<sup>16</sup> earning an average wage of 500 dollars per month, working with only 3,000 nurses. The Lebanese health system is also witnessing a rapid proliferation of tertiary units providing a range of high technology investigations and treatments. For instance in 1997, there were 12 open heart surgery units, 12 in-vitro fertilization centers, and 39 centers for renal dialysis – all for a population of 4 million people. There is a concentration of doctors and hospitals in Beirut and Mount Lebanon, and the overwhelming majority of beds are provided by private hospitals.

Agents	Share of national spending on health	
	Consulting and Research Institute	Central Administration of Statistics
Households	53.8%	43.8%
Private Insurance	16.1%	19.6%
Ministry of Health	11.2%	13.7%
National Social Security Fund (NSSF)	9.0%	10.9%
Ministry of Defense	3.7%	4.5%
Ministry of Interior	3.1%	3.8%

Source: Social protection and social safety nets.

The budget of the health sector absorbs 10% of GDP, however in 1997, 58% of households are not covered by any health plan. Spending on health in Lebanon comes from three main sources: the state, quasi-public institutions, and the private sector. The Ministry of Health covers whoever is not covered by a private insurance company or the National Social Security Fund (NSSF). The ministry ends up allocating, and has been for several year now, about 80% of its budget to contracted private hospitals where civil

<sup>15</sup>Source: Paper of Adnan al-Amine from a study made by the Ministry of social affairs in 1996.

<sup>16</sup>The ratio per person (2.8/1000) falls within the OECD range of 1 to 3.8 per 1000.

servants, their families, and whomever is covered by the state prefer to go. There are also other governmental bodies that spend on health services for their employees such as the Ministries of Defense, Interior, and Social Affairs, as well as the Employees' Mutual Fund and the Council for the South. Quasi-public spending is mostly channeled through the NSSF, financially and administratively an autonomous body, but under the direct supervision of the Council of Ministers and the Ministry of Labor. In the private sector, over 65 insurance companies operate covering close to 175,000 people.

### (c) Social protection and social safety nets

A number of institutions in both the public and private sectors provide formal social protection for their employees. The most often-used medium is the NSSF, which by 1999 covers close to 1.2 million Lebanese - one-third of the population. The social system is not comprehensive, however, and benefits are often limited. For example, few self-employed professionals are covered. Moreover, services are suspended once an employee retires or is dismissed from his job.

Among the problems faced by Lebanon's social security system is complex bureaucratic procedures, lack of coverage for eligible employees, high compensation for military personnel and dependents, etc. The end result is that social protection is not provided to the disadvantaged segment of the population, such as retirees and the unemployed, who need assistance the most.

A number of state institutions and ministries provide an indirect social safety net, though this is uneven in terms of geographical distribution. All in all there exists no far-reaching social safety net in Lebanon, assisting specific target groups such as the elderly or the transitional poor. There are a number of institutions which provide some social protection schemes, but little information is available on the existing needs and coherence of these schemes. Thus the

problem does not lie in the instruments of social policy, but in the absence of an overall safety net policy.

### Globalization and trade policy

The impact of globalization on developing countries includes wider markets, access to technology, stiff competition, and market volatility. However, because different countries have different economic and social backgrounds, these impacts will vary.

Where is Lebanon situated in this increasingly globalized world? When we examine the ratio of manufacturing exports to total exports, Lebanon is about average in terms of competitiveness. On the other hand, the composition of Lebanese exports of mostly non-durable low-valued goods shows a less-than-competitive economy. Lebanon is more open than average developing countries if the trade-to-GDP ratio is considered.

The high trade restrictions on imports originating from Middle East countries tend to weaken the argument of openness. The restrictions are still high relative to other developing countries with a weighted average of 24% compared to 7% for Israel, and 9% for Central Europe. Arab countries too impose high tariffs against Lebanese exports. This means that Lebanon's trade with its Arab partners tends to be less open than with other countries. Tariff rates in simple averages imposed by Arab countries ranged in 1995 from 42.2% in Egypt to 11% in Syria whereas the simple tariff rate imposed on Lebanese exports destined to Europe, the United States or Japan was about 4.5%.<sup>17</sup> The high trade and non-trade barriers between Arab countries make all the more substantial the potential impact of a pan-Arab free-trade zone on regional exchanges. Trade agreements between Lebanon and a number of Arab nations have been bilateral and limited in scope, with customs duties lowered on a select number of items.<sup>18</sup> An Arab free-trade zone is expected to be in full operation by the year 2008. The liberalization of trade among the Arab states will increase the volume

<sup>17</sup> Source: Paper of Mona Haddad.

<sup>18</sup> The tariff rates between Arab countries remain volatile. A country could raise the base rate rendering the trade agreement neutral or the net impact of the liberalization insignificant.

<sup>19</sup> For instance trade diversion.

of regional trade, but most of all it will limit the costs<sup>19</sup> of and complement the emerging Euro-Mediterranean free-trade zone.

Lebanon can expect both positive and negative repercussions if it joins the World Trade Organization. Lebanon is not a major exporter with known comparative advantages, so its bargaining power in the WTO negotiations is very modest. In addition Lebanon may gain little from the dispute resolution mechanism of the WTO: As it is a minor exporter, Lebanon will find it difficult to challenge competitors for unfair trade practices. On the other hand, it stands to gain from the WTO's most-favored-nation clause, which means that it will enjoy the benefits offered to any other WTO member. Furthermore, Lebanon, being a developing nation, is authorized to gradually adjust its system and agree to commitments the country is ready for. This should ease the transition and minimize the associated costs of globalization.

