Lebanon Economic Monitor

GROWING TENSIONS IN A RESILIENT ECONOMY

SPRING 2013

Poverty Reduction and Economic Management Unit
MIDDLE EAST AND NORTH AFRICA REGION

The World Bank

PREFACE

The *Lebanon Economic Monitor* provides an update on key economic developments and policies over the past six months. It also presents findings from recent World Bank work on Lebanon. It places them in a longer-term and global context, and assesses the implications of these developments and other changes in policy for the outlook for Lebanon. Its coverage ranges from the macro-economy to financial markets to indicators of human welfare and development. It is intended for a wide audience, including policy makers, business leaders, financial market participants, and the community of analysts and professionals engaged in Lebanon.

The *Lebanon Economic Monitor* is a product of the World Bank's Lebanon Poverty Reduction and Economic Management (PREM) team. It was prepared by Eric Le Borgne (Lead Economist), Wael Mansour (Economist) and Samer Matta (Economic Analyst), under the general guidance of Bernard Funck (Sector Manager) and Manuela Ferro (Sector Director). Special Focus contributors include Chadi Bou Habib for the section on the impact of the public sector salary scale increase, Wael Mansour for the section on the impact of the Syrian conflict on Lebanon. May Ibrahim (Senior Executive Assistance) provided Arabic translation and Zeina El Khalil (Communications Associate) print-produced the report.

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LIST OF KEY ABBREVIATIONS USED

bps: Basis points
H1, H2: First half of the year, second half of the year.
3mma: Three-months moving average
pp: Percentage points
Q1 (Q2, Q3, Q4): First (second, third, fourth) quarter of the year
qoq: Quarter-on-quarter
sa: Seasonally adjusted
saar: Seasonally adjusted, annual rate
yoy: Year-on-year
LHS, RHS: Left hand side, right hand side (for axis of figures)

EXECUTIVE SUMMARY

i. The political standoff combined with an escalating Syrian conflict hampered growth in 2012, and is projected to continue doing so through the first half of 2013. Economic growth in 2012 is estimated to have decelerated to 1.4 percent due to a weak second half of 2012 following a downturn in the security situation. From the demand side, a robust increase in government consumption buttressed the growth slowdown in 2012 while private consumption remained weak due to the uncertain security situation. From the supply side, the sharp deceleration in the services sector, notably tourism, drove the growth slowdown. Provided the political and security situations improve in the second half of 2013, growth is projected to reach 2.3 percent in 2013. Risks to growth prospects, however, are significant and tilted to the downside.

ii. The major fiscal expansion that took place in 2012 is creating fiscal challenges for 2013, particularly in the context of a promised increase in public salaries. The fiscal expansion, measured by the change in the central government's primary fiscal balance, reached a staggering 4.6 percentage points of GDP in 2012. The overall fiscal deficit reached 9.4 percent of GDP in 2012. Slightly more than a third of the rising deficits were driven by a sharp drop in revenue, in part due to a new VAT exemption on diesel. The remaining two-thirds were due to a rise in expenditures stemming from wages and salaries (following a large cost-of-living adjustment) and transfers to the electricity company. Slow growth and rising deficits combined to reverse the downward trend in the debt-to-GDP ratio, which reach 134 percent at end-2012. For 2013, under current policy, the fiscal deficit would remain broadly unchanged (as a ratio of GDP).

iii. The balance of payments deficit narrowed in 2012 thanks to improvements in capital inflows. These inflows are primarily short-term capital inflows that are partly driven by the widening domestic-international spreads. Gross foreign exchange reserves remain large, covering 17 months of imports at end-2012. As the economy decelerates, Lebanon's trade deficit in goods continues to shrink though at a slower pace than expected, due to offsetting impacts from the Syrian conflict.

iv. Inflationary pressures rose despite tepid economic activity. Headline inflation accelerated notably in the second half of 2012. Core inflation has also been on an upward trend, reaching 5.3 percent by end-2012. Domestically, inflationary pressures can primarily be attributed to (i) increases in disposable income in early 2012 due to the increase in the minimum wage and public sector salaries' cost of living adjustment; and (ii) a cumulative output gap that remains positive following above-potential growth in 2007-2010. External factors include the Syrian conflict that exerted upward pressure on domestic prices through the consumption of the Syrians in Lebanon and the need to substitute cheap Syrian goods with more expensive non-Syrian import.

v. The conflict in Syria—a country that is closely linked, both through historical, social and economic ties to Lebanon—has created a humanitarian crisis of enormous scale. While Lebanon is to be commended for its openness to Syrian refugees, the conflict is severely and negatively impacting the Lebanese economy. The largest impact arises through the insecurity and uncertainty spillovers and touches at the heart of Lebanon's societal fabric. This insecurity negatively affects investor and consumer confidence. The conflict also directly impacts Lebanon's trade routes. The tourism sector is the most negatively affected while real estate and banking have proven to be resilient. Inflationary pressures seem to mount, in part due to imports substitution away from cheap Syrian products, and localized price pressure from the large refugee influx (e.g., on rents). This influx is also creating pressures on both employment and nominal wages for host communities, and crowding out access to public services. The resulting hardship for hosting communities is stirring social tensions, which could further erode confidence and, ultimately, macroeconomic stability. Prompt policy responses to help hosting communities are warranted to limit these material downside risks and address the mounting developmental challenges that are emerging. Support from the international community, including financial assistance, should urgently be provided so as to help Lebanon's hosting efforts.

vi. Amid uncertain growth prospects and shrinking fiscal space, the government›s initial decision to significantly increase public sector employees› salaries is raising significant challenges. While the cost of living increase aims to offset the erosion of real wages over time, the change in the structure of salary scales is not accompanied by a similar structural revision of tasks and efficiency of public sector employees. At the macro-economic level, the overall increase in wages would weaken the Lebanese economy through the return of unsustainable debt dynamics, pressures on the peg, lower economic growth, and increased unemployment. Introducing revenue measures would reduce these negative impacts but would lower resilience to shocks and impede the use of counter-cyclical fiscal policies. Reforming the pension system would further reduce the negative impact, but such reform cannot be separated from the need for strengthening social safety nets.

إلى إرباك الثقة وبالتالي إلى تلاشي الاستقرار الاقتصادي. فهناك ضرورة ملحة لرسم السياسات المناسبة لمواجهة هذه الصعوبات والحد من تداعيات الأزمة السورية على لبنان ومساعدة المجتمعات المضيفة بهدف تقليص المخاطر والتصدي للتحديات التنموية التي بدأت تتضاعف. وبناءً على هذه المعطيات، على المجتمع الدولي أن يتحرك بشكل طارئ لدعم لبنان ومساندته مالياً في جهوده لاستضافة النازحين.

٦. **في أعقاب توقعات نمو غير مؤكدة، وتقلص الحيز المالي، فإن قرار الحكومة المبدئي في ما يتعلق بزيادة رواتب موظفي القطاع العام يشكل تحديات حقيقية.** وبما أن الزيادة في مخصصات كلفة المعيشة تهدف إلى التعويض عن تآكل الأجور الحقيقية عبر مرور الزمن، إن التغيير في هيكلية سلسة وجداول الأجور لم يتزامن مع مراجعة مماثلة لهيكلية المهام وفعالية موظفي القطاع العام في لبنان. فعلى المستوى الاقتصادي الكلي، إن الزيادة الإجمالية في الأجور سوف تضعف الاقتصاد اللبناني من خلال استعادة ديناميكية ديون غير قابلة للاستمرار، إضافة إلى فرض المزيد من الضغوطات على نظام تثبيت سعر العملة، وانخفاض في مستوى النمو، وارتفاع في مستويات البطالة. فإدخال التدابير المناسبة لجهة الإيرادات قد تحد من تلك الآثار السلبية، إلا أنها سوف تضعف قدرة الاقتصاد على مواجهة الصدمات وستعيق من استخدام السياسات المالية لمعالجة التقلبات الدورية. أما إصلاح نظام التقاعد فمن شأنه أن يحد أيضاً من التأثيرات السلبية، لكن تلك العملية الإصلاحية لا يمكن فصلها عن الحاجة إلى تعزيز شبكات الأمان الإجتماعي.

الملخص التنفيذي

١. **أدت المواجهة السياسية في لبنان، بالتزامن مع الأزمة المتصاعدة في سوريا، إلى عرقلة النمو الاقتصادي في العام ٢٠١٢، ومن المتوقع أن يستمرّ هذان العاملان بالتأثير سلباً على سير النمو في النصف الأول من العام ٢٠١٣.** تباطأ النمو الاقتصادي في العام ٢٠١٢، ليسجلّ معدلاً بلغ ١,٤ بالمائة جراء ضعف الأداء الإقتصادي في النصف الثاني من السنة مع تراجع في الأوضاع الأمنية. فمن جانب الطلب، أدت الزيادة الكبيرة في الاستهلاك الحكومي إلى تخفيف التباطؤ في النمو خلال العام ٢٠١٢، بينما بقي الاستهلاك الخاص ضعيفاً بسبب الأوضاع الأمنية غير المستقرة. أما من جانب العرض، فالتباطؤ الحاد في قطاع الخدمات، وبالأخص في مجال السياحة، كان له الأثر الأكبر في تراجع معدلات النمو. وإذا ما طرأ تحسنٌ في الأوضاع السياسية والأمنية، خصوصاً في النصف الثاني من العام٢٠١٣ ، تشير التوقعات أنه من الممكن أن يسجل النمو ارتفاعاً ليبلغ ٢,٣ بالمائة. بيد أن العوائق في آفاق النمو ما تزال كبيرة، وما زال اتجاه النمو مثقلاً بالمخاطر ويميل نحو الأسفل.

٢. **إن التوسع المالي الحاد الذي شهده الاقتصاد اللبناني في العام ٢٠١٢ قد خلق تحديات كبيرة في العام ٢٠١٣**، ولا سيما في سياق الوعود المتعلقة بزيادة رواتب موظفي القطاع العام. فقد بلغ حجم التوسع المالي، الذي يتم قياسه عبر التغيير الحاصل في العجز الأساسي لموازنة الحكومة المركزية، نسبة مقلقة قدرت بنحو ٤,٦ نقطة مئوية من الناتج المحلي الإجمالي في العام ٢٠١٢. أما العجز المالي الإجمالي فقد بلغ ٩,٤ بالمائة من الناتج المحلي في العام ٢٠١٢. أكثر من ثلث العجز ناتجٌ عن الانخفاض الحاد في الإيرادات، ويعود ذلك جزئياً إلى الإعفاء الضريبي الجديد على القيمة المضافة لمادة المازوت (الديزل). وبالنسبة للجزء المتبقي من العجز فهو ناتج عن الارتفاع في حجم النفقات على الأجور والرواتب (وذلك بعد التعديل الملحوظ الحاصل في مخصصات كلفة المعيشة) والتحويلات إلى شركة كهرباء لبنان. وقد أدى التباطؤ في النمو والارتفاع في العجز إلى عكس الاتجاه الانحداري التي كانت عليه نسبة الدين إلى الناتج المحلي الإجمالي، والتي بلغت ١٣٤ بالمائة في نهاية العام ٢٠١٢. أما في العام ٢٠١٣، وفي إطار السياسة الحالية، من المتوقع أن يحافظ العجز المالي على معدله دون تغييرات على نطاق واسع (كنسبة من الناتج المحلي الإجمالي).

٣. **ضاق عجز ميزان المدفوعات في العام ٢٠١٢ وذلك بسبب التحسن في تدفقات رأس المال.** وتعتبر تلك التدفقات قصيرة المدى حيث أنها ناجمة عن ارتفاع في هامش الفوائد المحلية-الدولية. وقد حافظ حجم احتياط النقد الأجنبي على مستوى مرتفع، حيث استمر بتغطية ١٧ شهراً من الواردات حتى نهاية العام ٢٠١٢. أما العجز التجاري فاستمر بالإنكماش في ظلٍ تراجع النشاط الاقتصادي، ولو على وتيرة أبطأ مما كان متوقعاً، وذلك بسبب تداعيات الأزمة السورية.

٤. **ارتفعت الضغوطات الناتجة عن التضخم على الرغم من فتور النشاط الاقتصادي.** وقد تسارعت نسبة التضخم بشكل ملحوظ خلال النصف الثاني من العام ٢٠١٢. وقد شهد معدل التضخم الأساسي اتجاهاً تصاعدياً حيث بلغ ٥,٣ بالمائة في نهاية ٢٠١٢. ومن الناحية المحلية، يمكن عزو الضغوطات الناتجة عن التضخم إلى العوامل التالية: (١) الارتفاع في المداخيل القابلة للصرف في أوائل العام ٢٠١٢ وذلك بسبب زيادة الحد الأدنى للأجور وتعديل مخصصات كلفة المعيشة لموظفي القطاع العام، و(٢) والفجوة التراكمية في الناتج التي حافظت على معدل إيجابي وذلك في أعقاب نسبة نمو فاقت التوقعات في الفترة الزمنية الممتدة بين ٢٠٠٧-٢٠١٠. أما العوامل الخارجية فتتضمن الأزمة في سوريا التي أدت إلى ضغوط متنامية على الأسعار المحلية من خلال استهلاك السلع والخدمات من قبل السوريين في لبنان والحاجة إلى استبدال البضائع السورية المتدنية الأسعار بسلع مستوردة أكثر كلفة.

