The World Bank's Lebanon Economic Monitor – Spring 2016

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PART I: MACROECONOMIC OVERVIEW

The year 2015 held some glimmers of positivity for Lebanon with better security conditions, resurgence in the tourism sector, robust lending to the private sector and a decline in international oil prices which played out in favor of lower transfers to EDL. According to the Ministry of Finance, transfers to EDL reached $1.13B by the end of 2015, substantially lower than the $2.04B transferred over the same period in 2014.

The few positive circumstances witnessed in Lebanon during 2015 were not enough to overhaul the elements that weighed the economy down in turn compelling the World Bank to revise its 2015 real GDP growth for Lebanon from 2% to 1.5%. The presidential seat has been vacant for a second year now with no near-resolution in sight, only a short-term solution has been found for the garbage crisis and the real estate sector was down as shown by the 9.4% decline in registration fees and the 8.6% decline in cement deliveries. The lower transfers to EDL were not translated into a smaller fiscal deficit since they were more than offset by lower revenues. To start with the higher revenues seen in 2014 were not the result of a better economic activity but rather the result of exceptional one-off telecom transfers. After falling by 27% annually in 2014, Lebanon's fiscal deficit widened by 28.62% year-on-year (y-o-y) to $3.95B by the end of 2015. Moreover, despite a better security situation in 2015, Lebanon's security condition continues to be perceived as precarious as long as spillover risks from the turbulent region persist.

While political deadlocks are not new to the Lebanese economy, weaker growth in GCC countries due to the falling oil prices poses a new challenge. The remittances received primarily from the Gulf countries are sizeable, but now that these countries can no longer afford to sustain lavish public spending, services exports to the GCC such as consulting services are likely to drop in turn lowering remittances sent to Lebanon. The impacts of lower remittances will affect two key macroeconomic variables such as private consumption and the balance of payments. The balance of payments is already portraying a widening deficit due to lower Foreign Direct Investments (FDI), so lower remittances will only aggravate the deficit of the balance of payments.

PART II: MACROECONOMIC IMPACT OF LOWER REMITTANCES

Given the possibility of GCC countries terminating the contracts of a large number of Lebanese expatriates (which is the termination scenario), quantifying the impact of lower remittances gains traction. In its latest Lebanon Economic Monitor, A Geo-Economy of Risks and Reward, the World Bank attempted to quantify the macroeconomic impact of lower remittances.

Macroeconomic Impact of a 20% Fall in Remittances

Macroeconomic Indicator	Termination Scenario: Induced Change		
	2016	**2017**	**2018**
Real GDP growth (pp)	**-2.1**	**-0.7**	**-0.3**
Overall fiscal balance (pp of GDP)	-0.3	-0.5	-0.3
Primary fiscal balance (pp of GDP)	-0.4	-0.5	-0.5
Current account balance (pp of GDP)	-1	-0.8	-0.5
Remittances (pp of GDP)	-0.5	-0.6	-0.6
Gross reserves (months of imports)	-0.7	-0.8	-0.8
Debt-to-GDP ratio (pp)	6.7	9	7.2

The World Bank cites two channels through which the impact of lower remittances, estimated to drop by 20% in this analysis, will be felt:

- A Higher Balance of Payments' Deficit
- Lower private consumption

Lower remittances will widen the already large deficit in the balance of payments. First, the current account balance in Lebanon is in deficit and second the inflows of foreign capital in the country are declining since the preferred investment destinations were the sectors of construction and real estate, which have seen a decline since 2011. With lower remittances, the deficit in the current account balance is estimated to widen by 1 percentage point (p.p) of GDP in the year 2016, by 0.8 p.p in 2017 and by 0.5 p.p in 2018.

The second channel through which lower remittances will have macroeconomic implications is private consumption. In fact, most of the Lebanese expatriates' remittances are destined for household spending back at home. Many Lebanese families depend on these remittances for their livelihood. The World Bank concludes that a drop of 20% in remittances inflows will translate into a decline in private consumption growth equivalent to 2.4 p.p of GDP. Since private consumption is assumed to account for 85% of 2015's GDP, the 20% decline in remittances will translate into a 2.04 pp drop in the projected GDP growth.

However, the World Bank report did not take into consideration that the impact of the termination scenario on remittances might be the most pronounced in the later stages rather than the first period. A Lebanese expatriate working in the gulf countries will most likely liquidate any assets he owns and will come back to Lebanon once his contract is terminated. So, in the first period, when the Lebanese expatriate is on the hunt for a new job, he can still draw into his savings to support the household. It's only in the later stage that the Lebanese expatriate will not be able to provide his household with the same inflow of cash especially that if he is to find another job in Lebanon, the salary received is most likely going to be lower than that offered in the GCC countries.