## II. WHAT COULD BE DONE?

### What economic model for Lebanon?

What model do we want for Lebanon in the next ten years? To what extent should we allow the *laissez-faire* economic model to continue, and what is the appropriate role for the state in terms of social policies, creating jobs, and fostering the proper environment for the private sector? It is also important to determine how regional and international developments affect discussions of any model or strategic choice for Lebanon, and how to develop a policy-making mechanism that is forward-looking and not merely reactive.

Even if a common vision is agreed upon, it is even more important to prioritize economic objectives and develop a mechanism to effectively implement such a vision. As the Nobel laureate Douglas North noted, institutions and regulations play a vital role in economic growth. In the case of privatization, for instance, success requires a proper legal and institu-

tional framework. This could entail the creation of a higher committee for privatization led by the prime minister, a law to regulate privatized sectors, or the introduction of strategic partners into the entities that are going to be privatized.

### Fiscal and monetary policy

In light of the existing economic recession and the role of the public sector in remedying the situation, participants debated the Hoss government's five-year fiscal adjustment plan. The plan's main objectives include reducing the budget deficit to 4.5% of GDP, reducing the debt-to-GDP ratio to 96%, decreasing interest rates, and stabilizing the annual growth rate at 5.0%. A number of fiscal reforms were proposed to achieve these objectives and to ensure fiscal sustainability. The proposed reforms included modernizing the tax system, rationalizing public expenditures, increasing the tax revenue base, reducing the debt, and privatizing some public assets. Experts called on the government to fully implement the value-added tax (VAT) as well as a new general progressive household income tax. On the expenditure side, the institutional framework for debt management ought to be revised. Similarly, a ceiling must be imposed on expenditures, especially current spending, and public investment programs have to be rationalized and prioritized.

Some participants disagreed on whether reducing public spending and increasing revenues would resolve Lebanon's macro-economic imbroglio. That is because the ability of the state to raise more revenues is limited, given current socio-economic conditions. A better synchronization of monetary, fiscal, and economic policy is then required. Only once a better fiscal situation is in place will interest rates drop, provoking higher levels of investment and, consequently, an improved fiscal account.

Reducing the public debt is of paramount importance, given that debt servicing is consuming a majority of public expenditures. In order to escape the vicious cycle of high interest rates, increasing debt, and lower investments, the debt-management framework has to be consistent with a new interest-

reducing monetary policy. Few experts at the meeting questioned current orthodox monetary policy, which stresses curbing inflation and stabilizing exchange rates. Monetary policy needs to be viewed as an economic instrument which uses interest rates to stimulate private-sector investment. In the early 1990s monetary policy was centered on reducing inflation rates and pegging the nominal exchange rate. This was important at the time, but is no longer sufficient to jump-start the economy, and is not salutary in any debt-reducing strategy.

The debt substitution strategy could save the government a considerable amount of money. However, it should not be abused, since a large foreign debt share will increase Lebanon's economic vulnerability and political dependency on foreign creditors. Indeed, and as a result of this perceived liability, the Lebanese government has decided to place a 30-35% ceiling on foreign debt, as a portion of the total public debt.

The government also needs to maximize the use of bilateral and multilateral loans, a sizable amount of which has never been used, despite being earmarked by foreign countries for use in Lebanon. Meanwhile, on the local debt market, there is a need to improve and modernize the market infrastructure, foster the development of a secondary market, and introduce new debt instruments.

### Labor market and employment policies

Lebanon must adopt an employment policy that is consistent with its global development strategy. The issue of employment has been dealt with so far in a residual way, as a by-product of economic policy. The Ministry of Labor, for instance, is not part of the economic ministerial council, which defines the country's economic policies.

Lack of orientation and support for the young and has contributed to the existing disequilibrium in the labor market, where there is a surplus of workers in some sectors and shortages in others. Young people need assistance and advice in making their career choices. There are three parties that can provide such a support: the family, the school, and the state.

The state can help by reviving the Employment Bureau, especially its research department. With a new database on the labor market, job seekers and job providers can be better linked. A more efficient system based on reliable data will help future employees find the job that best suits their training. It will also permit employers to save resources by quickly choosing the appropriate candidate.

Moving beyond the structural disequilibrium in the labor market, there is less upward mobility in the Lebanese labor force in terms of skill improvement. Professional training and rehabilitation programs need to be encouraged in both the public and private sectors. The government should provide and enforce work licenses and permits to all, based upon a skill test that is offered on a regular basis. Life-long learning is a strategic choice Lebanon needs to consider as part of the continuous effort aimed at raising productivity and real wages, and reducing unnecessary production costs. Life-long learning is more than a rehabilitation program and less than a formal college degree. It is a system of continuous training and improvement through which employees and productive agents in the economy can continue to acquire new skills and be compensated accordingly. Outdated labor laws are an overriding problem in the labor market. The newly formed parliamentary committee for updating legislation should be assisted in revising labor laws. This should help improve work and safety conditions, rectify gender imbalances, and provide incentives for employers to create new jobs. Rejuvenated laws ought to determine fair conditions and norms for strike action, guarantee employees' rights, and restrict arbitrary dismissals. Contracts need to be flexible and the minimum wage regularly calculated according to a formula that best reflects the current state of the economy.

Last but not least, immigration policies and laws should be revised, since the size of the foreign labor force has direct implication on unemployment rates, most notably in the lower-skilled bracket. A number of measures have been proposed, including taxing foreign labor and forcing foreign laborers to purchase personal insurance. Some have called for a selective immigration policy based upon market needs, and a minimum wage enforceable on all.