٥. **إن الأزمة في سوريا - هذا البلد الذي يرتبط بشكل وثيق بلبنان، أكان من حيث الروابط التاريخية أو الاجتماعية أو الاقتصادية - قد خلقت أزمة إنسانية ذو حجم هائل.** مع التنويه بقرار لبنان بإستقبال النازحين، فإن الأزمة تؤثر سلباً وبشكل حاد على الاقتصاد اللبناني. أما العامل الأهم فهو التراجع في الوضع الأمني الناتج عن تداعيات تلك الأزمة والتي تمس قلب النسيج المجتمعي في لبنان. فإن عدم الاستقرار يؤثر سلباً على ثقة المستثمر والمستهلك على حد سواء، كما يؤثر بشكل مباشر على الممرات التجارية. أما قطاع السياحة فهو الخاسر الأكبر، بينما أثبت قطاع العقارات وقطاع المصارف قدرة على الصمود في وجه الأزمة. بالإضافة، الضغوط الناتجة عن التضخم تستمر في الارتفاع، وذلك يعود جزئياً إلى استبدال البضائع السورية الأقل كلفة بسلع مستوردة، ويرتفع الضغط المحلي على الأسعار من قبل اللاجئين السوريين (على سبيل المثال: بدل إيجار الشقق). كما أدى تدفق اللاجئين إلى المزيد من الضغوط على فرص العمل والتشغيل ومستوى الاجور الإسمية مما يخلق تنافساً ويحد من فرص المجتمعات المضيفة، إضافة إلى المزاحمة في الحصول على الخدمات العامة. ونتيجة لتلك الصعوبات التي تواجهها المجتمعات االمستقبلة للاّجئين، ترتفع حدة التوتر المجتمعي مما قد يؤدي

RECENT ECONOMIC AND POLICY DEVELOPMENTS

Output and Demand

1. **The continued domestic political standoff combined with an escalating Syrian conflict took their toll on the Lebanese economy notably from the second half of 2012 onwards.** Economic growth in 2012 is estimated to have decelerated sharply, to 1.4 percent, posting its lowest growth performance since 2006—when the economy suffered from the conflict with Israel. While the Lebanese economy expanded at a robust pace from 2007 to 2010—real GDP growth averaged 8 percent—growth decelerated to an estimated 3 percent in 2011, as a severe political impasse affected consumer and investor confidence.[1] A further growth slowdown occurred in 2012 as the escalating Syrian crisis, and, to a lower extent the slowing European economy, added to the continued domestic political impasse (see the Special Focus on page 22 for details on the impact of the Syrian conflict on the Lebanese Economy). As a result, the Banque du Liban's coincident indicator—the most timely proxy for GDP growth (Box 1)—decelerated sharply in 2012, with the second half of the year posting two consecutive quarters of negative growth (the first time since 2007)—Figure 1. Regionally, Lebanon's growth performance has been more volatile as the country has been impacted by large security shocks (Figure 2).

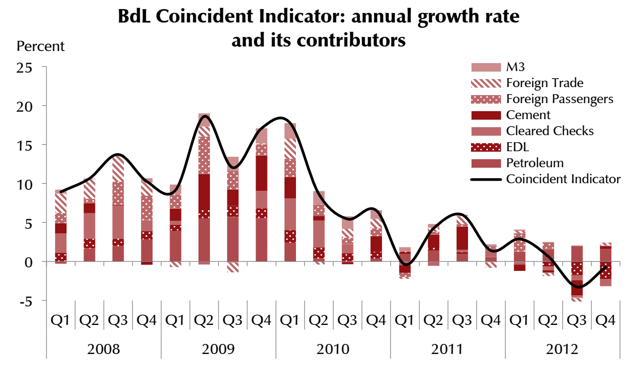


FIGURE 1. Economic activity contracted in the second half of 2012

Source: Banque du Liban and World Bank staff calculations.

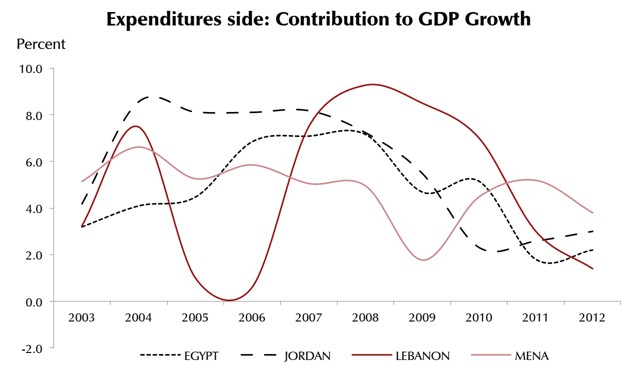


FIGURE 2. Lebanon growth under-performed at the regional level in 2011 and 2012

Source: World Bank staff calculations.

2. **From the demand side, a robust increase in government consumption buttressed the growth slowdown in 2012** (Figure 3). Thanks to an expenditure-driven large fiscal expansion (see Fiscal section), government consumption was a key growth driver in 2012.[2] Notwithstanding an increase in the minimum wage in early 2012, private consumption was soft in 2012 reflecting the uncertain security situation. The Byblos Bank/AUB Consumer confidence index fell its lowest level on record—Figure 4. Consumer confidence in Lebanon reacts sharply to domestic political and

[1] GDP data for 2011 are still World Bank estimates as the latest official national accounts data are for the year 2010. Box 1 details some of the severe limitations analysts and policy makers are confronted when analyzing economic developments in Lebanon.

[2] Kraay (2012) provides estimates of government spending multipliers in emerging market countries. (Aart Kraay "How large is the Government Spending Multiplier? Evidence from World Bank Lending," *Quarterly Journal of Economics*, Vol. 127, pp. 829-887.)

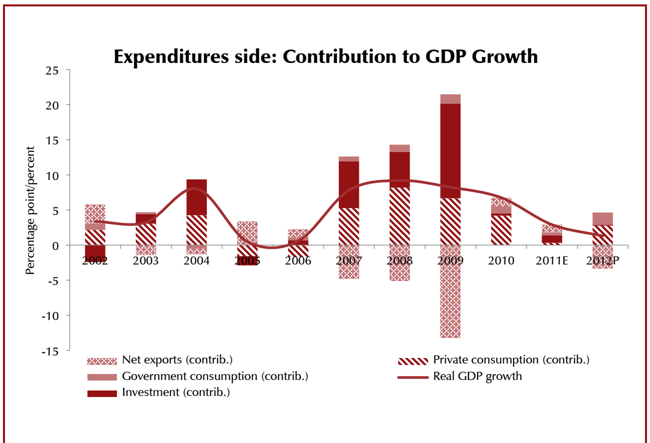


FIGURE 3. Consumption—public and private—sustained growth in 2012

Source: National income Accounts, World Bank Staff Calculations.

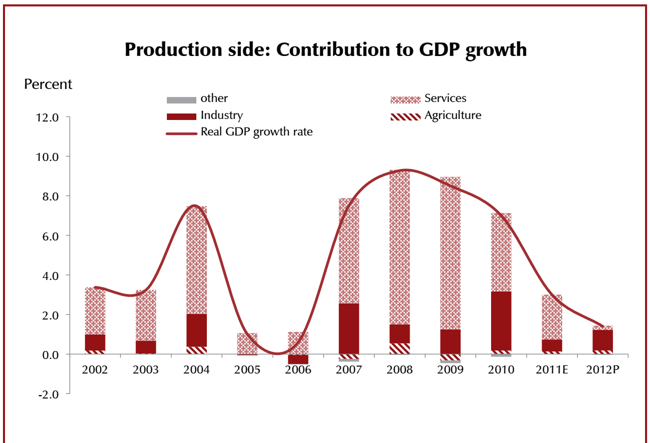


FIGURE 5. Services, historically the strongest growth driver in Lebanon, stalled in 2012

Source: National income Accounts, World Bank Staff Calculations.

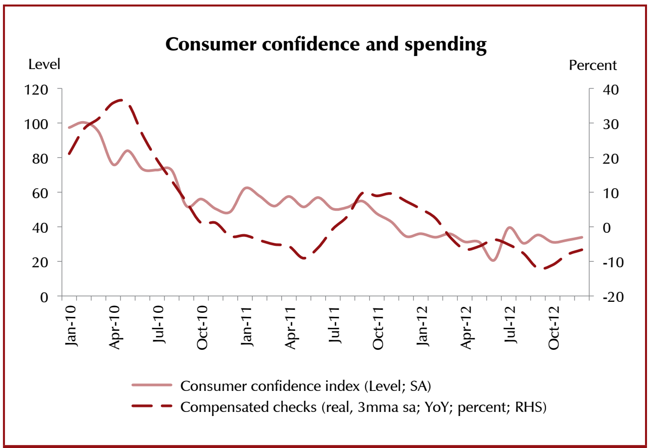


FIGURE 4. Consumer confidence dropped to record low while cashed checks contracted

Source: Byblos Bank/American University of Beirut (AUB).

security shocks. As a result, given the worsening security situation since June (e.g., high profile kidnappings, political assassinations, and armed conflict incidents) consumer confidence dropped further in the second half of 2012. This drop in consumer confidence and in consumption in the second half of 2012 is confirmed by the contraction in retail sales (by 12.3 percent yoy in Q4 2012—BTA/FransaBank retail sales index) and in the value of compensated checks in the second half of 2012 (Figure 4)—the latter posted the deepest contraction (in real terms) since 1999 (aside from the 2006 Israel conflict period) Figure 3. Sales of new and used cars dropped 4.1 percent in nominal terms 2012 (Association of Automobile Importers in Lebanon), though new car sales (especially for lower priced cars) grew modestly, likely reflecting the minimum wage increase of February 2012 and the public sector cost of living adjustment.[3] The trend was also maintained throughout Q1 2013.

3. **From the supply side, the sharp deceleration in the services sector significantly dampened growth in 2012 and at the start of 2013** (Figure 5). The Syrian crisis affected key growth drivers of the Lebanese economy (for details see the Special Focus on page 22). These include the services sectors—which accounts for about 75 percent of GDP, and in particular tourism, trade, and

[3] Aaronson et al. (2012) find that most of the spending response to minimum wage increases is caused by a small number of individuals purchasing cars. See Aaronson, D., S. Agarwal, and E. French, 2012, "The Spending and Debt Response to Minimum Wage Hikes," American Economic Review, Vol. 102, pp. 3111-39.

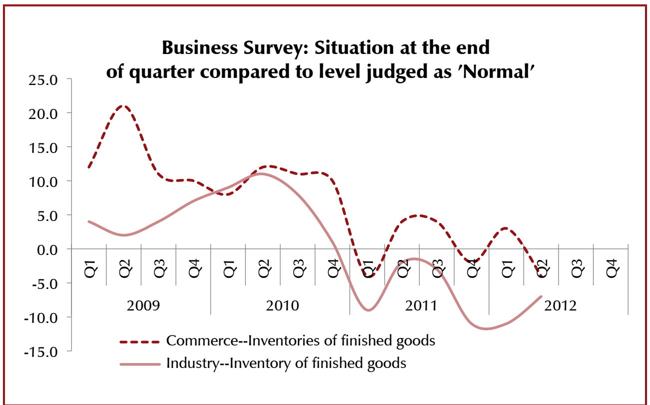


FIGURE 6. Business confidence remains weak

Source: Banque du Liban.

transportation. Tourism, which is historically a key source of growth and employment for the economy, performed poorly. Excluding Syrian nationals, passenger arrivals dropped by 12.3 percent (sa) in 2012 alone and by further 3.6 in Q1 2013 (sa yoy). This mostly reflects the decision taken by several countries to discourage their citizens from visiting Lebanon on account of rising security concerns. Industry, which accounts for about 20 percent of Lebanon's GDP, continued to be weak. Managers' opinion on industrial production remains in negative territory while inventories are below their "normal" level (Figure 6). The construction sector slowed down in 2012 as indicated by a 4.4 percent contraction in cement deliveries and a 10.8 percent contraction in construction permits throughout the year. Some recuperation was observed in though Q1 2013 as cement deliveries rose by 13.6 percent (yoy). However, future prospects remain uncertain as echoed by the 21.8 drop in construction permits during the quarter.

Labor Markets[4]

4. **Growth in Lebanon does not create enough employment particularly for women, the youth, and skilled workers.** The unemployment

BOX 1. Lebanon's poor quality of economic data impedes economic monitoring

The quality of national accounts in Lebanon is weak, both in terms of data compilation, timeliness and frequency. This regrettably prevents an in-depth and rigorous monitoring of economic activity. It also means that policy making is based on inherently uncertain information which would affect the quality of the decisions taken.

As of April 2013, Lebanon's latest national accounts are from 2010. Aside from being significantly delayed, national accounts are also only available on an annual basis—such a weak national accounting framework is extremely unusual globally, especially given Lebanon's level of development.

Due to these severe shortcomings of the national account data, analysts rely on imperfect proxies to estimate the performance of the Lebanese economy. A key contribution to economic monitoring is provided by the Banque du Liban (BdL) which produces a monthly coincident indicator (available about six weeks after the end of each month). The estimation of the performance of the Lebanese economy is further complicated by the lack of variables that would be very informative for economic monitoring. These include the lack of regular information on labor markets' developments and households' living conditions, weak balance of payments statistics, and weak inflation statistics (Since January 2013, CAS, the statistical office, has stopped collecting price data so that no official inflation rate is being published).

[4] For further details, see World Bank (2012) "Good jobs needed: the role of macro, investment, education, labor and social protection policies (MILES)", December. All numbers quoted in this section are based on a labor survey conducted in 2010 for this MILES study.

rate in Lebanon is estimated at 11 percent,[5] a rate that is similar to the MENA average. However, this figure masks some worrying labor market trends and low participation rates. Only 70 percent of working age men and 24 percent of working age women are active in the labor force. Unemployment rates are alarmingly high among youth (34 percent), women (18 percent), and, to a lower extent, educated workers (14 percent for tertiary education holders). The large majority of the unemployed are under 35 years of age. Over the past 15 years, GDP expanded at an average rate of 3.7 percent per year, yet employment grew by only 1.1 percent. World Bank simulations show that over the next decade, the economy would need to create 6 times the number of jobs it is currently creating in order to merely absorb the new labor market entrants. With the economy projected to grow below its potential, short-term labor market prospects remains bleak.

5. **Jobs created are concentrated in low productivity sectors despite the fact that the Lebanese education system has been generating a high number of skilled graduates.** The main net contributors to job creation are trade (61 percent), low productivity services sectors (33 percent) and construction (10 percent). High productivity sectors such as information and communication technologies, financial and insurances, and those involving professional, scientific and technical activities have actually shed jobs. Currently, low productivity services employ 35 percent of wage employees and 61 percent of the self-employed while 14 percent of wage employees and 3 percent of self-employed only are in high productivity services. The wide mismatch between job creation and human capital input has pushed educated workers into unemployment (14 percent) or migration.

6. **Structural reforms are needed to address the above bottlenecks.** Lebanon will need to (1) consolidate fiscal policy to remove distortions affecting investment, increase efficiency of public investment and improve the business environment to increase job creation in high productive sectors; (2) reform the social insurance system to reduce the share of informal employment and encourage labor mobility; and (3) re-think training and active labor market programs to upgrade the labor force skills and labor market transitions – from school or inactivity to work, out of unemployment and from low to higher productivity jobs.

Fiscal Policy

7. **A major fiscal expansion took place in 2012.** The central government's fiscal balance posted a deficit of 9.4 percent of GDP in 2012, up by 3.7 percentage points of GDP compared to 2011. As global interest rates reached historical lows, total interest payments to service Lebanon's large public debt continued to decrease. As a result, the change in the primary fiscal balance (i.e., excluding interest rate payments), deteriorated by 4.6 percentage points of GDP between 2011 and 2012; the 3.6 percent of GDP primary surplus in 2011 turned into a 1 percent of GDP deficit in 2012. Primary government spending rose by 3.2 percent of GDP fueled by an increase in transfers to the electricity utility (EdL) (up by 0.9 percent of GDP), and a rise in public sector wage bill (up by 1.2 percent of GDP).[6] Pressures on

[5] Excluding non-surveyed foreign labor.

