Productivity setbacks impede Lebanon industry

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It goes without saying that the industrial sector in Lebanon remains in a challenging situation. Against all odds, industrial production in Lebanon grew at a CAGR of 10.6% between 2010 and 2013. This means that Lebanese industrialists are still surviving the repercussions of the local and regional instabilities hitting the country for more than 5 years now.

According to 2015's national accounts, the industrial sector's contribution to the country's Gross Domestic Product (GDP) reached only 8%. However, the Ministry of Industry (MoI) estimates the sector's contribution to GDP at 12%. If the ministry's figure is accurate then there is a high chance that one third of industrial activity is derived from some firms under-declaring their profits while the remaining completely derives from the informal economy.

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Lebanon's Industrial Sector in Numbers

The industrial sector in Lebanon comprises a satisfactory number of establishments, mostly small-sized and specialized in light-manufacturing activities. According to the MoI, the latest number of licensed factories in 2017 reached 4,688 as compared to 4,033 in 2007. While most of these establishments are located in Mount Lebanon, nearly 26% operate in the Food and Beverages (F&B) industry. Factories producing construction materials grasped 12% of the total, while each of the Chemical and Furniture and Wood Products industries grasped a similar 8% share of the total number of establishments. It is estimated that the number of employees at almost half of the existing establishments is below 10, while the stake of large-size businesses in Lebanon, employing more than 100 employees, is still below 10%.

It was noticeable that the recent publication of updated industrial indicators by the Association of Lebanese industrialists (ALI) in March 2017 revealed that the number of industrial plants stood at 1,977 in 2015, down from 2,365 in 2011. Possible explanations for this discrepancy with the MoI's data are that ALI's figure excludes small businesses engaged in the craft trade and only includes 13 sub-sectors out of a wider variety of industrial branches that stand at 26, according to the MoI records. Another point that should be underlined is the reliance of ALI's publication on the Ministry of Finance's data that could be partly inaccurate as several factories tend to provide falsified statements on their financial statement to either evade taxation or reduce their tax payments.

Industrial Performance Is Limping…

Domestically, activity seems to be dwindling amid the prevailing security and political environment. In fact, a difficult operating environment was reflected in the performance of Lebanon BLOM Purchasing Managers' Index (PMI) that remained, since its inception in May 2013, below the 50 neutral-mark signaling a continuing economic contraction at the Lebanese private sector companies. Also, Kafalat guarantees for the industrial sector, a proxy of the private sector's appetite to establish new Small and Medium Enterprises (SME), revealed a slowdown in activity since 2011 in line with the decreasing number of guarantees in all sectors. In absolute terms, the number of industrial guarantees shed from 486 in 2011 to 220 in 2016. In addition, data published by the Association of Lebanese Industrialists (ALI) showed that total sales at industrial firms shrank from 2012's high of $10.5B to $8.8B in 2015, recording their lowest level in five years. Sales to the local market grasped 83% of total sales in 2015, while exports took the remaining share of 17%.

As for exports, a gradual decline was depicted in the past five years amid a challenging local and external situation. Specifically, the downward trend began in 2012 when the value of industrial exports reached an all-time high of $3.57B. In 2016, industrial exports reached $2.53B, their lowest level since 2007. The main exported products in 2016 were Machinery and Mechanical Appliances (23% of the total), followed by Prepared Foodstuffs (18% of the total) and Products of the Chemical Industries (17% of the total). In December 2016 alone, the primary export markets for the Lebanese industrial products were Saudi Arabia, Syria, and the United Arab Emirates, with respective shares of 11.4%, 11.2% and 9.3% of total exports.

In line with total imports hitting a substantial $18.71B in 2016, industrial imports also reached alarming levels. According to the MoI, some industrial products are flooding the Lebanese market such as articles of clothing (3% of total imports) in addition to dairy (1.5% of the total) and plastic products (1.6% of the total). In specific, the value of imported machinery and industrial equipment reached $235.5M in 2016, decreasing by 18% from 2012’s level.

…Undermined by Several Obstacles

The lack of confidence among the Lebanese in some of the local industrial production is paralyzing the development and competitiveness of some sub-sectors in the industrial domain. In reality, the quality of some national industrial supplies severely deteriorated in quality during the Civil War and afterwards due to an absence of a quality control body. Lebanese consumers started perceiving such products as inferior in quality to those made in more reputable countries.

Still, several local sub-industries such as the F&B, alcoholic drinks, jewelry and luxurious clothing industries succeeded in gaining local confidence and hereafter strongly positioning their products in foreign markets. This was reflected by the progress in the overall attitude of Lebanese consumers regarding these products as revealed by the improvement of local reliance on national goods. In fact, the value of local products’ consumption out of total local demand for industrial goods rose from 3.5% in 2010 to 8.6% in 2013. In other terms, local demand for Lebanese goods grew at a CAGR of 45% between 2010 and 2013.

Given political neglect and unappealing marketing, changing public opinion and raising awareness remain hard. On one side, the industrialists bear part of the responsibility due to their poor marketing strategies. And on the other side, with Lebanon having a service-oriented economy, the industrial sector is not prioritized or supported by the government. This is holding back industrial factories from operating at their full capacity as they are bearing all the burdens of poor infrastructure, lack of complementary services and the elevated costs of energy, and real estate properties. In this context, Dr Fady Gemayel, President of the Association of Lebanese Industrialists (ALI) called for the support of the existing energy-intensive factories that only constitute 5.7% of the sector but employ near 7,000 workers and are feeders of other industries. “These environmentally friendly establishments mostly working in paper recycling, ceramic and plastic industries should have the support of the government at the level of their energy costs as the latter are eating up near 35% of their sales volume”.