## Social vision

To what extent does Lebanon have a social vision? The 1999 budget seems to reflect a deficiency in the government's social spending. However, if one closely examines the Lebanese budget, he will find that the government does indirectly spend on socially-relevant sectors. An example of this is the government's providing education allowances or money allocations for social training centers. While this comes under the heading of current spending in the budget, it is in fact a form of hidden investment, with concomitant future returns for society and the economy as a whole.

Optimal international practice reveals that countries viewed as socially active, such as Finland and Sweden, often have low levels of public social investment. In these countries, the state does not compete with the private sector, but acts as a catalyst for growth. It is often an agent that guarantees the existence of a proper macro environment, and a smart spender with a futuristic, preventative vision.

The primary role of the government is, thus, to create a new paradigm for economic and social development. This includes providing basic social services and infrastructure, ensuring competitive behavior and the adoption of international standards, strengthening regulation and monitoring of economic activity, and acting as a catalyst for economic development.

### (a) Education

Some of the participants argued that the role of government in education is defined by one of three possible strategies: The state can carry on with its current policy of allowing the education system to be subject to the forces of supply and demand with limited governmental interventions and presence; it can withdraw gradually from the education sector; or it can revive the public school consolidation program, reinforce the Lebanese University and revive public education.

Because education consumes a large portion of

GDP, spending on education must be made more efficient and effective. This means addressing a number of issues, including the excess of instructors and school mapping. As for immediate measures, the state has to merge the three education line ministries<sup>20</sup> and carry on with the unification of the Lebanese University. Spending on primary education yields higher returns than spending on higher education. Therefore the state ought to focus on providing basic educational services, which are of particular benefit to disadvantaged groups in Lebanese society.

The participants offered several other suggestions: There is a need to strengthen foreign languages, which would ensure that Lebanon maintains its regional comparative advantage. The education system must be made more flexible. And educational and research institutions must be encouraged to integrate and interact when it comes to their activities. The minimum age for compulsory education should be raised from twelve to at least fifteen in order to ensure that the student finishes his or her basic education (9th grade or Brevet). Correcting this mismatch can better help fight illiteracy and increase enrollment in high school and ultimately college.

### (b) Health

The health sector is subject to both market failures and moral hazard behavior.<sup>21</sup> There is, thus, a need to put in place an incentive-driven mechanism that will ensure that the market functions in the interest of the society as a whole and not to benefit certain agents in the health sector. Compulsory health insurance could be part of the solution with a system similar to that in the United States. In the American system, the family physician acts as an intermediary between the patient and the specialist. This helps reduce the abuse of some services and assist customers in determining their healthcare needs. HMO companies, on the other turn, compete through better services and lower prices.

Public spending on health in Lebanon is very high,

<sup>20</sup> Ministries of high education and culture, vocational and technical training, and education.

<sup>21</sup> Abuse (e.g., over-consumption) of the system by one party affecting other involved parties (principal-agent theory).

though the share allocated for basic health services, demanded mainly by lower-income families, remains low. This misallocation of resources must be reversed. Furthermore, the largest portion of the Ministry of Health's budget goes to contracted private hospitals, which are expensive and generally take advantage of the system. The state needs to reduce its reliance on the private sector and better use public facilities, especially a series of new, though not yet equipped hospitals.

Some participants also stressed the need to promote investment in the drugs market,<sup>22</sup> since spending on medicine consumes close to 40% of the national health budget. The state's policy of permitting exclusivity in the importation of drugs, which is a necessity product, must be revoked to allow more competition.

The role of the state in healthcare has to be revised where the government becomes a regulator, a service provider, a monitor, and a proactive agent providing the appropriate incentives for private institutions to work in the best interest of the economy.

### (c) Social safety nets

Among the important challenges facing the Ministry of Social Affairs is the better targeting of disadvantaged groups such as the handicapped, orphans, and the elderly. Objective criteria must be set to determine the basic needs of each of these social groups. The ministry has also to review its role vis-à-vis students in private technical schools, re-evaluate its strategy and the effectiveness of its social development centers, and put an end to the automatic, unchecked, renewal of contracts with NGOs. Participants also emphasized the need to give the social security administration more independence. They added that compensation to public-sector employees must be re-examined and the collection of fees improved.

Plans for partial state intervention to address specific social needs are insufficient: experience has proven that partial plans are usually expensive and not very effective. A comprehensive socio-economic vision is both easier to execute and more effective,

and ties in social development to economic growth. Social objectives are best met when there is growth based on a reorganized labor market, a reformed fiscal system, and flexible and equitable economic policy.

### From balanced development to globalization

A national strategy for regional development necessitates a strong state willing to undertake development activities whose outcomes may not be perceptible in the short term. This means formulating a global and coherent *plan d'aménagement*, rather than dissociated sectoral policies. In this way, Lebanon would be able to put in place a system of balanced rather than parallel growth.

Lebanon should encourage competitiveness between regions. This is the case in Europe, where regions compete one against the other to attract foreign investment. The extent to which municipalities are able to play this role in Lebanon remains subject to discussion, but regional economic councils may be set up to stimulate investment. A successful balanced development strategy would also benefit from the establishment of new regional centers with executive authorities. The regional authorities could be at level of the *caza*, the *mohafazat*, and even the municipal level. Decentralized decision-making is essential at both the political and administrative levels as it efficiently and effectively serve the needs of the region. The creation of regional authorities promotes as well the action of intermediary political leaders, counterbalancing the central elite.

With an internally balanced economy, Lebanon will have an easier task preparing for globalization. The country remains very expensive for both consumers and producers. Unless production costs are reduced, Lebanon will remain not competitive globally. The example used by one participant was illustrative of the problem: the Beirut port is open for only a few hours per day. A simple, and inexpensive, measure to reduce costs would be to increase working hours. This would reduce costs to importers and exporters, since merchandise would flow faster, while the

<sup>22</sup> The monopolization of supply and the subsequent high prices of drugs is pushing health costs too high.

increased volume of trade would expand the tax base. Commercial banks can also play a role in helping Lebanon regain a competitive edge. Their lending policies need to be revised with the dual objective of making reasonable profit, and allocating funds to promising productive sectors.