[6] Other notable increases included transfers to municipality (up by 0.4 percent of GDP) and transfer to the Higher Relief Council (by 0.3 percent of GDP).

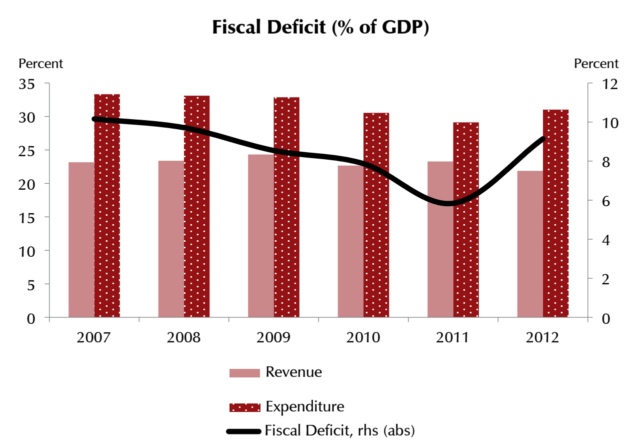


FIGURE 7. A major fiscal expansion took place in 2012

Source: Ministry of Finance and WB staff Calculations.

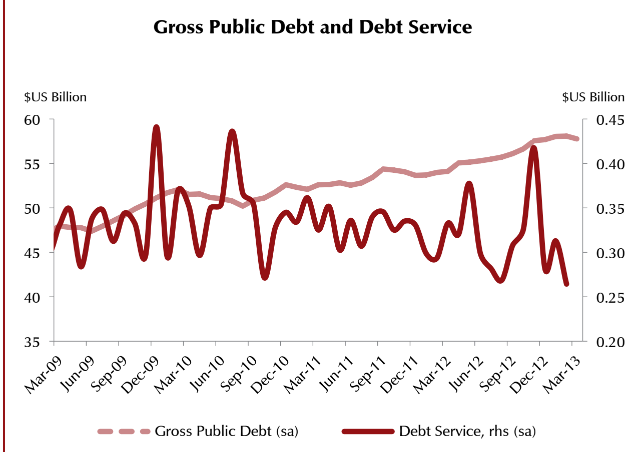


FIGURE 8. Public debt increased while debt service decreased during 2012

Source: BdL, Ministry of Finance, and WB staff calculations.

the wage bill reflect the cost-of-living adjustments on civil servants' basic salaries introduced in 2012, additional recruitments, and higher allowances in the military and internal security agencies. EdL losses remain a major structural and macro-critical problem as public transfers to the company accounted for 61 percent of government deficit in 2012. Tackling those losses is critical to Lebanon's long-term fiscal consolidation efforts.[7] On the revenue side, total revenue dropped by 1.4 percent of GDP as tax receipts and non-tax revenues both declined by 0.8 and 0.6 percent of GDP. This drop came primarily as a result of a decline in VAT (by 0.7 percent)[8] and income taxes, notably on corporate profits (by 2.6 percent), echoing the slowdown in economic activity. Additionally, telecom proceeds dropped (by 4.7 percent) as tariffs were lowered and investments in sector increased.[9]

8. **Low growth and rising deficits have reversed the downward trend in the public debt-to-GDP ratio that started in 2006.** The debt-to-GDP ratio rose from 133.8 in end-2011 to 134.2 by end-2012. While Lebanon's debt ratio is significantly lower than in 2006 when it peaked at 180 percent of GDP, the country debt ratio remains elevated. This is a source of risk for the economy. The debt structure also exposes the country to a material exchange rate risk as 42.3 percent of the public debt is denominated in foreign currency (up from 39 percent in 2011).[10] Some offsets to this risk exposure are (1) the highly concentrated and domestic ownership of Lebanon's sovereign paper

[7] The cumulated annual transfers has reached 34.5 percent of GDP since 2004, the year those transfers started.

[8] Pushed by VAT exemptions provided for diesel products during specific time in the winter period. This exemption became effective on March 5, 2012 when Parliament voted the law number 207.

[9] According to Lebanese laws, the ministry of telecom has off-budget accounts and transfers to the ministry of finance the telecom proceeds in net terms after deducting maintenance and investments.

[10] The share of foreign-currency denominated debt remains, however, below the 2002-09 average of 47.7 percent.

(53.9 percent are held by Lebanese commercial banks and 20.7 percent by the BdL) and (2) a large pool of public sector deposits amounting to 20 percent of GDP (14.9 percent of total public debt).

Monetary Policy and Prices

9. **While economic activity decelerated sharply in 2011 and 2012, inflationary pressures rose throughout this period due to both domestic and external factors** (Figure 9). Headline inflation accelerated in 2012, notably in the second half of the year. Meanwhile, core inflation (i.e., excluding food and fuel) has also been on an upward trend, rising from 3 percent in February 2012 to 5.3 percent by end-2012. Inflation abated slightly in early 2013, with headline CPI inflation dropping to 4.4 percent yoy for the first quarter of the year.[11] Domestically, inflationary pressures can be attributed to (1) an erroneous sudden jump in the official inflation rate from 2 percent in June to 9 percent in July[12] (yoy) which is likely pushing up inflation expectations (e.g., trade unions requested cost of living adjustment; tuition fees rising by 14.5 percent in Q4 2012); (2) large increases in disposable income in early 2012 due to the increase in the minimum wage and increases in public sector salaries stemming from the cost of living adjustment; and (3) a cumulative output gap that remains positive following several years of above-potential growth from 2007 to 2010. External factors include the Syrian conflict that exerted upward pressure on domestic prices through the consumption of the large influx of Syrians refugees in Lebanon, and the need to substitute cheap Syrian goods with more expensive non-Syrian import (See Special Focus #1 page 22 for details).

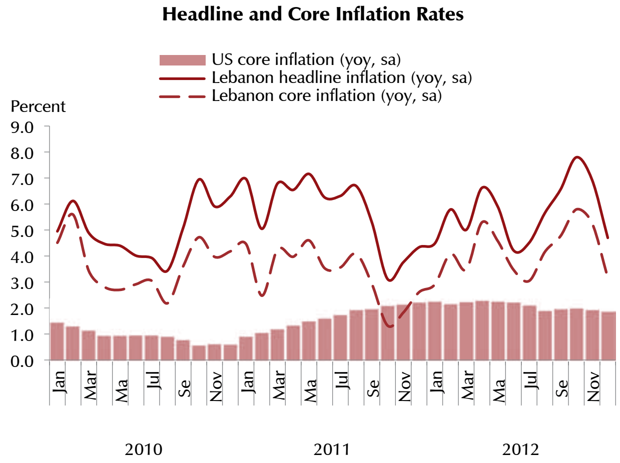


FIGURE 9. Headline and core inflation have accelerated in the second half of 2012 1/

Source: CAS, CRI, and WB Staff Calculations. 1/ Core inflation depicts changes in domestic prices excluding fuel and food. It is calculated using the CPI figure of CRI and recalibrated by the weights of the official CPI of CAS

[11] This is headline inflation estimated by CRI. Core inflation was not calculated in 2013 as the Central Administration of Statistics (CAS) has so far stopped producing inflation figures as the Prime Minister did not sign on the recruitment of the field workers required to collect prices.

[12] The sudden jump in headline CPI, as measured by the Central Administration of Statistics (CAS), is the result of the infrequent measurement of rent prices by CAS (every three years). When CAS measured rent prices in July 2012, these were 44 percent higher than its previous observation point last updated in July 2008. Hence, CAS reported a 44 percent increase in rents in July 2012 (mom) while it has been reporting zero percent rent inflation from July 2008 to June 2012. As rents have a weight of 16 percent in the CPI basket, this 44 percent change increased the July inflation rate by around 7 percentage points. Inflation thus jumped from 2 to 9 percent solely because of this incorrect reporting of rent inflation over the previous three years. It should be noted that, since the 44 percent increase in rents in July 2012, reported rent inflation from August 2012 onwards has been nil.

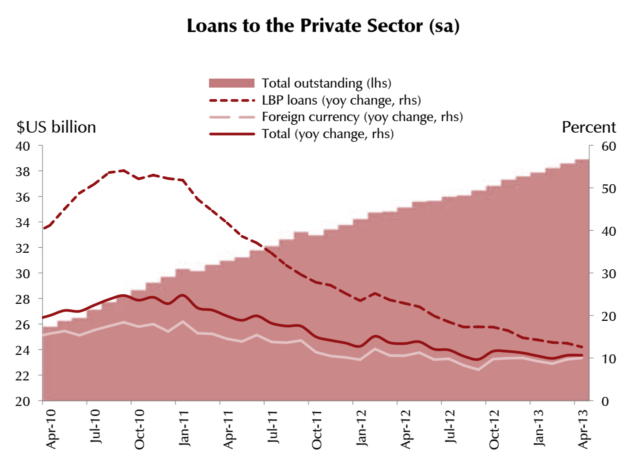


FIGURE 10. Lending to private sector continued to increase broadly in line with nominal GDP growth

Source: Banque du Liban.

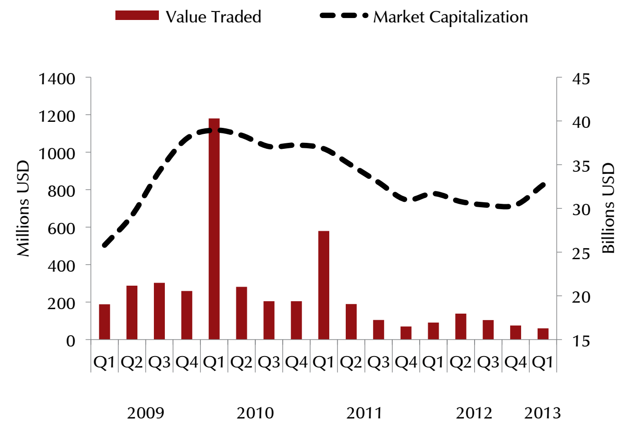


FIGURE 11. The Performance of the Beirut Stock Exchange weakened in 2012

Source: Beirut stock exchange and Bank staff calculations.

10. **Money supply and lending to the private sector remained buoyant.** Money supply (M3) increased by 6.7 percent yoy in December 2012 thanks to the continuous inflow of foreign deposits attracted by the wide spreads between domestic and international interest rates. This trend continued in early 2013 with figures for the first quarter showing a 1.8 percent rise in M3 compared to end-2012. Notwithstanding rising sovereign credit risk—as shown by rising sovereign spreads (Paragraph 13)—the dollarization rate of deposits remained stable (Figure 21). Lending to the private sector grew by 10.6 percent in 2012 (broadly in line with nominal GDP growth), but slightly below the 12.9 percent growth experienced in 2011. At the same time, banks remained cautious, as seen by the 9.2 percent yoy increase in their reserves during 2012. Again the upward trend was maintained in 2013. Private sector credit grew by 2.7 percent between end-2012 and March 2013.

11. **To stimulate the economy, Banque du Liban launched a subsidized interest rate program.** In January 2013, BdL introduced a US$1.46 billion stimulus package. The package allows commercial banks to borrow this amount from the BdL at a low rate of 1 percent and to onlend it at a weighted average rate of 4.1 percent (some 310 basis points lower than the current average lending rate). This lending is primarily earmarked to the housing sector (56 percent of the total package) and some innovative economic activities including solar energy, environmental projects, entrepreneurship and research. Given the current weak consumer, investor, and banker sentiment, the multiplier impact of this stimulus package is expected to be limited. The primary benefit of the package will, therefore, be the lower cost of financing on US$1.46 billion. Under such a scenario, BdL's stimulus package could boost GDP growth by 0.2 to 0.3 percentage points.

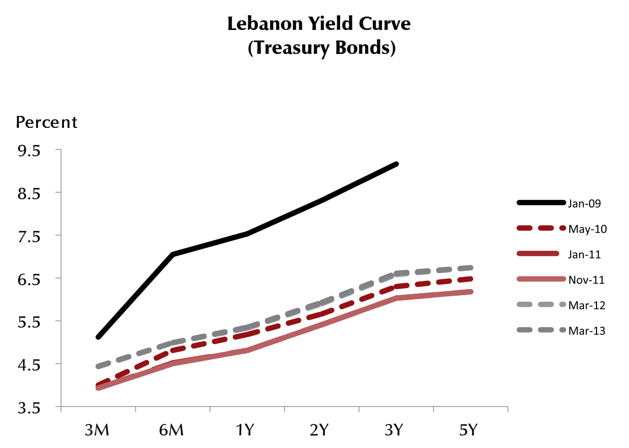


FIGURE 12. Rising domestic inflation and higher risks in 2012 translated into higher T-bond yields

Source: Banque du Liban.

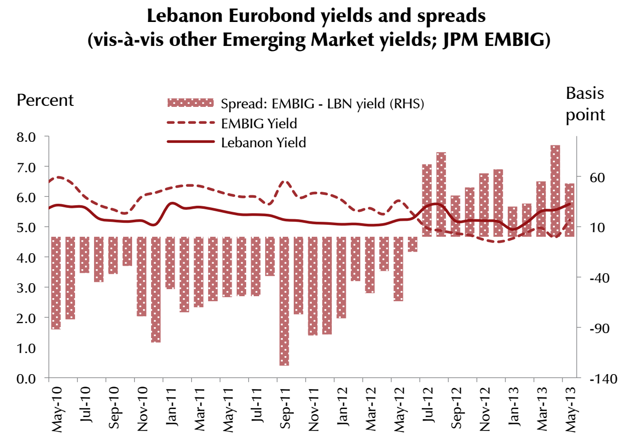


FIGURE 13. Spillovers from the Syrian crisis have strongly impacted risk perceptions towards Lebanon

Source: JP Morgan and World Bank Calculations.

Financial Markets

12. Weak public finances and spillovers from the Syrian conflict are negatively impacting Lebanon's sovereign credit rating. Higher instability in 2012 translated into an upward shift of the yield curve and a downgrade of the sovereign credit outlook by Standard and Poor's to negative. Political instability translated into higher yields for short and long term maturities in March 2012 (Figure 12) after a stable period from 2010 till early 2012.

13. The bond market's reaction to the mid-2012 security shocks is similar in magnitude to that following PM Harriri's assassination in 2005. Spreads between Lebanon's Eurobonds and those of other emerging markets (as captured by the EMBI Global) jumped by 87 basis points (bps) between the pre-crisis period of May 2012 and the crisis period of July 2012 (Figure 13). This compares with an increase in Lebanon's Eurobond spreads vis-à-vis the EMBI Global of 82 bps from Jan 2005 to May 2005 (Figure 15).