PART III: GROWTH OPPORTUNITIES

The lack of job opportunities for skilled Lebanese is the first motive for seeking new growth opportunities. According to the World Bank, "employment growth has been concentrated in low productivity activities as higher productivity have not grown proportionally". A 2015 International Labor Organization (ILO) report quoted by the World Bank signals that over the past ten years, 47.3% of new employment stemmed from trade, 34.7% stemmed from public and private services while only 10% stemmed from construction. However, job growth in activities such as communications, financial services, agriculture and manufacturing was negligible. Given that foreign workers dominate the low-skilled segment of the labor market, the World Bank concludes that even high GDP growth rates in Lebanon did not translate into a significant job creation for the Lebanese.

From this standpoint and with unemployment already at 9% even before the tumult in the region and the spillovers began, it is imperative for policy makers to focus on the development of the industrial sector. According to the World Bank, focusing on the industrial sector is an interesting opportunity, since the low-starting level can reap significant returns. The Lebanese industrial sector's value added in GDP averaged 17.4% between 2000 and 2015 compared to 68.3% for services and 4.9% for the agriculture sector. The industrial sector's value added over this same period also pales in comparison with the 26.6% registered by Jordan.

Another argument in favor of the development of the industrial sector is that it would reduce the dependency of the Lebanese economy on capital inflows to finance its imbalances. Lebanon suffers from chronic twin-deficits (current account balance and fiscal deficit) and has so far relied on capital inflows to finance these vulnerabilities. However, as the saying goes "Capital goes where it's welcome and stays where it's well treated". Unfortunately, the real estate, tourism and construction sectors that were welcoming and attracting capital inflows witnessed sizeable declines in activity. It is then evident that Lebanon needs to develop other areas of its economy, especially since diversification will allow the country to better hedge against potential shocks and risks.

In regards to how the industrial sector can be developed, the World Bank points to spatial industrial policies. Concretely, these policies would aim at creating industrial parks and Special Economic Zones (SEZ) which would pave the way for higher investments and increased competitiveness. The creation of industrial parks and SEZs would particularly lure foreign companies into introducing their new technologies in the domestic economy which will generate higher productivity. Currently, the medium-to-high technology in manufacturing in Lebanon, regarded as an indicator of productivity by the World Bank, is around half the OECD average and ranks around halfway in the region.

Lebanon is endowed with a program for industrial zones but their benefits are impeded by political instability, corruption, and poor electricity service. 60% of enterprises identified political instability as the most pertinent obstacle and corruption as a major obstacle. Particularly for firms in the manufacturing sector, access to electricity was pin-pointed as a major obstacle by 70% of firms and as the top obstacle by more than 16%. According to the World Bank's survey figures, manufacturing enterprises in Lebanon face around 300 hours of electricity outages per month – more than 10 hours per day - and that costs them 8% of their annual sales.

TABLE 3. Assessment of electricity constraints identified in Enterprise Surveys (2013).

	Avg hours of electricity outages per month	Losses from electricity outages (% of annual sales)	Days to obtain electricity connection	Electricity identified as a major constraint
All countries	16.6	2.6	32.0	32.0
Middle East & North Africa	114.4	4.7	41.1	40.5
Lebanon - all enterprises	262.6	5.7	56.0	55.1
Lebanon - manufacturing	331.5	8.1	84.7	69.8
Lebanon - food & manufacturing	323.4	6.6	129.9	77.6

Source: World Bank Enterprise Surveys (2013)

Land has also been identified as a major hurdle for manufacturing establishments. Empty lands for industrial operations with an appropriate location are scarce. The plots of land that are available are expensive and most investors are inclined to utilize these lands for real estate activities rather than manufacturing activities.

When embarking on the development of industrial parks and SEZ, Lebanon must keep in mind two important caveats. The first is that the establishment of industrial parks and SEZs will require an efficient coordination amongst ministries but should also explore the possibility of partnering with the private sector. The second is that policy makers should prioritize when it comes to the existing industrial zones in Lebanon and select the zones with the most viability and with the highest future potential.

The second area of opportunity for the creation of skilled job opportunities is the development of the tech startup ecosystem. The Central Bank of Lebanon has already embarked on this by allowing banks to participate in the equity capital of enterprises in the knowledge economy. Supporting actions should however complement this initiative. According to the World Bank, the internet infrastructure must be improved with enhancement of broadband quality and prices, spaces must be developed for startups to scale up and grow, homegrown mentorship and angel investment (i.e. from local successful startups) should be developed but also linkages to international talents and networks should be nurtured.

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