Some participants noted that Lebanon, in terms of intra-industry trade, can more effectively compete with Middle East countries than with non-Arab trading blocs such as the European Union. Lebanon is, therefore, expected to benefit from liberalization in inter-Arab , since trade barriers with the Arab countries are the highest.

Lebanon must join the WTO. However, it needs to better prepare itself for negotiations with the world trade body. This will mean, first, appointing an accomplished negotiating team. It will also imply educating and informing the Lebanese private sector on the trade agreements and their impacts. Moreover, the state must develop a trade strategy that both capitalizes on Lebanon's human resources and promotes private investments in niche markets and productive sectors.

### III. CONCLUDING REMARKS:

In conclusion, the following is a recapitulation of the basic views and orientations of the participants, as they emerged from the overall discussion.

At the outset, most participants agreed on the characteristics of the current economic and social crisis: a severe budget deficit; costly public subsidies, mostly to the energy, air transportation, and agriculture sectors; an inflated and largely unproductive public sector; the heavy weight of the state in the national economy – more than 45 % of GDP; and the general slowdown, if not the stagnation, of the economy. Many participants argued that this was not a short-term situation. Rather it is the product of an economic model that became dominant in Lebanese society in the last several decades. This model led to the development of a *rentier* economy, domestically and externally – whether regarding transfers, remittances, speculation, interest, real estate deals, cus-

toms protection, and public-sector employment – and the domination of such activities and revenues over the economic cycle. This was accomplished at the expense of real economic productivity and competence. This, in turn, was reflected in the deteriorating quality of locally-marketed goods and services, and those oriented towards exportation. It also led to a devaluation of productive work and work ethics in Lebanese society in general.

Several participants wondered whether a break with this economic model was needed to take the country out of its structural crisis? Was such a break possible? What would its political, economic, and social costs be, or its phases and risks? Would an inevitable future adjustment provoke a shock, a social crisis, or a large and dramatic migration? Indeed, some estimates put the number of Lebanese who left the country at 800,000 over the last decade.

At a time when Lebanon, the region, and the world are changing profoundly, some questioned whether Lebanon should reproduce the past – or more precisely images and illusions of the past. More urgent was the reversal of the country's deteriorating quality in education and services, the declining productivity of industry, and the diminishing competence of human, administrative and scientific resources.

The participants underlined the importance of a sustained effort to lower the very high production costs in Lebanon, when compared to other countries in the region and in the developing world. This was imperative to again make Lebanon competitive. Examples mentioned were the low efficiency of the Beirut Port, the problems faced by express mail companies, the high cost of energy, traffic problems, the irrational nature of social expenditures, and other issues.

Some asked: Was it acceptable that Lebanon should remain without a national map and compass? The country lacks a population census, national accounts, and detailed and regular statistics on manpower and productivity, on tourism and occupancy rates, on construction activities, on remittances, on service exchanges. In sum, can Lebanon today, as a country without national data, without sectoral indicators, without the comparative studies required in this information age, set public policy and encour-

age investors and individuals alike to rationalize decisions and institutional initiatives?

Participants emphasized, in addition, the urgency of a serious and sustained engagement of the state in administrative reform, privatization efforts, fiscal reform, and the gradual suppression of subsidies. They noted that what is needed is a strong focus on policies and incentives to promote high value-added and exportable Lebanese goods and services in different sectors.

In terms of social expenditures – on education, health, or social protection – the participants underlined that the problem was not the level of spending: Lebanon – whether the state, institutions, or households – allocate more than 20% of its GDP on socially-relevant sectors, one of the highest ratios in the world. In spite of this high level of expenditure, Lebanon has not been able to insure basic needs in health and education for all its citizens. It is not clear that protection and social assistance is reaching the right groups in society. The quality of social services is diminishing, as are administrative efficiency and the ability to deliver. Political interference is leading to distortions and waste in public spending. The state hesitates to define a proper role for the public sector – whether in terms of administration, promotion, monitoring, social solidarity or a mix of these. In sum, Lebanon needs a comprehensive social development plan, injecting an overall sense of direction to the activities of the public sector, private institutions and civil society organizations.

Uneven regional development has underscored the lack of an overall vision for the Lebanese territory as a whole. The participants noted the absence of coordination and synergy between sectoral policies, particularly regarding their impact on different regions and on a balanced regional development. They noted that the logic of most reconstruction plans since the 1970s revolved around rehabilitating and expanding what existed before the war, in the same places where they existed. Plans did not aim at correcting significant historical distortions and altering the excessive concentration of activities and resources around the capital and some areas of central Lebanon and the coast.

Participants agreed on the need for a more equitable

distribution of public services to deprived regions. More important, these regions require new investment and job-creation. This means directing economic activities to these areas. This can be done through publicly-mandated fiscal, legal, and administrative measures. Also required are political-cultural incentives, as well as policies promoting deconcentration and administrative decentralization. These can encourage Lebanese, whether they live in Lebanon or abroad, to contribute to the well-being and renaissance of their regions of origin. A proper conduit for this would be revitalized municipalities, or new representative local structures at the *qada* or *muhafazat* levels.