FIGURE 14. Lebanon: market capitalization remains below regional average

Source: Word Development Indicators.

While the 2012 spreads widening remain below that observed during the 2006 conflict with Israeli (when spreads jumped 227 bps between June and July 2006 (Figure 16), the increase in spread is nonetheless significantly more persistent. To date, the negative spillover from the Syrian conflict on Lebanon's spread is not abating.

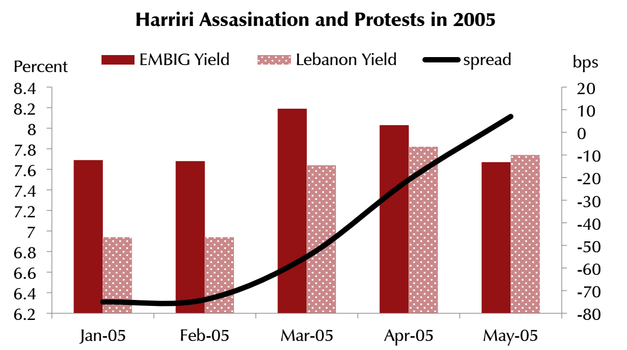


FIGURE 15. Spread on Lebanon foreign-denominated debt rose due to domestic instability 1/

Source: JP Morgan and World Bank Calculations.

1/ The spread is defined as the Lebanon-component of the EMBI-Global minus the EMBI-Global..

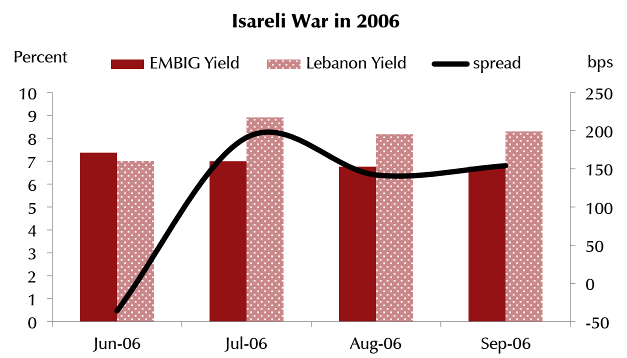


FIGURE 16. ... and during the Israel Conflict in 2006

Source: JP Morgan and World Bank Calculations.

14. **The Beirut stock market posted a weak performance in 2012 but recouped some of its losses during the first five months of 2013.** The Beirut Stock Exchange (BSE) price index lost 11 percent of its value in 2012, thereby posting its second consecutive annual loss (Figure 13). Liquidity dropped sharply (over 50 percent) as trading values slumped to US$408.5 million in 2012. Over the first five months of 2013, the BSE index rose by 1.6 percent compared to the same period in 2012. Lebanon's market capitalization remains below regional average and remains dominated by a few companies (Figure 14).

Balance of Payments and External Debt

15. **The balance of payments deficit narrowed in 2012 thanks to the improvement in capital inflows** (Figure 17). Lebanon's balance of payments deficit shrank, from 5 percent of GDP (US$2 billion) in 2011 to 3.6 percent of GPD (US$ 1.5 billion) in 2012. This improvement occurred despite a widening in current account deficit, from 12.1 percent of GDP in 2011 to 14.4 percent in 2012, due to drop in exports notably exports of services. The increase in net foreign inflows of services, transfers, income, and capital, by US$1.4 billion during 2012 compensated for the rise in the current account deficit. The increase in net foreign inflows is primarily a result of continuous short-

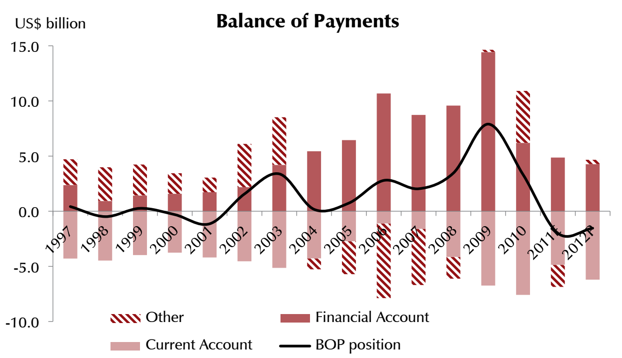


FIGURE 17. A widening current account deficit drove down the BoP surplus in 2012...

Source: National Accounts, BdL, and WB Staff Calculations.

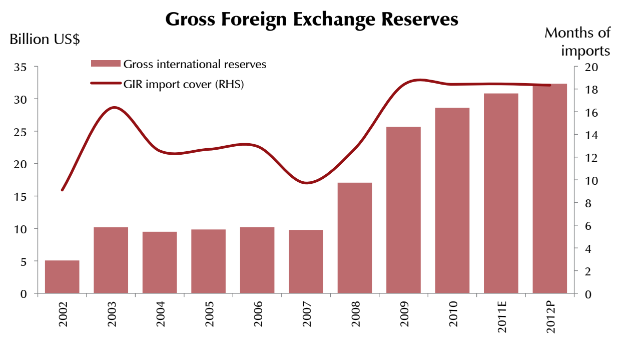


FIGURE 18. ... which impacted Banque du Liban's gross Foreign exchange reserve accumulation

Source: Banque du Liban and World Bank staff calculations.

term capital inflows. The latter are partly driven by the wide spreads between average domestic interest rates and international ones (e.g., 345 bps in December 2012). The spread widened further to 355 bps by March 2013. This helped sustain net foreign inflows. The latter reached US$4.3 billion in Q1-2013, compared to US$4.4 billion in the same period in 2012.

16. The strengthening balance of payments has enabled the Banque du Liban to maintain its foreign exchange reserves (Figure 18). Gross reserves reached US$30.6 billion by March 2013, a 1.3 percent rise from its end-2012 level. In terms of month of goods imports, the coverage reached 16.5 percent by March, a decline from the 16.9 and 18.3 levels recorded respectively in 2012 and 2011. The deposit dollarization rate slightly declined, in part due to a widening of interest rate spreads on LBP denominated deposits and some restored confidence as security concerns remain contained. The dollarization rate went from 65.9 percent in December 2011 to 64.8 percent by December 2012, and 65.2 in March 2013 (Figure 21).

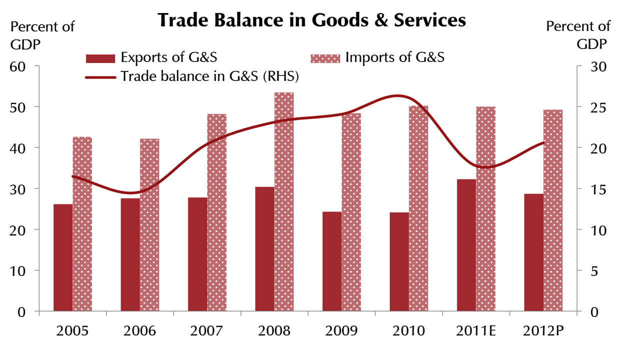


FIGURE 19. Lebanon's trade deficit deteriorated in 2012 in part due to export disruptions from the Syrian crisis

Source: National Accounts, World Bank Staff Calculations.

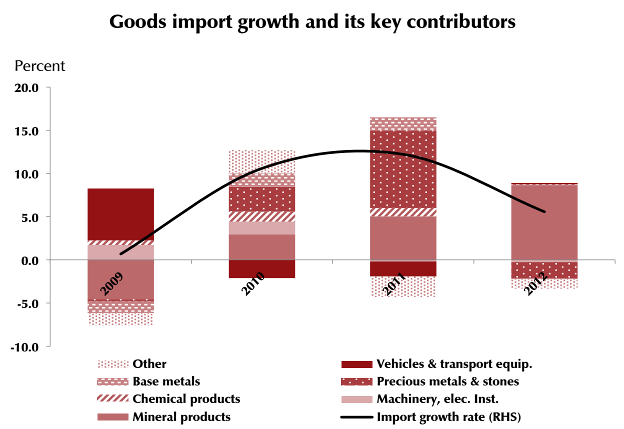


FIGURE 20. Goods import growth in 2012 was driven by oil imports, in part due to the Syrian conflict

Source: Lebanese customs and World Bank staff calculations.

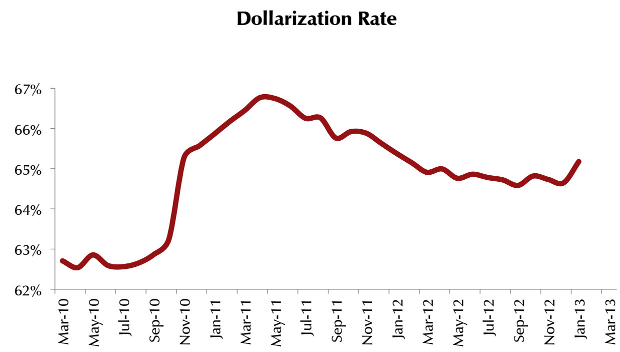


FIGURE 21. Dollarization rates of deposits has steadily improved since mid-2011

Source: Banque du Liban.

17. As the economy decelerates, Lebanon's trade deficit in goods continues to shrink though at a slower pace than expected due to the Syrian conflict (Table 2). After peaking at 35.3 percent of GDP in 2008, Lebanon's trade-in-goods deficit steadily narrowed and reached an estimated 30.1 percent of GDP in 2012 (Figure 19). Exports of goods grew by an estimated 5.9 percent in 2012. Lebanon's largest exports were "precious stones and metals" (up 15.6 percent in 2012) and "machinery and electrical instruments" (up 7.9 percent in 2012); these account for about 40 percent and 10 percent of Lebanon's total exports, respectively. Imports of goods grew by an estimated 5.3 percent in 2012, mostly driven by oil imports (Figure 20). The sharp rise in oil imports reflect rising international prices and a likely impact from the Syrian conflict. Prior to the conflict, cheap oil imports were reported to be smuggled into Lebanon through Syria. With the conflict and the collapse in Syrian oil production, oil trade is now occurring in the opposite direction.

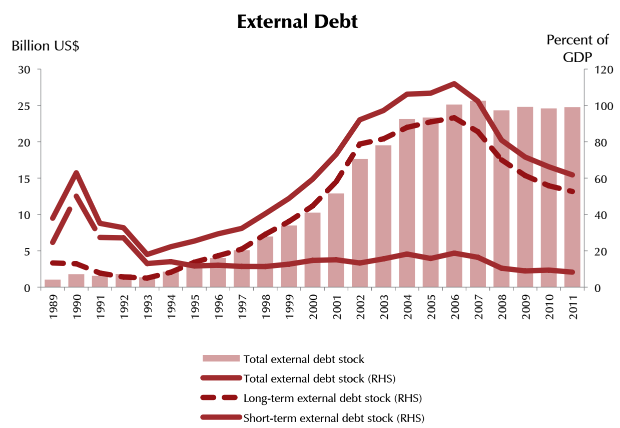


FIGURE 22. Total external indebtedness (public & private) is shrinking (as a ratio of GDP)

Source: Banque du Liban, and World Bank staff calculations.

More generally, the production disruptions in Syria have pushed Lebanon to diversify away from neighboring Syrian goods to similar, but more expensive, goods produced from countries further afar. The trend continued at the start of 2013. The trade deficit dropped by 10.4 percent in Q1 pushed primarily by a 7.7 percent drop in imports, echoing fluctuation in petroleum purchases[13] and the slowdown in the economy,[14] and a 3.3 percent rise in exports who still suffer from access problems as a result of the Syrian crisis.

[13] Data reporting on fuel imports suffer from irregular, delayed and miss-reporting of EDL fuels on monthly basis. This primarily arises due to customs arrears that the company accumulates.

[14] Non-oil related imports dropped by around 0.5 percent.

PROSPECTS

18. Short-term prospects for the Lebanese economy remain challenging as political and security uncertainty concerns remain overwhelming. Subject to an improvement of the political and security situations in the second half of 2013, World Bank estimates a recovery to take place in 2013 with real GDP growth reaching 2.3 percent for the full year (Table 2). The recovery will be driven by private consumption and investment, and, to a lower extent, government consumption—partly reflecting the full year impact of some 2012 measures such as the cost of living increase. The private sector-led recovery will be driven by an assumed moderate improvement in (1) the domestic political stalemate following the legislative elections scheduled for June 2013, and (2) the security situation. Private investment will also benefit from the BdL stimulus package.

19. Risks to growth prospects for 2013 are significant and tilted to the downside. Under a scenario where the domestic political stalemate and repeated outburst of significant security incidents continue throughout 2013, consumers and investors will remain cautious. This would negatively impact the projected recovery. Further downside risks to growth would emerge if the Syrian conflict were to generate larger security spillovers for Lebanon. On the upside, growth could materially exceed the 2.3 percent projected for 2013 if the above downside risks were resolved in a decisive manner. This would improve confidence, led to the return of key tourist segments to Lebanon, and generate a strong recovery. Such a scenario could mirror the one that took place following the resolution of the severe political and security crisis that took place in May 2008 with the Doha Agreement and which pushed 2008 GDP growth to reach a historical high of 9.3 percent.

20. A stronger recovery is expected in the medium term as the enabling environment for reforms improves. Under the same baseline scenario where the political and security situations improve moderately in the second half of 2013, economic growth is projected to accelerate in 2014 as a the elections are assumed to lead to the formation of a government that can implement some long-standing structural reforms, such as those related to infrastructure and competitiveness bottlenecks. A relative political and security stability would enable private consumption and investment to resume. At the sectoral level, the recovery will mostly be reflected in the services sectors, especially tourism. Nevertheless with its high fiscal and current account deficits, vulnerabilities will remain. Renewed fiscal consolidation should therefore resume. In contrast to the 2006-2011 economic growth cum debt reduction period, stronger emphasis should be placed on improving the structural fiscal balance of the country. Continued prudent monetary policy is warranted to manage risks and strengthen buffers.

21. After a large fiscal expansion in 2012 and amid uncertain growth prospects, the government faces severe fiscal challenges in 2013, most notably on public salaries. While Lebanon experienced a sharp decrease in its debt-to-GDP ratio since 2006, a decomposition of the drivers of that improvement reveal that the surge in GDP growth was by far the dominant factor. As growth has stalled in the past two years, and with a large fiscal stimulus already initiated in 2012, fiscal space is again becoming severely limited in Lebanon. The government's March 2013 proposal to increase civil servant salary scale, in response to popular demands, would further strain fiscal space and could have significant negative impacts (see Special Focus

#2 page 31).[15] Policy options to introduce such a measure include reforms to limit its overall fiscal cost (e.g., delinking public salary scales to pensions), a staggering over several years of its implementation, and the introduction of offsetting revenue measures.[16] Without any revenues reforms, the fiscal deficit is projected to exceed 10 percent of GDP, putting the debt ratio on an upward trend over the medium-term. The absence of a budget, and the prospects of adopting one, prohibits public financial management reforms. The recurrence to treasury advances continues to distort the transparent and efficient uses of public resources.

