COUNTRY ASSISTANCE STRATEGY FOR LEBANON

This second Country Assistance Strategy (CAS) represents the continued partnership between the World Bank Group (WBG) and Lebanon on development cooperation which was resumed after the cessation of fifteen years of civil war and a major invasion of the country.

Such cooperation began on the heels of devastation and the havoc of a long conflict which left massive destruction of physical and social infrastructure and resulted in over 150,000 casualties. A large number of people were displaced and impoverished, and institutions were severely weakened and in disrepair. The loss of professionals and entrepreneurs through migration abroad drained one of the country’s most valuable assets.

When the Government, led by H.E. Prime Minister Rafic Hariri, took office in late 1992, it faced colossal challenges of providing for security and social peace, addressing problems of a disarrayed economy, and initiating the process of reconstruction. These challenges required courageous action and the marshaling of massive resources, both domestic and external. The damage to infrastructure alone was estimated at $25 billion.

Though the World Bank recognized such needs, the initial response was rather slow. But after the interventions of the late President of the Bank, Mr. Preston, and of Mr. Caio Koch-Weser, the Bank began to respond with a great deal of understanding and a sense of urgency. Arab development institutions and governments in the region and elsewhere also responded quickly by providing some concessional assistance. Notwithstanding the importance of these contributions, Lebanon’s needs for concessional finance remain pressing in view of the sizable investments required to restore infrastructure and to prevent a further buildup of debt financing.

On this occasion of formulating a second CAS for Lebanon, I wish to express, on behalf of my authorities, our appreciation to the Board, Management, and Lebanon Country Teams in the Bank Group for the continued efforts to support the on-going and future development operations in Lebanon. We are most grateful to our President, Mr. Wolfensohn, for taking the time during his visit last June to see first-hand the progress that is being made by the Government in partnership with the private sector in restoring and re-vitalizing the economy.
Lebanon has achieved considerable progress in its reconstruction and development efforts. To date these include:

- Substantial progress in the rehabilitation of basic infrastructure and services.
- Initial economic recovery conducive to GDP growth and macroeconomic stability.
- Reduction of inflation from over 100 percent to single digit level (8.9% in 1996).
- Building up liquid reserves (gold and foreign exchange) equivalent of 10 months of GNFS imports.
- Rehabilitating institutions and reforming public administration, and preparing infrastructure in key sectors for commercialization and corporatization.
- Rehabilitating institutions and facilities in the social sector, focusing primarily on the displaced population.
- Achieving high liquidity in the banking sector. Capital has increased from US$143 million in 1992 to US$1,547 million in September 1997, representing substantial investment in an industry that is at the core of Lebanon’s prospective role as the region’s financial center. It is expected that capital invested will reach about US$1,800 by year end. Return on equity has been more than 28% over the past four years, and return on assets increased from 0.9% in 1993 to 1.3% in 1996.

Despite these achievements in a very short period of time, the Lebanese authorities are well aware of the difficulties and challenges that lie ahead. Numerous issues are yet to be addressed to ensure full recovery and place the economy on a sound and sustainable growth path. Government’s future agenda includes addressing the following major issues:

**The Fiscal Stance**

The Government has always acknowledged that the main challenge to its economic program lies in the area of fiscal policy. Having embarked on an ambitious post-war economic revival program and with inadequate international aid, the Government naturally ran budget deficits financed mainly through domestic borrowing. Furthermore, the years of turmoil significantly reduced the State’s ability to collect revenues and by 1992 the Revenue Department at the Ministry of Finance was severely handicapped. Indeed, the weak revenue base, coupled with sharp increases in both capital and current expenditures, resulted in fiscal deficits and debt accumulation.

While it is true that most of Lebanon’s public debt is domestic (84%), increased credibility has allowed the Government since end 1996 to increase the maturity structure of its debt: by end October 1997, 24-month TBs constitute more than 55% of total debt and 12-month TBs were about 19%, while short-term 3 and 6-month TBs constitute only 8% of total public debt (including external public debt). Extending maturity of debt is a sign of confidence and will allow Government to reduce debt service through lower interest rates. Lebanon’s first US$400 million Eurobond issue has been fully repaid on maturity proving once more Lebanon’s creditworthiness, and another US$400 million 10 years Eurobond has been successfully issued in
difficult international financial circumstances, registering one of the lowest spreads versus US Treasury benchmarks compared to other new issues in the emerging markets.