The labor market is also problematical. There is an apparent increase in unemployment, leading to the emigration of Lebanon's youth. Manpower productivity has deteriorated to a low level on the world scale. The linkage between the educational sector and the labor market is very weak. There is a dearth of much-needed professional and technical skills, and a need to modernize training and rehabilitation institutions. Unplanned migrant labor is making more difficult the employment of Lebanese in certain job categories. Individuals in the so-called liberal professions, as well as enterprises, are often unlicensed. Lebanon lacks labor statistics and studies, preventing the formulation of a national strategy to deal with labor issues, and the upgrading of the labor force.

In terms of institutional reforms, the participants underlined the need for public sector reforms to ameliorate competence, productivity, flexibility and costs. However, they insisted that this was not the only national priority. Lebanon also needs, as urgently, to introduce radical reforms in the private sector, guaranteeing transparency, accountability, productivity, good management, and consumer and stockholder protection. This is a prerequisite for efficiency and competitiveness in private enterprises. This would make them attractive to institutional and individual investors.

What is needed, additionally, is imagination, so that the Lebanese cease to make the customary implicit or explicit assumptions about their "economic nature" and that of Lebanon. This will help over-

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come myths about the past, as well as perceptions of supposed comparative advantages and regional economic functions. On the contrary, the Lebanese should explore new and promising opportunities and activities, and firmly adopt public policies and private initiatives to seize these opportunities and consolidate and promote more advantageous activities.

More generally, participants called for a strategic socio-economic approach to present challenges, using a historical perspective. This is preferable to the present, short-term view in the country at large, with its emphasis on the pressing crisis, and oriented towards ready-made and quick-fix solutions. There is a need for a comprehensive national vision, a vision of what Lebanon should be in twenty or thirty years, and a determination to implement this

vision stage by stage. One thing definitely not needed is a list of public works projects, public orientations or public wishes, which will soon be abandoned or will remain unrealized.

Finally, the participants considered the conference a significant step towards building a consensus on a comprehensive development strategy for Lebanon. This, they agreed, must be followed up and encouraged through more studies, open dialogue, and appropriate public policies. The conference was said to have represented, in their view, the manifestation of an effective partnership between the state, civil society, the private sector, and the research community. Such a partnership can contribute to a national project to reconstruct Lebanon as a convivial, viable, and creative community for the 21st century.

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**UNDP conference on Linking Economic Growth and Social Development in Lebanon.**  
**11–13 January 2000, Beirut, Lebanon**

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# CONSIDERATION FOR LEBANON.

**by Moez Doraid**

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Economic growth expands the material resources available for the fulfilment of human needs. But the extent to which these needs are met depends on the allocation of the rewards of growth through the distribution of private and public resources (both income and assets). The distribution of opportunities, particularly employment is critical. Economic growth will not invariably translate into human development if other important factors are not in place. Among the most important of these factors is public policy. International experience shows that the link from economic growth to human development is not automatic.

There is also a key link back. Human development requires, among other things, considerable investment in education, health and nutrition. The result is a healthier and better-educated population capable of being economically more productive. Modern growth theories explain economic growth primarily in terms of expanded human and social capital rather than physical capital. Growth can also be linked to many other elements of human development—such as political freedom, cultural heritage and environmental sustainability. Without social progress, economic growth is unsustainable.

Lebanon has made significant strides in economic and social development since the end of the civil war. Today, accelerating growth is a major challenge. An equal, if not greater, challenge is to ensure that this growth translates into human development in terms of better living conditions, more choice and

greater opportunities for the Lebanese, particularly poor people. Public action is needed, first to accelerate growth in order to expand resources available for human development; second, to ensure that the available and newly created resources are actually allocated towards human development priorities; and third to ensure their efficient use to address people's priorities.

This note presents aspects of Lebanon's developmental progress and imbalances. Rather than suggesting solutions, it highlights facts and issues related to the links between human development and growth.

## HUMAN DEVELOPMENT DESPITE SETBACKS

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In the latest Human Development Report (HDR), issued by the United Nations Development Programme (UNDP), Lebanon's rank according to the Human Development Index (HDI) is 69th among 174 countries. The HDI is a composite index reflecting life expectancy, educational attainment, and per capita income.

Among the Arab states, Lebanon is ranked sixth according to the HDI. Interestingly, Lebanon is the highest ranking in terms of human development among the Arab countries that do not have large oil revenues.

The armed conflict between 1975 and 1990 had disastrous effects. Among a population of three mil-

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lion, about 150,000 people lost their lives, 200,000 were injured and 50,000 were left with serious disability. In addition, nearly half a million were displaced and about one third of the population, or 900,000, left the country. Losses in terms of infrastructure were estimated between US \$ 25 and US \$ 30 million – ten to twelve times the national income. Astonishingly, progress in terms of several human development indicators was sustained despite the war's great human losses and suffering. Between 1975 and 1997, Lebanon reduced more than a third of the shortfall between national averages for life expectancy and educational attainment and the highest international levels. After the war, Lebanon's HDI increased by 12% between 1993 and 1996. Growth in per capita GDP has been largely responsible for the improvement in the HDI in the 1990s.

### Economic development

Lebanon's economic recovery has been considerable despite the lack of international assistance. The currency has been stabilized, inflation controlled and international creditworthiness re-established. Basic infrastructure has benefited from extensive rehabilitation and public services have been largely restored. Lebanon achieved impressive GDP growth rates since the end of the war. GDP annual growth rate peaked at 8% in 1994 and averaged 6.5% between 1992 and 1995. As part of the rebound from the war, the construction sector along with banking and finance led the economy during the first half of the nineties. Between 1996 and 1998, GDP growth slowed down to average 3.5% annually. In 1999 it has slowed further to about 1% and is forecast to grow at 1.8% in 2000.