22. The fiscal challenges and recent demonstrations highlight the need for comprehensive and structural reforms. The debate about the salary scale reveals several longstanding structural weaknesses, both a micro- and macro-economic levels in Lebanon. These include (i) the equity of the tax system and its distributional function among factors of production, (ii) the need for civil service reforms, the role of the public sector and the quality of public service delivery, (iii) the scope of the social safety net, including universal health coverage and pension reforms, and (iv) private sector development as a source of growth and employment creation; (v) infrastructure investments in electricity, water and transport all considered as bottlenecks to growth and services delivery; and (vi) the military armament program needed to maintain security stability in a context of political tensions and Syrian crisis ramifications.

23. Monetary policy is expected to boost private sector credit and to manage reserves amidst growing pressures from a widening current account deficit. The current account deficit is projected to widen driven primarily by an increase in imports as the economy recovers over the medium-term. This puts pressure on Lebanon's foreign exchange position. However this risk is mitigated by a large gross reserves level that will be sustained as capital inflows continues to rise benefiting from generous spreads, and as remittances continue to expand in line with the positive growth outlook of the GCC countries. Going forward, monetary policy is expected to continue its support to private sector lending especially in domestic currency. More active measures from the central bank can be expected. This will therefore help accommodate the expected increase in interest rates coming from the rise in key global policy rates, especially those in the United States.

[15] The Council of Ministers approved on March 21, 2013 a new salary scale and ordered for the transfer of this decision to Parliament for approval. The implementation of this decision and its related measures is linked to several regulatory and legislative changes which will likely require significant Parliamentary time. Parliament has yet to review this draft law.

[16] Considerations have been given to several tax and non-tax measures, including raising VAT, capital gains, real estate registration fees, interest income tax, and fees on construction permits for green buildings remain contentious among members of the government coalition, stakeholders of the private sector, unions and other pressure groups.

SPECIAL FOCUS

THE IMPACT OF THE SYRIAN CONFLICT ON LEBANON'S ECONOMY

24. *The conflict in Syria—a country that is closely linked, both through historical, social and economic ties to Lebanon—has created a humanitarian crisis of enormous scale. While Lebanon is to be commended for its openness to Syrian refugees, the conflict is severely and negatively impacting the Lebanese economy.* The largest impact arises through the insecurity and uncertainty spillovers and touches at the heart of Lebanon's societal fabric. This insecurity negatively impacts investor and consumer confidence. The conflict also directly impacts Lebanon's trade routes, raising the cost of imports, and lowering exports notwithstanding some benefits reaped in niche Syrian markets. The tourism sector is the most negatively affected while real estate and banking have proven to be resilient. Inflationary pressures seem to mount, in part due to imports substitution away from cheap Syrian products, and localized price pressure from the large Syrian refugee influx (e.g., on rents). The refugee influx is also creating pressures on both employment and nominal wages for host communities, and crowding out access to and lowering the quality of public services. The resulting hardship for hosting communities is stirring social tensions, which could further erode confidence and, ultimately, macroeconomic stability. Prompt policy responses to help hosting communities are warranted to limit these material downside risks and address the mounting developmental challenges that are emerging. Support from the international community, including through financial support, should urgently be provided so as to help Lebanon's hosting efforts.

25. The Syrian protests that started in 2011 have gradually transformed into a fierce armed internal conflict. The conflict, which took a sectarian dimension in many aspects, has drawn a political divide in the international community with international and regional players firmly supporting the various fighting groups. The conflict has been brutally destructive not only for the country's infrastructure but also to its economic and social fabric (Figure 23). The United Nations estimates the death toll to have reached 80,000 since the start of the conflict. The geographical location of Syria in the Middle East, bordering 5 countries, meant that the crisis had political, social, and economic ramifications on the whole region. This is particularly the case for Lebanon.

26. The conflict in Syria has resulted in massive movements of people, especially towards Lebanon. In early June 2013, over 1.5 million people had registered, or were awaiting registration with the UNHCR in Jordan, Lebanon, Turkey, Iraq and Egypt. Of these, over 500,000 have crossed the border into Lebanon—with about 300,000 having arrived in 2013 alone (Figure 24).[17] Given the current rate of entry, and the Government of Lebanon's commitment not to close the borders, the number of refugees is expected to double by end-2013. They would then represent about one quarter of the Lebanese population. Such a large and rapid influx of refugees a created a humanitarian crisis of enormous scale. Most refugees in Lebanon lack sufficient assistance, income, or social networks to

[17] For more details on the Syrian refugees in Lebanon: http://data.unhcr.org/syrianrefugees/country.

meet their immediate household needs (EMMA, 2013).[18] While Lebanese communities are to be commended for hosting Syrian refugees, such a high and rising level of refugees and the protracted conflict in Syria are gradually eroding the capacity of host communities to absorb refugees. Not only are vulnerabilities steadily growing amongst members of the host community, but access to public services is proving more difficult and/or the quality of such public services is being rapidly eroded.

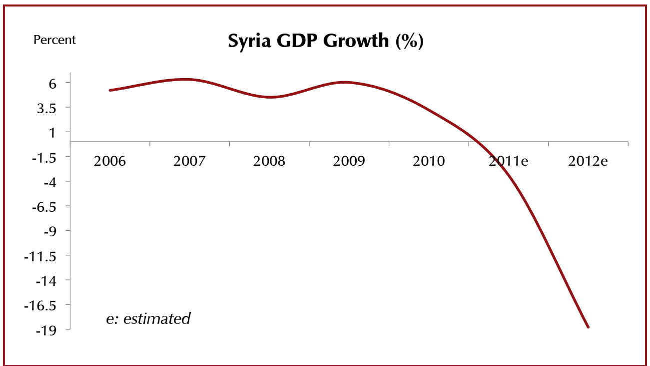


FIGURE 23. Syria: Impact of the domestic conflict on GDP growth

Source: Economist Intelligence Unit.

27. Lebanon's openness to the Syrian refugees is all the more commendable that the country has been more impacted by the conflict than Syria's other neighbors. While in 2011 the Lebanese economy was slowing down after four years of robust growth, the Syrian conflict accelerated that movement. This Special Focus presents the channels through which the conflict is impacting the overall economy and highlights the sectors mostly hit. Two obstacles are faced in this regard. First is the challenge of disentangling some of the domestic-driven impacts from those related to the Syrian conflict (e.g., the security environment and incidences such as kidnapping or domestic fighting, which directly impacted among others the tourism sector). Second is the absence of high frequency data and regional information; this renders the quantification of the Syrian crisis impact—and more generally any other shock faced by the economy—difficult to quantify precisely (as detailed in Box 1).

28. The security spillover of the crisis has negatively affected private consumption activities. Consumer confidence, as measured by the AUB/Byblos consumer confidence index, reached a new low in 2012, plunging by 36.8 percent compared to 2011 (which itself was already comparatively low). As security incidents have continued to increase in 2013, a further decrease in consumer confidence is expected to have taken place in the first four months of 2013. This is expected to drive households to increase their precautionary savings and, as a result, to consume less. This directly reduces aggregate demand leading to a slowdown in economic activities. The 1.5 percent drop in checks cleared for 2012 and the continued 0.6 percent decline in Q1 2013 (yoy) are consistent with such a slowdown in consumption.

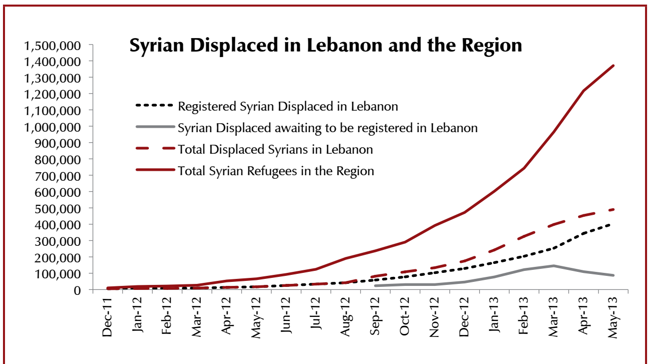


FIGURE 24. Number of Syrian refugees to the region and to Lebanon, 2011-2013

Source: UNHCR.

[18] See the "Lebanon Emergency Market Mapping Analysis", (April 2013) produced by the International Rescue Committee, Save the Children, Danish Refugee Council, OXFAM, and UKaid.

29. The drop in aggregate demand has also weakened by the impact of the Syrian conflict on private investment. Faced with uncertainty regarding final demand, private investment has also declined. This can be depicted through investment indices such as cement deliveries, construction permits, and electricity production which all dropped in 2012 by respectively 3.2, 10.1 and 12.8 percent (yoy). No tangible improvement was depicted so far in 2013.[19] Additionally the political deadlock in the country, which are strongly intertwined with the events in Syria, has blocked long awaited reforms to improve the business environment in Lebanon,[20] tackle infrastructure bottleneck, increase competitiveness, and facilitate access to credit. This has further weakened private investment and private investors risk perception of the country.

30. Government consumption on the other hand has slightly increased as a result of the crisis. While most of the services for Syrian refugees are now being provided or paid for directly by Donors and NGOs, the government has nonetheless extended some public services such as education, transfers to EdL (to the extent that Syrian refugees have access to EdL-provided electricity) to refugees. As Lebanon does not provide blanket subsidies (e.g., bread, petroleum products)—in contrast to many countries in the region—the immediate impact on the expenditure side of the budget is more limited. As the number of refugees and the length of time they are staying in the Lebanon grow, the associated pressures on public services is expected, however, to grow rapidly and non-linearly (e.g., once spare capacity at health or school facilities are exhausted, to serve the additional patient or student a new building needs to be bought or rented). It should be noted that the impact on revenues, however, could be significant given the negative impact of the Syrian conflict on aggregate economic activity.

31. The Syrian crisis has also put negative pressures on net exports. The neighboring conflict has led to a widening Lebanon's trade deficit. Exports are estimated to have shrank in both 2012 and 2013 due to the conflict, while the surge in imports observed in a select but large number of categories is not aligned with the slowdown in domestic economic activity observed in 2012. The effects and channels are further investigated in the next section.

Trade

32. The Syrian crisis took its toll on Lebanese exports as transit routes have been severely disrupted if not closed altogether. Lebanese overall exports have dropped by 0.2 percentage points of GDP to 10.4 percent of GDP in 2012 (Figure 25). While, the slowdown in economic activity of major trade partners, notably the EU, account for some of this drop, the fighting in Syria also had an impact as it limited the access of Lebanese products to Arab markets. Insurance and freight costs significantly rose, and traditional land transit routes gradually closed as the conflict intensified in Syria. As a result, exports through Syria dropped by 0.5 percent of GDP in 2012 (Figure 25), particularly in the second half the year (Figure 26). This trend continued so far in 2013, with the exports through Syria dropping by 20.2 percent.[21]

[19] Figures for Q1 2013 show a continued drop in electricity production and construction permits by respectively 10.2 and 21.8 percent (yoy). Cement deliveries rose on the other hand by 13.6.

[20] Lebanon has slipped further in the doing business ranking from 111 in 2011 to 114 in 2012.

[21] Cumulative exports up to April 2013 (yoy).

33. Local Syrian demand for Lebanese exports, on the other hand, grew robustly thereby partially offsetting the negative impact on exports transiting through Syria. Lebanese exports to Syria rose by 0.15 percent of GDP in 2012 to reach 0.7 percent, their highest level since 2008. The increase came primarily from light industrial products, agro-food items, fuel products and tobacco. Two reasons explain this rise. First, these Lebanese exports fill part of a supply gap especially with the destruction of the Syrian manufacturing and industrial base, notably in Aleppo and Homs. Second, Lebanon remains one of the few market entry points to conflict-affected Syria as borders remain open especially in the Masnaa area, the closest entry point to the capital Damascus. This trend continued in 2013, with exports to Syria up by 21.3 percent (yoy) for the first four months of year. Nevertheless, such niche market remains volatile and highly dependent on border security. Repetitive closures, as has occurred in 2013, keep disrupting the flow of goods and reduce their magnitude (Figure 26). Lebanese exporters are also getting more accustomed with maritime exports—set up as an alternative export route when border crossings with Syria are closed—though these remain significantly more expensive and time consuming.

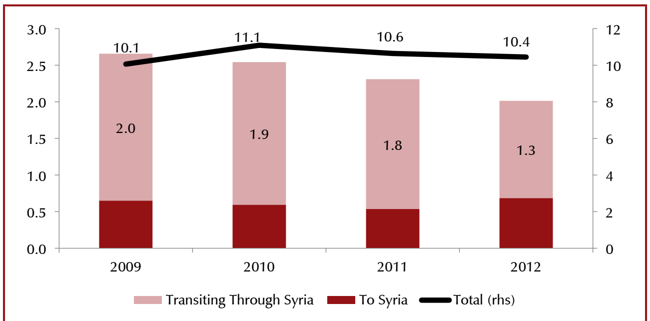


FIGURE 25. Lebanese exports (% of GDP)

Source: Lebanese Customs and World Bank Staff Calculations.

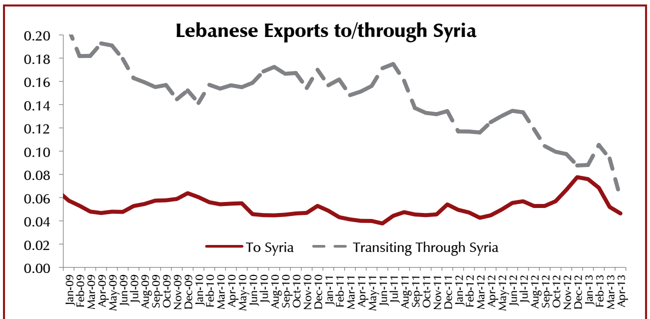


FIGURE 26. Lebanese exports crossing Syrian borders (% of GDP; 3 months moving average)

Source: Lebanese Customs and World Bank Staff Calculations.