Another critical issue is related to the nature of industrial establishments in Lebanon as most of the existing companies are family businesses. As Lebanon is a small market for goods, industrial companies will have to increase their production and export their goods in order to realize economies of scale and reduce their costs. Hence companies will have to bring in new investors to increase their size and to open up to new markets; and this creates a major hindrance for the development of the sector as family firms are usually reluctant in raising funds externally in fear of losing control of their business.

The eruption of the Syrian war is also a major factor hindering the sector’s performance, to a certain extent. On one side, the Syrian conflict heavily affected demand from Syrian importers of Lebanese industrial production. In addition, export activity through Syria to Arab countries has been severely hit, which in turn prolonged delivery times and increased transportation costs to Lebanese industrialists in exporting their products. According to the MoI data, the value of industrial exports to the Arab world through Syrian land fell from $716M (or 17.4% of total industrial exports) in 2012 to $450,000 (or 0.02% of the total) in 2016. However, according to Mr. Dany Gedeon, Director General of the MoI, “the loss incurred in land trade through Syria was offset by an increase in local demand thanks to the Syrian refugees.” In addition, Dr Fady Gemayel, President of ALI, stated that “the positive point deriving from the war in Syria is the reduction of Syrian dumping practices. Besides that, Syrian companies are opening illegally in Lebanon and competing with local producers mainly in the food and packaging sectors."

This highlights another issue related to Syrian aid programs as international organizations are usually more inclined towards foreign firms in their procurement tenders. Given the cost of the Syrian war on Lebanon, prioritizing local suppliers during procurement processes is the least that can be done, which could easily increase industrial sales by $400M-$500M.

Another main issue is the fierce and unfair foreign competition facing both local and export markets. In fact, several trading partners like Turkey, China and several Arab countries subsidize the cost of production. This has resulted in relatively cheaper goods flooding the Lebanese market. On a related note, some trade agreements have allowed Lebanese products to get access to new markets and increased foreign demand for unique high-end Lebanese supplies, however several concerns emerged as to the level of competitiveness of the Lebanese economy. For instance, the trade agreement with the European Union (EU) in 2003 helped the total value of exports to double by 2015 to $344M and open up to a market of 500M consumers; however the volume of European imports surged from $3.28B in 2003 to $7.59B in 2015. In addition, Mr. Gedeon revealed that the principal of reciprocity is not applied in some commercial agreements with other countries, which is drowning the market with foreign goods. "For instance, imported pharmaceutical drugs from Arab countries are easily registered in Lebanon. However, the Lebanese pharmaceutical factories are facing problems registering their products in many Arab countries despite the GAFTA agreement," added Mr. Gedeon.

A Strong Support System Should Be Put In Place

Improving the quality of Lebanese products will definitely have a positive impact on both the goods market, local and export, and the labor market. Insuring that the products are of high quality is essential to improve local and foreign confidence. Hence having local production compliant with international standards is an important step towards improving the competitiveness and the attractiveness of Lebanese products. This should be coupled with aggressive marketing campaigns that highlight the uniqueness of the national products.

As a result, a better quality of exports will enhance local production and will have a direct impact on the employment level in Lebanon. In fact, and thanks to the industrial sector's multiplier effect, every additional job in the manufacturing sector creates 2.2 jobs in other sectors, according to the United Nations Industrial Development Organization (UNIDO). Hence, "if we manage to increase industrial production by $1B, we can easily create 20,000 new jobs in the industrial sector and consequently 44,000 new jobs in different economic sectors." stated Dr. Gemayel.

In fairness, some efforts exist and could pave the way for future progress. For instance, the MoI should finalize by September 2017 a $100M project to create 3 industrial zones in Baalbeck, Tirbel – Bekaa, and Jleiliyeh – Chouf. The project was financed by the Italian government, the European Investment Bank, and the World Bank. Another project targeting 5 rural locations in Lebanon to build industrial zones has debuted in cooperation with the Unions of Municipalities. As most of land is owned by municipalities, industrialists will benefit from long term leases at low costs. Such projects could improve the competitiveness and productivity of the Lebanese industrial sector and attract Foreign Direct Investments (FDI). In the same context, the establishment of Tripoli's Special Economic Zone, which kicked off in 2009 and expected to be finalized by 2020, aims to support the city's economy and private businesses across all sectors relating in Tripoli and North Lebanon. Investments in this special zone will be related to trade, industry, services, excluding tourist activities, and will be exempted from customs duties, consumption taxes, import and export duties in addition to income taxes on the business profits.

Furthermore, the MoI launched its integrated vision for the year 2025 to develop and modernize the industrial sector in Lebanon. The vision includes several operational and strategic objectives, of which reaching an 18% contribution of the industrial sector to the country's GDP by increasing production and reducing imports in addition to boosting the country's industrial exports and the sector's competitiveness.

Another initiative was recently made by the Central Bank of Lebanon (BDL) to support the sector. According to the Intermediate Circular # 462, Lebanese banks can benefit now from a 100% reduction in reserve requirements against LBP denominated loans offered to finance the working capital of licensed industrial companies that export their output.

In short, the Lebanese industrial sector in Lebanon could become the country's saving grace if adequately empowered. The sector's resilience to local and external shocks should be strengthened and the country's open market should not become a threat to the Lebanese products.

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