Mounting public debt, incurred to fund the reconstruction, has drained public finances. The ratio of gross public debt to GDP rose from 56% to 102% between 1992 – 97. In 1997, public debt servicing amounted to 88% of public revenues which still constituted only 16.3% of GDP in 1997 even after increasing considerably.

### Social development

Lebanon has achieved significant progress in the social sectors. Despite the disastrous civil war, most social indicators have improved since 1970:

- Ü Life expectancy has increased by nearly six years from 64 to 70 ;
- Ü Infant and under-five mortality rates have fallen by nearly one fourth to respectively 30 and 37 per 1,000 live births;
- Ü Adult literacy is about 84% and has been virtually eliminated among younger age groups;
- Ü The combined school enrolment rate is among the highest in the Arab region;
- Ü Daily per capita supply of calories increased by nearly one third.

### A TALE OF TWO LINKS

Human Development Report 1996, presented two chain reactions in the economic growth–human development cycle (figure 1). One leads from economic growth to human development—growth for people. The other leads from human development to economic growth.

#### Growth for people: from economic growth to human development

The chain towards human development has two main sets of links—the influence of household activity and spending on human development, and the influence of government policies and expenditures.

##### Households

Households contribute to human development by using their income to obtain nutrition, health care, education, to purchase food, vaccines and medicines, schoolbooks and other means for improving their capabilities. In Lebanon, for example, 50% of expenditures on health care are private (around 12% of GDP) and two-thirds of pre-university students are enrolled in private schools. All this increases the significance in Lebanon of expenditures by households and civil society in contributing to building

capabilities through health and education – two cornerstones of human development. Noteworthy, the largest increase in mean years of schooling in the world in the post-World War II era took place in the Republic of Korea which, like Lebanon, largely relied on private rather than public spending to fund education.

The effect of family income on human development depends not only on the size of the income but also on how it is spent. Conspicuous consumption often diverts scarce income from its optimal use for human development. Studies show that income is more likely to be spent on human development when women control the cash. The fact that salaries of males are between 27% and 50% higher than salaries of females in Lebanon does not contribute to improving women's autonomy that has also been shown to have positive effects on their children.

### **Government**

By contributing to economic growth, government action can add to the material resources for human development. But whether the additional resources are actually used to enhance human development depends largely on the pattern of growth and on the distribution of private and public resources that it produces. These factors are interdependent and are affected by government actions.

Job creation is critical if income growth is to effectively improve peoples' lives. Public policy promoting labour intensive growth is needed. Otherwise, income growth does not automatically contribute to employment opportunities. An analysis of the experience of about one hundred countries during the eighties showed that in only about a third was growth associated with an expansion in employment opportunities (measured as the difference between the growth rate of employment minus the growth rate of the labour force). In about a fifth of the cases employment opportunities contracted despite growing income.

Policies can encourage patterns of growth that create jobs, increase real wages and raise market demand for human capital—and thus for the health care and education that enhance this capital. So, by contributing to growth and influencing its patterns, govern-

ments influence both the supply of and the demand for human capital.

Human development has great intrinsic value and thus in itself warrants supportive government action. But there are also strong economic arguments for such action. Government intervention may be needed, for example, to rectify market failures that tend to inhibit investments in human development. High incidence of unemployment among university graduates in Lebanon is a case in point. International experience shows that effective correction should not be through guaranteeing government jobs for graduates as other countries in the region have tried and failed. Instead correction should be through adapting the education system to the demands of the labour market.

Because of the intrinsic value and positive spillover effects of investments in human development, governments, acting on society's behalf, should make more investments in human development than individuals or households acting alone. Government can greatly influence the state of human development by channelling a high proportion of public spending into priority social spending – particularly through universal provision of basic social services.

Much of this is happening in Lebanon, though there is potential for improvement. Allocations to the Ministry of Health from the national budget ranged between 5.3% in 1992; 2.3% in 1996 and 3% in 1999. In 1996, the Ministry of Health spent 13% of its budget to basic health services – double the proportion in 1992. Allocations channelled through the Ministry of Health, Ministry of Social Affairs and other government bodies to basic health services between 1992 – 99 ranged from 1.33% in 1994 to 0.8% of the overall national budget in 1999. Public spending on education accounts for 4% of GNP and 23% of the national budget. This complements the bulk of spending on education in Lebanon that is private.

### **A stifled link from growth to human development?**

The link from growth to human development relies on the distribution of private and public resources. These resources include the distribution of private income and capital (human, social and physical cap-

ital). They also include the allocation of public expenditures and the accessibility of public assets to different income groups. Maldistribution or misallocation of these private and public resources weakens the effect of growth on human development. For example, if income distribution is skewed, many households will not have enough money for food, education and health care, again slowing human development. Brazil, Egypt and Pakistan are examples of countries that have experienced weak links from growth to human development —fairly good growth but slow human development during the past four decades.

Since 1990, growth in Lebanon has not been adequately translated into the betterment of people's lives. Progress in the social sectors, though significant, did not match the acceleration of economic growth during much of the 1990s. Social development advanced at a slower pace than economic progress. For example, between 1994 and 1996, the HDI's increased by only 8.3% while real per capita GDP increased by 11%. About 35% of the Lebanese have inadequate access to basic needs. Wide disparities in social and economic development persist among regions and groups.

Lebanon has also witnessed growth with inadequate job creation. Between 1996-97, unemployment increased from 7% to 8.3% despite an annual real GDP growth rate of 4%. Applying a different and broader definition of unemployment produces an estimate of 13.4% in 1997.