34. Lebanese imports from and especially transiting through Syria have steadily declined since the onset of the conflict in 2011 (Figure 27). The decline worsened as the fighting intensified and Syrian borders with neighboring countries closed. The observed drop does not solely include Lebanese imports transiting by land, but also imports from Syrian origin as the economy continues to contract. Estimated figures indicate that imports from Syria dropped to 0.6 percent of GDP in 2012, down from 0.8 percent in 2011 and 0.9 percent in 2010. Similarly other imports crossing through Syria declined by 0.7 percent of GDP in 2012 (0.9 percent if compared to 2010). The trend accelerated in 2013, probably reflecting the fact that some fighting became closer to the Lebanese borders (Figure 28).

35. On the other hand, the increase in Lebanon's aggregate import bill is likely mostly due to the Syrian conflict. Lebanon's total import of goods grew by 5.6 percent in 2012 compared to the previous year while non-fuel imports surged by 11.3 percent (yoy) in April 2013. Such increases in demand for imports are not aligned with domestic economic demand trends especially since GDP growth is projected at around 1.4-2.3 percent during these two years. The Syrian conflict is likely to account for some of these developments through several channels. First, some goods are imported via Lebanon but

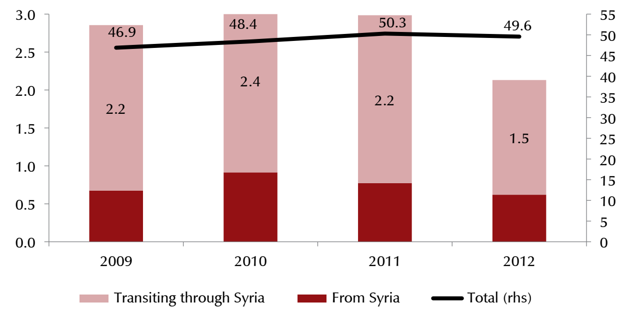


FIGURE 27. Lebanese imports (% of GDP)

Source: Lebanese Customs and World Bank Staff Calculations.

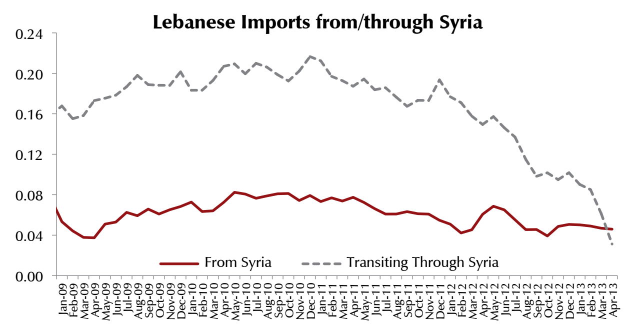


FIGURE 28. Lebanese imports crossing Syrian borders (% of GDP; 3 months moving average)

Source: Lebanese Customs and World Bank Staff Calculations.

could then be smuggled across the borders for Syrian consumption—given the extent of supply disruptions likely taking place in Jordan. In this case they are not registered as re-exports. Second, smuggling from Syria to Lebanon has likely been significantly cut as a result of the conflict. As a result, imports would have to be sourced from a more expensive source, which is also more likely to be formally registered on customs data. Such a phenomenon is likely to have been critical for oil derivatives (whose imports volumes increased by 18.6 percent in 2012 at a time when Lebanon's real economic activity is estimated to have grown by 1.4 percent). This artificial increase in the import bill contributes to the widening trade deficit which is estimated at 30.1 and 29.9 percent of GDP in 2012 and 2013, respectively.

Tourism sector

36. **Tourism, Lebanon's leading services export sector, has been one of the sectors most severely hit by the Syrian crisis with 2012 losses estimated at 0.5 percent of GDP.** A notable decline in tourists' arrival and in hotel occupancy rates have been observed since the start of the Syrian conflict (Figure 29). Tourist arrivals dropped in 2012—from an already low 2011 base—while hotel occupancy rates dropped by around 4 percentage points to 22.1 percent.[22] The Syrian conflict partly contributed to this decline as (i) the passage points for tourists, notably Arabs, crossing to Lebanon by land through Syria was blocked as the fighting intensified; and (ii) violent incidences, clashes, and kidnappings continued. Events fueled by a highly divided Lebanese political scene over the handling of the Syrian crisis, which also triggered a GCC travel ban to Lebanon; (iii) increase in general public perception of danger in the Middle East further pushing away non-Arab tourists. Using historical trends (Figure 30), World Bank staff projects a loss of 0.5 percent of GDP (equivalent to around US$303 million) in tourist spending in Lebanon for 2012 alone. In the absence of more recent figures, anecdotal evidence suggests these losses continued into Q1 2013, as tourist arrivals dropped by 14.2 percent (yoy). As the critical summer (June-August) and end-of-year (December)

[22] Occupancy rates are calculated based on the average for all regions and all levels of hotels.

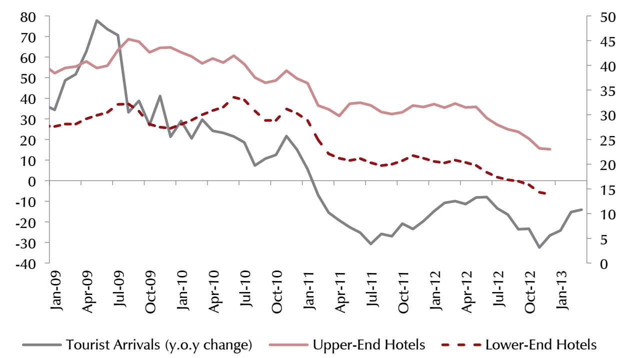


FIGURE 29. Tourist arrivals and hotel occupancy rates (% of GDP; 3 months moving average)

Source: Ministry of Tourism and World Bank staff calculations. Upper- end is defined as 5 and 4 star hotels; Lower-end is 3 and 2 star hotels. Classification adopted is that of the ministry of tourism

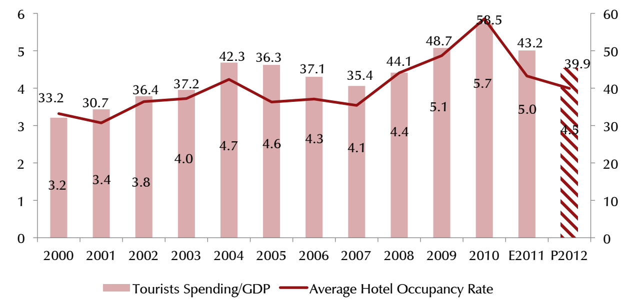


FIGURE 30. Tourism expenditures and hotel occupancy rates (%)

Source: National Accounts for tourism spending, Ministry of Tourism for occupancy rates, and WB staff calculations. Note: 2011-2012 is projected using a simple OLS regression with tourists spending as a function of hotel occupancy rates and tourists arrivals.

tourist seasons loom, the continued security threats are likely to further drag economic activity.

37. **Tourism losses were partly compensated by the consumption of Syrian citizens and refugees who entered and are residing in Lebanon.** As the fighting intensified many Syrian citizens fled their own country and arrived into Lebanon. The Central Administration of Statistics (CAS) reported that a net of 458,226 Syrians have crossed the border during 2012 (up by 113 percent compared to 2011[23]), and another 284,389 in the first 4 months of 2013 (an increase of 67 percent yoy).[24] While this includes more than 340,000 UNHCR-registered refugees, it is believed that the tourism sector has partly catered for the consumption demands of the rest of these Syrians.[25] This is most visible with rental apartments and occupancy at non-luxury hotels, especially in the North, Bekaa and Beirut. This explains some of the resilience depicted in occupancy rates for this segment of hotels (Figure 29). While these Syrian nationals might not spend on high-end products, their average stay significantly exceeds regular tourists. Many Syrians also opt to stay in apartments and therefore exert upward pressure on rent prices as anecdotal

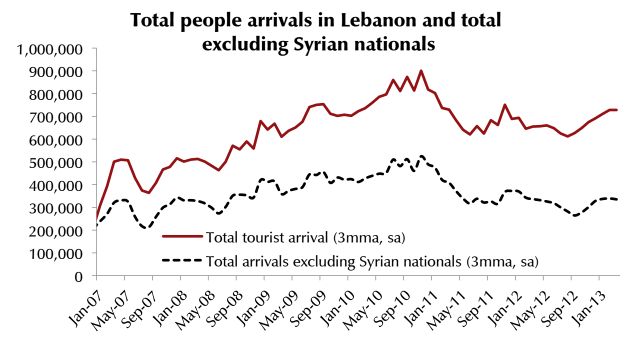


FIGURE 31. Excluding displaced Syrians, total arrivals in Lebanon contracted by 14 percent in 2012

Source: Ministry of Tourism and World Bank calculations.

[23] This is the difference between Syrian entering and exiting Lebanon. CAS reports the official figures of the Security General. These figures report legal entries and exits of people into Lebanon.

[24] According to the UNHCR the number of Syrian refugees has reached 1,216,706.

[25] Aside from the registered refugees, another 91,759 refugees were awaiting registration with the UNHCR bringing the total UNHCR-mapped refugees to 439,584 at end-April 2013.

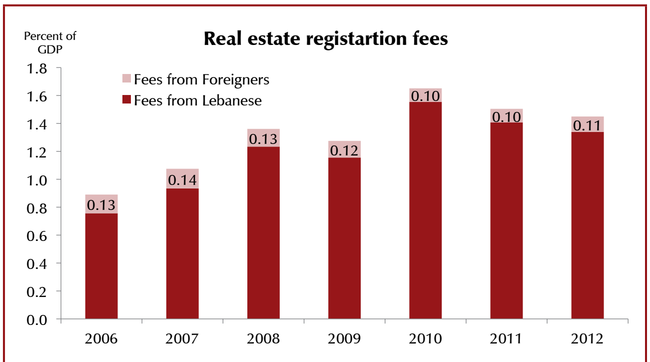


FIGURE 32. Transactions by Syrians likely fully offset the decrease from other foreigners in 2012

Source: Ministry of Finance Cadaster, WB staff Calculations.

evidence suggest. This is notably the case in border areas, especially in the North and the Bekaa.

Labor and Poverty

38. **The large inflow of Syrians results in a major increase in the labor supply in Lebanon, creating downward pressure, in the short-term, on host communities' wages and employment.** Regardless of the exact labor force participation rate of the Syrian refugees, the sheer scale of the influx in comparison to Lebanon's labor force, is expected to put significant downward pressure on wages in the short-term. This pressure would arise since a mismatch between the rapid expansion in labor supply will not be immediately met by a commensurate increase in the demand for labor—especially if the Syrian crisis is resulting in an overall softening of economic activity. Over time, the boost in aggregate demand resulting from the influx of Syrian refugees, would likely boost the demand for labor. In the short-term, pressure is expected to be most acute for lower-skilled jobs. Indeed, given the close historical integration of the two countries, Syrian nationals can easily enter the labor force in Lebanon as they do not need to have work permits. Even prior to the Syrian conflict, Syrian workers dominated several labor-intensive sectors in Lebanon (e.g., construction and agriculture), and had also a visible footprint in non-traditional sectors such as small trading activities. The comparative advantage of these Syrian activities in terms of prices disfavors local businesses and workers thereby creating potential tension with local hosting communities.

Real estate markets

39. **The large influx of Syrians is boosting the demand for housing, putting upward pressure on rents and, to a lower extent, on real estate prices.** An increasing number of Syrians, mostly from higher income groups, have purchased apartments in Lebanon in the past two years. Motivations could include a mix of immediate housing needs and desire to invest savings in relatively safe assets. Such transactions have partially offset the drop in real estate activity observed since 2010: while property registration fees paid by the Lebanese have dropped to 1.3 percent of GDP in 2012 (down from 1.6 percent in 2010), those paid by foreigners have maintained their share and have slightly increased (Figure 32). While Gulf citizens have progressively and drastically reduced their real estate transactions in Lebanon through 2012 following bans on travel to Lebanon, Syrian nationals have been able to more than offset this decrease. This offset, however, is likely not sustainable if the Syrian conflict and its spillover on Lebanon's security stance remains. In fact, figures for Q1 2013 reveal a 58 percent drop in real estate fees collected from foreigners compared to Q1 2012.[26] The offset that took place in 2012

[26] The drop in total fees recorded 30 percent over the same period.

might prove to be a one-shot surge in demand for properties by wealthier Syrians at the start of the conflict. As political and security uncertainty rises in Lebanon, the perceived safe value of real estate in Lebanon by Syrian nationals might be waning.

Banking sector

40. The banking sector remains resilient despite the Syrian shock. Seven Lebanese banks are currently operating in Syria. Their market share before the crisis was around 22 percent (in terms of total deposits and lending in the Syrian banking sector), and more than 60 percent of the share of privately-owned banks.[27] Pre-crisis banks' assets in Syrian branches were estimated at US$2 billion and belonged to strong banks, which have adequate reserve coverage and therefore do not impose an unreasonable added risk. BdL estimated the total losses of Lebanese banks operating in Syria at around US$400 million.[28] This constitutes 18.7 percent of the total banking sector profits and 0.27 percent of total assets of the consolidate balance sheets of Lebanese banks. The banks have increased their provisions to cover these losses. This will impact their profitability on the short term. However, the medium to long term outlook remains positive. Indeed, Lebanese banks grew rapidly in Syria before the crisis, and can assume a similar role when the conflict is resolved.

Fiscal cost

41. Fiscal costs are uncertain but growing rapidly; they are also likely to further accelerate the longer the Syrian conflict lasts due to non-linearities in public service delivery. The influx of Syrian refugees has created an additional fiscal burden on the government to provide basic services. Beyond the fiscal cost, the influx has strained public services in services such as health and education. In some instances it even led to higher prices. To date, notwithstanding the significant uncertainty, the fiscal costs seem limited at the macroeconomic level. Nevertheless, these costs are bound to rise sharply as the Syrian conflict lengthens and refugee influx increases. With limited fiscal space and a rising budget deficit, it will be hard for the Lebanese government to provide these needed services. This could deepen the human crisis, fuel social tensions, and enhance security threats on the country. In this context, security operational costs are also expected to increase. This comes as an indirect consequence of the political ramification of the Syrian conflict on Lebanon with rising security incidences and increasing need for intervention by the army and the security forces.

42. In January 2013, the GoL made an appeal of US$370 million to the donor community to finance its comprehensive plan for services provision to Syrian refugees. The appeal was presented in January 2013 both at the Arab League's Foreign Secretaries' special meeting on Syria held in Cairo and during the International Humanitarian Conference for Syria held in Kuwait. The plan allocates US$180 million for services provided by the ministries of health, education, social development, and the higher relief council. The remaining US$190 million are intended to finance activities organized by international organizations. While donors have pledges US$1.5 billion at the Kuwait summit, the Lebanese share of the grants is still to be disbursed. On the other hand, UNHCR has launched a US$267 million appeal to

[27] Lebanese banks constituted 60 percent of assets, 70 percent of deposits, and 57 percent of loans of private banks operating in Syria.