It is also important to point to the effects of “dollarisation” in Lebanon. It is true that the Government accounts for the major share of banking sector credit in Lebanese Pounds. However, credit to the private sector is largely in foreign currencies (more than 87%). As such, there is very limited or no crowding out of private sector credit and investment, despite the high interest rates on Lebanese Pounds Treasury bills.

In short, the Government is fully aware of the need to improve the fiscal position and is committed to ameliorate the debt dynamics and allow for a soft landing of the economy over the medium term. To this effect, the Government is proposing for 1998 a strict, and more importantly, realistic budget which entails a front loaded fiscal adjustment.

The 1998 Budget Proposal

The expenditure side of the 1998 budget proposal continues to be dominated by non-discretionary spending, mainly interest payments, wages and salaries, and direct and indirect social transfers. Discretionary spending, in line with previous budgets has been kept at a minimum. What distinguishes the 1998 budget proposal, however, is that non-budget treasury expenditures amounting to L.L.550 billion, have been included in the presentation for the first time to ensure that actual expenditures are in line with Budget projections.

Furthermore, the proposed Budget Law includes a provision to cancel all uncommitted carryovers for the year 1995 and prior. To further curb the potential for expenditure overruns, the Government has reaffirmed its determination to forbid any additional expenditure without additional, appropriate and proportional revenue increases.

Most importantly, the 1998 Budget proposal builds on the revenue measures taken in August 1997 which consisted of an increase in taxes on cellular phones, automobiles and tobacco, and introduces measures that broaden the tax base and set the stage for an eventual general sales tax. The measures also build on the progress in strengthening the tax administration through a taxpayer survey and tax identification numbers, the recruitment of additional tax auditors, and the reorganization of the Revenue Department. Together, these measures promise to reduce the budget deficit by about 25%.

The Government is also actively attempting to encourage the private sector to play a larger role in the provision of infrastructure in order to relieve fiscal pressures and enhance efficiency of investments. To this end, the Government has embarked on a series of BOT infrastructure projects such as cellular phones, the free zones, and the parking lot at the Beirut airport, in addition to other projects such as the Beirut Damascus Highway and the Beirut ring roads.

Moreover, the Government intends to prudently restructure its debt stock with a view to increase the maturity structure and diversify the currency composition of its debt.
Investment in Human Resources

The Government is fully aware that human resources constitute one of Lebanon’s most valuable assets and in this regard is seeking the support of the World Bank in the areas of vocational, technical and general education. The Government is also embarking on a systematic training program for civil servants which is essential for improving capabilities and skills in public administration. In view of the immense need for upgrading and improving the capabilities and skills of the civil service, especially in economic management and analysis as well as other related fields, we would like EDI to undertake specific training programs in key sectors on the basis of a medium-term strategy developed in consultation with the Government and private sector.

The achievements to date, as already indicated, are encouraging. They have been made possible by the remarkable resilience of the Lebanese people, the relentless efforts by Government to restore law and order, as well as the support of the WBG and the international donor community.

The CAS for 98-2000

The CAS for 98-2000 outlines the Government agenda and highlights development priorities. My authorities have worked closely with our Bank colleagues in the formulation of the strategy and assistance program and are in full agreement with the proposed WBG lending and non-lending activities. While my authorities are strongly committed to the implementation and success of the strategy, they, however, would like to reiterate and emphasize the following:

• The Government and the WBG have collaborated very closely in the implementation of the first CAS under unsettled regional situation and uncertain prospects for a peace settlement. This situation remains unchanged today, and the prospects of the second CAS could be undermined by unfavorable external factors. In these circumstances, the Government would expect that the WBG will assess performance in light of the underlying conditions and with due consideration of the importance of maintaining its support. This is all the more important in order to maintain the confidence of the private sector and financial markets, and thus to ensure continued private sector investment (domestic and foreign), as well as the flow of private capital from financial markets to support Lebanon’s reconstruction.

• Debt dynamics require a greater role for longer-term capital from official sources, and more involvement by the private sector in funding infrastructure investments. The WBG can play an important catalytic role in assisting Lebanon in its efforts to obtain such resources. In this regard, in addition to significant levels of support from the WBG, concessional resources remain important - at least in the interim period - until infrastructure investments become fully operational and generate revenues.

Finally, we hope that the implementation of this CAS and cooperation with Lebanon in general will continue to be conducted in line with the spirit of the Strategic Compact with emphasis on flexibility, dialogue, understanding and appreciation of the economic situation in
Lebanon, as has been the case over the past five years in implementing the previous CAS. I assure you that my authorities will do everything they can to adhere to this strategy. However, as you well know, to achieve the targets set will require continued support of the World Bank Group to mitigate uncontrollable factors.