Unemployment is one of the greatest challenges facing Lebanon. To reduce unemployment and absorb the 40,000 new entrants into the labour force every year, growth has to increase from the current levels. Yet it will not help human development, if investment creates growth that is jobless. The path to job-full growth in Lebanon passes through small and micro-enterprise. They are the most critical creators of employment. Yet credit remains overly concentrated on larger enterprise. In 1993, for example, a very small fraction of borrowers (0.2%) received in 1993 about 21.4% of loans while 77% received only 6.5%. Retail financing through banks or companies, operating in a competitive environment, is the most likely to be effective, as shown by recent develop-

ments. In May 1997, the Government initiated a support programme for small and medium industrial, agricultural and tourism enterprises through granting a interest subsidy on loans. A few donors have made available resources for small-scale loans in cooperation with commercial banks.

Medium-to-small-to-mini firms have been a cornerstone for export-oriented development in East Asia. Experience there highlights their potential for helping to bridge Lebanon's trade deficit. Yet they remain largely invisible to macro-economic planners and financiers. Their potential for creating jobs and growth is stifled by red tape. Their access to credit is severely constrained. Misconceptions that supporting micro-enterprises require subsidised credit reduces the reach and scale of support programmes because it makes them more expensive. While subsidizing credit limits its coverage and makes it attractive for political manipulation, it ignores the fact that high interest rates are not the constraint binding micro-entrepreneurs from accessing credit. What hinders the access of mini-firms to credit is their lack of acceptable collateral and inability to provide bank requirements such as feasibility studies and business plans. The efforts of national authorities to establish a national guarantor of small and medium loans should help in this regard.

The lags in social development could be attributed to inadequate resources being allocated to the social sectors as well as inefficiencies in converting resources into human development. More importantly the pattern of growth and reconstruction has to address human development priorities. The reconstruction effort largely focussed on infrastructure investments for the rehabilitation and development of electricity, telecommunications, vital public facilities such as the water supply, waste water, hospitals, schools, roads, the airport and port. The National Emergency Recovery Programme, covering the period 1993 – 95, dealt exclusively with the rehabilitation of the physical infrastructure of public services. The plan Horizon 2000 for Reconstruction and Development (1993 – 2002) had a similar focus though it took into consideration the regional distribution of public investment. Neither plan was officially approved, though sector programmes and pro-

jects were approved by parliament.

A social vision has been lacking. Hopefully, the forthcoming five-year development scheme will provide this much needed vision for balanced socio-economic development.

It is important to note, however, that the lack of a comprehensive nationally-endorsed social vision did not prevent achievements in many areas of human development and many social sectors, including but not limited to:

- Ü an ambitious programme targeting deprived regions in Baalbeck and Hermel;
- Ü a major health sector rehabilitation programme;
- Ü the approval of free and compulsory primary education;
- Ü reestablishment of development services centers;
- Ü a number of socio-economic surveys; and
- Ü a gradual shift of focus of the Council for Reconstruction and Development from reconstruction to development.

### From human development to growth

The many ways in which human development contributes to economic growth have been documented. In recent years more studies have emphasised the strength and diversity of the links between the two. Recent economic analysis has incorporated many of these links into new theories of growth.

A basic fact: Healthy, well-educated people make an economy more productive. But this does not mean that the only purpose of investments in health and education is to improve productivity—or that one should not make investments that do not improve productivity. No one would seriously suggest abandoning investments in health and education even if economic analysis found that such investments had low economic returns. The development of human capabilities is an end in itself.

Most investments in human development have a positive impact on the economy. Productivity can be increased by improving the capacity and organization of workers and management, enabling the use of higher levels of technology, attracting foreign investment and technology and strengthening insti-

tutions both private and public, including the government and the legal and financial systems.

Human development alone cannot transform an economy. Even skilled and vigorous people need machinery, buildings and infrastructure. Yet here too human development has a bearing, since the quality of investment decisions and policy-making is influenced by the capacity of managers and policy-makers.

Some of the clearest economic benefits of human development arise from making workers, especially poorer workers, more productive by improving their nutrition, health and education.

Ü Nutrition—Studies indicate that an increased calorie intake can lead to gains in labour productivity of up to 47%. Investing in child nutrition results in stronger adult workers. Examples, from middle-income countries like Lebanon are many. In Chile providing children with nutritional supplements generated productivity benefits six to eight times the cost of the original intervention. In Cali, Colombia, a health and nutrition programme for children increased their lifetime earnings considerably—by up to nine times the yearly wage of an illiterate worker.

Ü Health—The overall contribution of a healthy population to economic growth is evident from a cross-country study showing that a 10% increase in life expectancy, equal to 5.7 years in 1970, raises the growth rate by an estimated one percentage point a year.

Ü Education—The positive effects of schooling show up in many empirical studies. Research suggests that increasing the labour force's average education by one year raises GDP by 9%. But this holds only for the first three years of extra education. After that, the returns to each additional year diminish to around 4% of GDP. This spotlights a major opportunity. Even countries with initial schooling level that are moderate to high by international standards like Lebanon, can still make substantial gains.

In rural areas the benefits can often be seen in agricultural output. In Ghana, Malaysia and Peru one extra year of schooling for a farmer is associated, on average, with an increase in output of 2–5%.

The high economic rates of return to schooling do not decline rapidly with the level of development.

Also clear is that the kinds of education investment that bring the highest returns tend to enhance equality. The returns appear to be highest for basic schooling (primary, and later secondary), for which further expansion will mainly involve enrolling more children from poor families. It has been estimated that a one percentage point increase in the share of the labour force with secondary education is associated with increases of 6–15 percentage points in the share of income received by the poorest 40%. And the total returns are higher for women than for men, another consideration for equity.