[28] As of September 2012. With the crisis intensifying in Syria, this number is expected to have risen significantly.

sustain refugees-related humanitarian operations.[29] So far,[30] 88 percent of this appeal has been met.[31] As the refugee influx keeps soaring, a significant scale up of the international community's support for Lebanon is warranted.

43. **The Syrian conflict is negatively impacting fiscal revenues on a net basis.** The boost in customs receipt and VAT revenues coming from imports substitution, aggregate demand in Syria, increased exports to Syria, and Syrians consumption in Lebanon are outweighed by the drop in revenues as a result of the economic slowdown. Therefore a net negative effect of the crisis is depicted on domestic revenues.

Inflation

44. **The Syrian conflict exerts upward pressure on Lebanon's domestic prices.** Figure 19 reveals that inflation has been broadly trending up since the start of 2012. Indeed, core inflation[32] jumped above 3 percent since February, and has accelerated further in Q4 2012 reaching 4.9 percent in October and 5.3 percent by end-2012. Looking at Q1 2013, headline inflation reached 4.4 percent.[33] These inflationary pressures are attributed to a mixed effect of domestic factors, including the February 2012 wage adjustment (Special Focus #2 page 22), and the impacts of the Syrian conflict (Special Focus #1 page 31). Focusing on the latter, domestic prices were influenced by (i) the rise in aggregate demand related to Syrians consumption in Lebanon; (ii) import substitution from cheap Syrian goods to more expensive foreign sources; and (iii) the rise in rent prices as result of the large demand shock in the housing market coming from Syrians seeking refuge in Lebanon and the relatively inelastic housing supply in the short-term. This is particularly the case in the bordering regions of the North and the Bekaa where the housing stock is initially low[34] and the concentration of Syrians taking residency is high. In the absence of reliable rent data in Lebanon, it is, however, difficult to quantify the contribution of the increase in rent prices to inflationary pressures.

[29] Excluding services or assistance provided to Syrians that are not officially registered as refugees with UNHCR.

[30] As of May 2013. Source: UNHCR http://data.unhcr.org/syrianrefugees/country.php?id=122# .

[31] Lebanon also received some grants for refugees assistance from entities like the EU (Euro30 million), Norway (US$10 million), the USA (US$80 million), Australia (US$11.5 million, still a pledge), UN agencies operating in Lebanon, Iran (in-kind donation of food rations and non-food humanitarian items for 30,000 families), and Russia (in-kind donation, 37 tons of humanitarian aid for refugees).

[32] Core inflation is defined as headline inflation minus fuel and food inflation. Due to data limitations, it has been calculated using the CPI figures of the Consulting & Research Institute and recalibrated by the weights of the official CPI of the Central Administration of Statistics.

[33] As the official CAS inflation data have not been published to date for 2013, core inflation cannot be calculated. Only headline inflation calculated by the private firm CRI is available.

[34] The exogenous nature of the shock and the uncertainty of its length hinders investment decision to expand housing units so as to accommodate the increase in rental demand, especially that such investments have a long horizon that is not necessarily aligned with the expectation that the current surge in demand is temporary.

IMPACT OF THE PROPOSED CHANGES IN PUBLIC SECTOR WAGES[35]

45. *Amid uncertain growth prospects and shrinking fiscal space, the government›s initial decision to significantly increase public sector employees› salaries is raising significant challenges. While the cost of living increase aims to offset the erosion of real wages over time, the change in the structure of salary scales is not accompanied by a similar structural revision of tasks and efficiency of public sector employees. At the macro-economic level, the overall increase in wages would weaken the Lebanese economy through the return of unsustainable debt dynamics, pressures on the peg, lower economic growth, and increased unemployment. Introducing revenue measures would reduce these negative impacts but would lower resilience to shocks and impede the use of counter-cyclical fiscal policies. Reforming the pension system would further reduce the negative impact, but such reform cannot be separated from the need for strengthening social safety nets.*

Introduction

46. In 2012, the government announced and partly implemented measures boosting public sector wages: a cost of living (CoL) adjustment and an adjustment to the salary scales. Nominal salaries in Lebanon are adjusted for inflation relatively infrequently, in part due to a policy decision taken to freeze nominal wages when the country was experiencing fiscal duress. As public debt dynamics had improved significantly, the government introduced a CoL in 2012 (the increase was retroactive to February 2012 but disbursements occurred throughout the year). Prior to the 2012 adjustment, a lump-sum adjustment was provided in 2008, and the one prior to 2008 was in 1997. The CoL increase is aimed at restoring some of the lost purchasing power of public wages. In addition to the CoL, in March 2013 the government adopted a salary scale adjustment along with a package of measures aiming to secure the budget neutrality of the proposed adjustment. These measures are: (1) introducing a revenues package, (2) paying the increase by installments,[36] and (3) cutting the salary scale adjustment down from the original proposal and reforming the pension system by including an increase in pension contributions and a revision in pension benefits so as to reduce the total cost of the salary scale adjustment.[37]

[35] For more details, see Chadi Bou Habib, Eric Le Borgne, and Mohamed Ali Marouni (2013), “Lebanon: economic and labor force impact of the proposed change in the wage structure of the public sector”, Policy Note, forthcoming, World Bank office in Beirut.

[36] These installments are implemented according to the following scheme: (i) no salary adjustment payments occur until April 2013, (ii) from April 2013 to March 2014, installment represent 50 percent of the monthly due, (iii) from April 2014 to March 2015, installments amount to 75 percent of the monthly due, (iv) from April 2015 onward, the full monthly scale adjustment is paid, and, (v) from January 2016 to June 2017, the government pays in monthly installments the backload of salary adjustment due from February 2012 to April 2013 and the residual of the installments of the period April 2013 – March 2015.

[37] The salary scale adjustment can be traced to the increase in the salaries of judges passed by the parliament, which triggered demands for further adjustments by the rest of the public sector. This episode shows that the legal control of the government over the budget is not complete, since parliamentarians can propose binding amendments with fiscal implications within the fiscal year.

47. **If adopted in its entirety, the proposed package of measures would lead to a substantial salary increase for all public sector employees and pensioners in Lebanon.** The beneficiaries from CoL and salary scale adjustment are civilian and military staff of the government and own-budget agencies, which represents approximately 16 percent of the labor force and 22 percent of wage earners in Lebanon. Retirees would also benefit from the increases as their pensions increase is linked to public sector salary increases. The 2012 accrual annual cost of CoL and salary adjustment is estimated at LBP1,995 billion, or 3 percent of 2012 GDP—1.3 percent of GDP for the CoL and 1.7 percent of GDP for the salary scale adjustment. If cash payment of these increases are back-loaded through installments, the payment for 2013 is estimated at LBP1,319 billion while the payment for 2016 would reach LBP3,077 billion.

48. **The scale and scope of the proposed wage measures raise significant concerns regarding their economic impacts.** The various areas of concerns include public finances (e.g., are these affordable?), the labor market (e.g., impacts on private sector wages, on reservation wages, on unemployment?), on inflation (e.g., will the additional spending prove inflationary, will public sector wage increases result in similar increases in the private sector?), on the balance of payments (will the increased public sector wage bill result in higher imports to meet higher consumption, and in lower exports as price competitiveness could be impacted by rising domestic prices/cost of production), and on economic growth in general.

49. **This note assesses the economic impacts of the combined CoL increase and salary scale adjustment.** Two complementary models are used for this assessment. First, a Computable General Equilibrium (CGE) model constructed under the MILES project for Lebanon.[38] Second, the standard macroeconomic model of the World Bank (Rmsmx - Revised Minimum Standard Model-eXtended). The CGE is based on a social accounting matrix that puts in relation GDP, investments, forward and backward linkages between sectors, GDP aggregates, factors of production, remunerations, and labor force. The Rmsmx is a macroeconomic consistency framework that puts in relations the major components of national accounts: consumption, investments, fiscal and external balances, and prices.[39]

50. **Five scenarios—reflecting different extent of adoption of the wage measures—are analyzed to better understand the expected impacts and trade-offs of the wage measures.** As the proposed salary scale increase has yet to be approved by Parliament, significant uncertainty exists regarding the scale and scope of the approved package. A baseline scenario simulates the situation in case no wage increases were introduced, not even the CoL increase of 2012. Four additional scenarios are investigated. Scenario 1 (current policies) builds on the baseline by adding the cost of living increase. Scenario 2 contains both the cost of living increase and the full salary scale adjustment (but without the offsetting measures proposed to accompany to salary scale increase). Scenario 3 adds to Scenario 2 the revenue measures proposed. Finally, Scenario

[38] World Bank, "Republic of Lebanon – Good Jobs Needed: The Role of Macro, Investment, Education, Labor and Social Protection Policies (MILES)", forthcoming.

[39] The models provide limited insights on the distributional impact of fiscal policies. For example, they do not allow simulating the impact of a tax increase affecting high income categories with lower propensity to consume, simultaneous with a wage increase benefiting to lower income categories with higher propensity to consume.

4 builds on the previous scenario by reducing further the net cost of the salary scale increase by adding the expenditure and pension reform proposed by the government. The extent to which the public sector wage increase spills into similar requests and gains from private sector workers have a major impact on economic impact of the wage measures. Therefore, under each scenario, two variants are analyzed: (a) a pass through of 10 percent from public to private wages and variant (b) a pass through of 37 percent.[40]

Impact of the public sector wage increases (without revenue measures)

51. **The CoL increase of 2012 is estimated to result in a widening of the fiscal deficit, rising macroeconomic vulnerabilities, and weaker employment and growth.** From the above two models the following key findings emerge compared to our baseline scenario (Table 1, scenario 1). First, public finances would deteriorate. Since no offsetting revenue measure accompanied the CoL increase, it automatically widened the central government's fiscal deficit. Over the period 2013-2019, the resulting cumulated deficits would reach 6 percentage points (pps) of GDP; these would increase the public debt-to-GDP ratio by a similar magnitude by 2019. Second, the current account deficit would widen and foreign reserves shrink by US$2.6 billion in 2019. This arises because the increase in domestic consumption would leak abroad as imports represent around 50 percent of domestic demand. Third, GDP growth would be lower by 0.5pp by 2019. Fourth, labor markets impacts would be mixed: while informality and outmigration would decline due to higher wages in the economy as a whole over a two to three years horizon, the unemployment rate would rise by 0.5pp by 2019 due to a decline in labor demand (under the low pass through assumption). Over the long-term, the steady increase in the unemployment rate ends by putting outmigration on an upward trend starting 2016-17.

52. **Without revenue measures the salary scale increase would further weaken Lebanon's economy if added to the above CoL increase.** Adding the salary scale increase on top of the CoL increase would exacerbate the problems highlighted in the above scenario (Table 1, scenario 2). Compared to the baseline scenario, the fiscal deficit would increase by 0.8 to 3 percent of GDP per year over the 2013-19 period, depending on installments. Consequently, the debt-to-GDP ratio would rise by 8pps of GDP in 2019. Imports would increase further. As inflation would accelerate, the real exchange rate would appreciate. The resulting weakening in Lebanon's price competitiveness would, in turn, hurt exports performance. This would lead to a decline in foreign exchange reserves of US$6.4 billion by 2019. Interest rates would increase, driven by higher deficits and higher inflation and would contribute to further increasing deficits through higher debt service. The longer term structural impact would be an additional slowdown in growth by 0.6pp in 2019 compared to scenario 1. Unemployment increase further by an additional 0.4pp (under the low wage pass through

[40] The 10 percent transmission rate corresponds to the average observed in the case of OECD countries and the 37 percent to what has been observed in the case of Morocco.

assumption) compared to scenario 1. The growth and employment impact comes essentially through the investment channel (i.e., rising fiscal deficits reduce domestic savings, which constrains private investment, reduces growth and labor demand and increases unemployment). Total investment drops by 17.3 percent compared to baseline by 2019.

53. **Construction and manufacturing sectors would be the most impacted by the CoL and salary scale increases** (Table 1). The collapse in investment would take a toll on the construction sector, since construction is a major component of gross fixed capital formation. The manufacturing sector, a major input provider to the construction sector, would also suffer. All other sectors would experience a fall in economic activity, but of a lower magnitude than for construction and manufacturing.

54. **Skilled non-youth and unskilled youth would be the most impacted by the CoL and salary scale increases.** Labor demand and unemployment would be affected both by the decline in investment and by the transmission of public sector wage increases to the cost of labor in the private sector. Unskilled youth would be mostly affected by the decline in the construction sector. Skilled non-youth would be mostly affected by the wage pass through, since their salaries are already on the upper bounds of the market. Indeed, salaries of skilled non-youth are relatively high and any pass-through that would push these salaries further would reduce the demand for skilled non-youth labor

The offsetting revenue package: assessment, alternative options, and impact

55. **The proposed revenue package includes several one-off measures and new fees.** The CoL and salary scale adjustment would increase annual current spending by LBP1,995 billion on average. Revenue measures proposed by the Government are expected to generate LBP3,952 billion additional revenues in 2013. The revenue increase proposed does, however, include a number of large one-off revenue measures. The large 2013 revenue take is, therefore, far higher than the permanent revenue flow that would result from the proposed revenue package. For example, 29 percent of revenues measures arise from one-off fines on illegal constructions, illegal use of public sea-shores, and illegal water wells (LBP265 billion), or to one-off taxes on asset reevaluations (LBP874 billion). An additional 34 percent of the proposed revenue package (LBP1,350 billion) is expected to come from a new investment fee where real estate developers buy the right to increase the size of built areas beyond what is allowed by current regulations.

56. **Some of the one-off revenue measures suffer from uncertain revenue yield, are potentially inequitable and unfair, and depart from fundamental tax policy principles.** More specifically:

- *Revenue uncertainty*. The new investment fee on real estate developers is still debated and might be fine-tuned and adopted as a "green building" code. Hence, its revenue yield is subject to significant uncertainty. As this accounts for more than one third of the estimated 2013 revenue gains, a major revenue shortfall could arise.