### **A strong link from human development to growth?**

In the chain from human development to economic growth the weak links could arise from government mismanagement, such as policies that introduce factor market distortions discouraging employment-generating production and exports—or savings or investment. Another possible weak link is a lack of science and technology geared to the needs of the economy. Costa Rica, Jamaica and Sri Lanka are examples of countries with exceptionally good human development but only moderate growth—again, lopsided development.

Lebanon has traditionally relied on a well-educated and qualified labour force for comparative advantage. Adult literacy rates are the highest in the Arab region after Jordan's and school enrolments are among the highest. There is great potential to further capitalise on these advantages.

Broad-based, high quality education is critical if Lebanon is to maximise the benefits from globalization in the information age. A well-educated labour force is probably the single most important factor in the quest to reap the benefits from international trade and capital.

Globalization adds extra urgency to investing in people. The diffusion of new technology increases the payoff to higher levels of human capital and to more flexible sets of skills. Those without the necessary education will be left behind.

With opening up, the 600,000 new entrants into the Lebanese workforce from now till 2015 will have

to compete with the more than half a billion entrants into the world's labour force. Most of the latter will be earning wages well below the average in Lebanon. Nearly all of them will have attended primary school and more than 150 million of them will have completed secondary school.

### **CONCLUDING REMARKS**

Probably the most important factor determining the outcomes of Lebanon's development efforts is clarity about their objectives. Nietzsche said that the most common human error is not being clear about what the objective of human action is. Consider globalisation. What are Lebanon's objectives from integration into the global market? Is it to increase national foreign currency reserves? To strengthen the national currency? To accelerate growth? Or to enhance human development so as to ensure people's capabilities and well being.

From a human development perspective the objective is clear. Integration in the international economy should aim at achieving human development - at expanding the choices available to the Lebanese to live a long and healthy life, to be educated and knowledgeable and to enjoy a decent standard of living. A selective and gradual approach serves this objective. Such a selective approach would follow the example of most East Asian economies. In the context of globalisation it may include some time-bound, performance-related protection for potentially viable industries, some industrial intervention and some management of foreign direct investment. This should help increase and diversify exports, which is necessary to reverse past trends and meet future import requirements.

The interdependence between social development and economic growth is amplified in the context of globalization. Growth needs to support social development, especially as deficit financing for long periods becomes less of an option. On the other hand, growth requires social development to increase people's productivity so as to capitalize on accelerated technological advancement and be able to address the increase in world competition.

The strong link between social development and growth is nothing new. Emphasizing that both are mutually reinforcing is particularly needed for Lebanon today. An analysis from Global HDR 1996 underscores the urgency of matching growth with social development and the dangers of lagging progress in health and education. HDR 1996 analyzed the growth and social development records of 117 countries over the period 1960-92. Decade by decade, it compared growth in per capita income with progress in education and health as measured by the HDI without the income component. In each decade, each country fell in one of the following four categories: (i). it either enjoyed both rapid growth and rapid social development (a virtuous cycle); (ii). suffered slow growth and slow social development (a vicious cycle); or (iii). experienced lop-sided development with fast growth and slow social development; or (iv). slow growth and fast social development. The analysis reviewed the record of sequencing growth and social development.

Extensive research for the HDR 1996, involving Professor Amartya Sen, Economics Noble Prize Laureate for 1998, produced an astounding finding. Not a single country was able to sustain the virtuous cycle of rapid growth and rapid social development without either first accelerating social development or at least advancing social development simultaneously with growth. Not one country was able to reach this virtuous cycle by accelerating growth first then following that with advances in social development. By contrast countries that were able to combine for several decades' rapid growth and rapid social progress, did so by accelerating improvements in education and life expectancy first. In the 1960s and 1970's, China and Indonesia, for example, enjoyed rapid increases in educational attainment and life expectancy. As human capital accumulated, economic growth accelerated and they moved to a virtuous cycle in the 1970s and towards even faster growth accompanied by rapid social development in the period 1980 - 92. The path to sustained growth is a function of social development.

Countries differ in how well they translate income into human development—their “human development efficiency.” At each general level of income are

countries that convert income into capabilities more effectively than others (figure 2). With GDP per capita for Guinea, Senegal and Sri Lanka around \$600, their human development levels, as measured by the Human Development Index without the income component (HDI\*), nevertheless differ markedly. Sri Lanka's levels are more than three times that of Guinea and Senegal. Countries that constitute the “human development frontier” of efficiency, include Canada, China, Costa Rica and Sri Lanka. These countries, together with others that lie very close to the frontier, such as Chile and Jamaica, have the highest efficiency.

There is potential for Lebanon to move closer to this group by accelerating growth and translating it more efficiently into greater choices and opportunities for the Lebanese. The efficiency of translating growth into human development has varied among countries. Between 1960 and 1992, both Indonesia and Pakistan enjoyed a 3% annual growth in real GDP per capita. However, Indonesia was more successful in translating this growth into much greater capabilities and well-being for its people. It achieved double the human development improvements of Pakistan. The efficiency of transforming income into human development shows that similar levels of human development can be achieved with markedly different levels of income. But human development's main concern is with the range of human capabilities available to an individual, and income is relevant only in helping to enhance those capabilities.

To accelerate growth and maximize its benefits to the people of Lebanon, a political commitment to advancing human development is needed. This commitment should be clear about the objectives of national development. Analysis of socio-economic conditions, challenges and prospects is required to induce, empower and effect the needed political commitment and mobilize the necessary resources.

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Prepared by Moez Doraïd, Sub-regional Resource Facility for Arab States, United Nations Development Programme, Beirut, 6 January 1999. This Note relies extensively on UNDP's Human Development Report 1996.

The views expressed in this note are those of the author and do not necessarily reflect the views of the United Nations Development Program.

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