- *Equity, fairness, and governance issues*. If not properly designed, the one-off fines on illegal constructions, illegal use of public sea-shores, and illegal water wells could potentially raise significant inequity, fairness, governance issues, and incite further illegal activity. The option of legalizing what are currently illegal activities is one of the two key options available (the other option is to refuse to validate the illegal activities and require these infringements to cease immediately). The penalties imposed on the illegal perpetrators of these activities, however, need to be carefully assessed and designed. They would need to incorporate not only the regular taxes that should have been paid had these activities been legally pursued, but also penalties and interests for the lack of payment on these taxes. Most importantly, to regularize their "ownership" the illegal "owners" should be requested to purchase from the state the illegally obtained assets at the current market price.
- *Time inconsistent tax policy*. The tax on asset re-evaluation is time inconsistent[41]—a major red flag in tax policy—as it is imposed on capital "gains" that accrued during a period through which no such tax existed. Investors, therefore, made their investment decision at the time based on the existing tax regime. Retroactively changing the tax regime severely undermines the credibility of the tax regime in Lebanon and could lead investors to assume that further arbitrary retroactive taxation will occur; this could result in a sharp fall of investment due to this "tax uncertainty" premium. Another issue with this tax is that it is applied on an estimated gain between the historical purchase value and the present without any transaction occurring—i.e., no actual gains have been cashed, yet capital gains taxes are claimed.

57. **The permanent revenue measures consist mostly of indirect taxes, administrative and stamp fees, or tariff reform.** These measures represent the remaining 37 percent (LBP1,463 billion) of the proposed revenue package. Of this amount, LBP600 billion is expected to be generated through an increase in stamp fees for construction permits. Various stamp fees on phone bills, travelers departures, administrative and commercial transactions are expected to generate LBP281 billion. The introduction of a 15 percent VAT rate on luxury goods, the lowering of VAT refunds for tourists, and raising excises on alcoholic beverages are estimated to generate LBP251 billion. An increase in electricity tariffs is expected to generate LBP275; this would reduce the central government's deficit by an equivalent amount given the large fiscal transfers EdL is receiving. Finally, a rise in taxes on lottery gains and the introduction of a 15 percent capital gain tax on real estate capital gains would generate LBP56 billion.

58. **The sustainability, efficiency, and equity of proposed revenue package could be improved.** An alternative to the tax on asset re-evaluation would be to introduce a property tax that applies to the estimated value of the property on yearly basis. Such tax is sustainable, since it will be providing a continuous stream of revenues, time consistent since this revenue is related to a yearly estimation of property value, efficient (limited distortionary effect as it taxes an immovable asset), and progressive as home ownership rises with income (the property tax rate could also be increasing with the underlying

[41] See Kydland and Prescott (1977) "Rules rather than discretion: the inconsistency of optimal plans," Journal of Political Economy, for a description of the time inconsistency problem and its application to taxation.

asset value so as to further increase progressivity).[42] The introduction of a second VAT rate would complicate the administration of the VAT, increase compliance costs, and increase the potential for fraud. A similar revenue gain could be achieved through the use of excises targeting the same luxury goods. Excises would be efficient on luxury goods as these are relatively price-inelastic.

59. **Recurrent and sustainable measures can significantly reduce the negative macroeconomic and structural impacts of wages increases.** Revenue measures would restore the upward trend in revenues observed up to 2011 and would bring revenues up from the low 22 percent of GDP observed in 2012 to 25.5 percent of GDP in 2019, the level generally observed in middle-income countries. Moreover, of the 3.5pps of GDP increase in revenues, 2.0pps would correspond to restoring revenues to the average of 24 percent of GDP observed in 2006-2011. Revenue measures would strongly reduce the negative impacts of the CoL increase and salary scale adjustments. The debt-to-GDP ratio would be only 0.9pps of GDP higher in 2019 than in the baseline scenario where the wage increases have not occurred. Increase in imports would remain moderate and reserves would be only US$648 million lower than the baseline. One major structural impact is limiting the decline in GDP growth to 0.3pp against 1.1pps in 2019 under the no-revenues scenario with low transmission. Also, unemployment would increase by a more modest 0.5pps. Importantly, outmigration and informality would decline throughout the period. Indeed, by maintaining savings and investments, revenue measures maintain growth and labor demand which has a positive effect on labor supply. These positive compensatory effects should, however, be weighed against the loss of fiscal space which lowers resilience to shocks and impede the use of counter-cyclical fiscal policies when needed.

Expenditure reforms aimed at reducing the total cost of the wage increases

60. **Beyond revenue measures, the Government is proposing a package of reforms to reduce the overall cost of the salary scale adjustment.** The proposed package includes a cut of 5 percent of the previously announced increase in wages and a reform of the civil service pension system, including an increase in pension contribution and a revision in pension benefits (e.g., imposing taxes on benefits, changing the eligibility of dependents to benefit from the pension of a defunct beneficiary). The overall saving from these measures is expected to reach a cumulative LBP800 billion over the period 2013-19.[43] These savings would improve further the macroeconomic and structural outcome of revenue measures, and GDP growth would be only 0.2pp lower than the baseline scenario.

[42] Introducing a property tax would, in the medium term, allow the Government to gradually consolidate all revenues and shares of revenues earmarked for municipalities with the overall budget and substitute them with a property tax that finances local Governments. In parallel, a property tax would be a powerful instrument for the implementation of the land-use plan and can support the implementation of the "green building" code.

[43] We exclude the expected additional tax on wages on salaries collected due to the salary increase (LBP250 billion over the period) since we have included it under the revenues package.

61. **Reforming the private sector pension and health systems could promote stronger public pension reforms and would further mitigate the impact of the wage increases.** Around 50 percent of the Lebanese population lacks any formal health insurance coverage. Pensions are also a rarity in the private sector as end-of-service (lump sum) indemnity is the rule. In contrast, public sector pension is generous and public sector health coverage is guaranteed. Hence, the incentive for queuing for public sector job is already high and will be reinforced by the increase in public sector wages. The eligibility of widows, children and single daughters to the pension and subsequent benefits of the dead beneficiary can be looked at as a social safety net in the absence of social protection and universal health coverage. In this context, a radical reform of the public pension system, although needed, is difficult to implement since it would be assimilated to a weakening of one major alternative to the absence of an efficient social safety net. Also, the substandard pension system in the private sector and the uneven access to health services reinforces the perception of public employment as a safe choice and deepens the distortions related to CoL and salary scale adjustment. In sum, public pension reform can be reinforced, and the distortive impact of CoL and salary scale adjustment can be further mitigated if they are accompanied with a reform of the pension system, health coverage and social safety nets for the rest of the population.

Conclusion

62. **Increasing revenues to accompany the CoL and salary scale increase is crucial to both maintain macroeconomic stability.** A CoL and salary scale increase entirely financed through deficit and money creation would result in a notable worsening of Lebanon's economy: debt would remain high, foreign currency reserves would shrink drastically, inflation and interest rates would rise, the real exchange rate would appreciate sharply thereby hurting the competitiveness of Lebanese exporters, and real GDP growth would be lower by 1.1 pp. On the labor market, while informality and outmigration would decline until 2016-17 due to higher public (and private) wages, they would increase again from 2017 onward as a result of the drop in economic activity and the rise in unemployment. Also, unskilled-youth and skilled-non youth would suffer the most from unemployment. Revenue compensation would reduce macro imbalances and allow Lebanon to maintain fiscal consolidation and reach a debt-to-GDP ratio of 119 percent by 2019, the same ratio as in the baseline scenario where no wage increases takes place.

63. **Revenue compensation would also and limit distortions in the economy and the labor markets.** When revenue measures are introduced to compensate for the fiscal cost of the wage increases, the unemployment rate increases slightly while informality and outmigration decline. With around two thirds of revenues generated through property tax, the scenario we propose places much of the burden of the revenue increase on capital income rather than on labor income and consumption. If this distributional approach is adopted, revenue compensation would not bear any additional burden for labor cost nor for the welfare of wage earners. Reducing the overall package of salary scale adjustment and reforming the pension system produces good macroeconomic outcome and reduces further the negative impact of wage increases on economic growth and labor markets.

64. More fundamentally, such large wage and revenue increases and pension reforms need to be accompanied by a reform of public employment, social protection, and health insurance. While the cost of living increase aims to offset the erosion of real wages over time, a structural salary scale adjustment of the magnitude proposed in Lebanon should be the counterpart of structural reforms. The latter should (i) define the mission of the public sector, (ii) define the functions of public institutions and, (iii) reshuffle the terms of reference of public sector staff. Reforms of public sector salaries and pensions, however, have to be linked to an overall reform of social protection and health insurance systems so as to widen coverage of the population. In sum, increasing public wages and reforming public pensions system should go hand on hand with the reform of private pension systems and health coverage, which would increase the attractiveness of private employment and reduce the reliance on public employment as source of welfare.

DATA APPENDIX

TABLE 1.

Lebanon: Impact of the public sector wage increases compared to baseline scenario (equilibrium impact as of 2019) 1/

	Cost of Living (CoL) Increase		*CoL and Salary Scale Increases*					
	No Revenues Measures		*No Revenues Measures*		*Revenue Measures*		*Revenue Measures, Cuts & Pension Reform*	
	Scenario 1		*Scenario 2*		*Scenario 3*		*Scenario 4*	
Elasticity of Private Wages to Public Wages	*0.1*	*0.37*	*0.1*	*0.37*	*0.1*	*0.37*	*0.1*	*0.37*
Growth and Labor Force								
GDP Growth (pp)	-0.5%	-0.6%	-1.1%	-1.2%	-0.3%	-0.3%	-0.2%	-0.3%
o/w Construction	-1.8%	-2.0%	-3.4%	-3.8%	-0.9%	-1.3%	-0.8%	-1.1%
o/w Manufacturing	-0.5%	-0.6%	-1.0%	-1.1%	-0.3%	-0.5%	-0.3%	-0.4%
Informal Labor Supply	-1.0%	-0.8%	-2.1%	-1.6%	-2.0%	-1.5%	-1.9%	-1.4%
Emigration of Lebanese	3.1%	3.5%	5.4%	6.1%	-1.4%	-0.6%	-1.4%	-0.7%
Unemployment (pp)	0.5%	0.9%	0.9%	2.0%	0.5%	1.5%	0.5%	1.4%
o/w Low Skilled Youth (pp)	0.7%	1.3%	1.3%	2.7%	0.6%	2.0%	0.5%	1.9%
o/w Medium Skilled Non-Youth (pp)	0.5%	1.1%	1.1%	2.4%	0.6%	1.9%	0.6%	1.8%
o/w High Skilled Non-Youth (pp)	0.8%	1.5%	1.7%	3.1%	1.1%	2.5%	1.0%	2.4%
Money and Prices (%)								
CPI Inflation (pp)	0.1%		0.3%		0.0%		0.0%	
Nominal Interest Rate (pp)	0.1%		0.3%		0.0%		0.0%	
Real Exchange Rate (pp)	0.1%		0.3%		0.0%		0.0%	
Government Finances (% of GDP)								
Revenues (pp)	0.0		0.0		2.0%		2.0%	
Expenditures (pp)	0.9%		2.7%		1.8%		1.7%	
Overall Balance (pp)	-1.0%		-2.7%		0.2%		0.3%	
External Sector								
Current Account (% of GDP, pp)	-0.1%		-0.7%		0.3%		0.3%	
Gross Reserves (US$ million)	-2,594		-6,393		-648		-495	
Public Debt (% of GDP)								
Debt Ratio (pp)	6.0%		14.0%		0.9%		0.0%	
Debt Service Ratio (pp)	0.4%		1.5%		0.3%		0.3%	

Source: World Bank Staff Simulations and Calculations. Note: pp stands for percentage points.

1/ The revenue measures included in the simulations are: the proposed increase in excises on alcoholic beverages, the increase in notary fees, the increase in the tariff of electricity, an increase the tax on wages and salaries to reflect the CoL and salary scale increases. We consider the fines on illegal constructions and on illegal use of public sea-shores as being one-time revenues collected in 2013 (2/). In parallel we disregard all the remaining administrative and stamp fees since they increase costs and reduce the competitiveness of some key sectors, such as telephony and travel and tourism. Also, we disregard the increase in the stamp fee on construction permits given the downturn in the construction cycle and the observed decline in construction permits. Finally, we disregard revenues expected from "green building" code since debate on the subject remains unsettled.

2/ Total recurrent revenues in 2013 would be LBP1,220 billion, including: LBP20 billion tax on wages and salaries, LBP150 billion increase in excises on luxury goods, LBP96 billion increase in excises on alcoholic beverages, LBP30 billion increase in notary fees, LBP874 billion property tax, and LBP50 billion tax on capital gain. One time revenues are: LBP100 billion fines on illegal constructions and LBP155 billion on illegal occupations of sea-shores. The tariff increase on electricity, LBP275 billion, is not a revenue for the Government and would be introduced as decline in subsidies to the electricity company. For the purpose of simulations, we consider the LBP874 billion expected from the tax on asset reevaluation as the revenue occurring from the proposed property. This number is consistent with the worldwide average of property tax to GDP ratio, estimated at 1.4 percent. For projections, we consider that the tax on wages to evolve with the CoL increase and the salary scale adjustment. Excises and electricity tariff evolve at the same rate as nominal GDP, while property tax and tax on capital gains evolve at the same rate as CPI inflation.

TABLE 2.

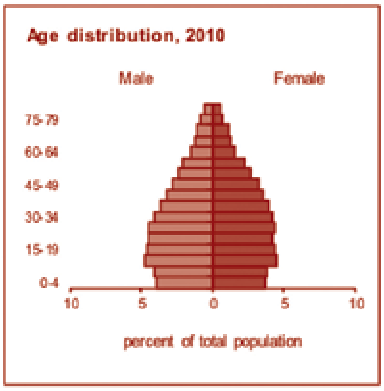
Lebanon: Selected Economic Indicators, 2009-15

	2009	2010	2011	2012	2013	2014	2015
	Act.		Prel.	Est.		Proj.	
Real sector	*(annual percentage change, unless otherwise specified)*						
Real GDP	8.5	7.0	3.0	1.4	2.3	4.0	3.8
Real GDP per Capita	7.7	6.2	2.3	0.7	1.5	3.2	3.0
Agriculture (share of GDP)	4.6	4.5	4.5	4.5	4.5	4.5	4.5
Industry (share of GDP)	18.7	20.1	20.1	20.1	20.5	20.7	20.7
Services (share of GDP)	76.7	75.4	75.4	75.4	75.0	74.8	74.8
Money and prices							
CPI Inflation (p.a)	2.8	4.9	5.7	5.7	4.9	3.7	3.0
Money (M3, including non-resident deposits)	23.1	12.1	7.1	6.1	8.0	10.0	10.0
Investment & saving	*(percent of GDP, unless otherwise specified)*						
Gross Capital Formation	34.7	33.9	29.8	29.4	30.0	31.3	31.2
o/w private	33.1	32.1	28.0	27.3	27.0	27.7	27.4
Gross Domestic Savings	6.9	5.9	12.2	8.8	9.6	11.0	11.4
o/w private	11.9	11.1	21.6	21.4	20.2	19.6	18.9
Central Government Finance							
Revenue (including grants)	24.7	22.8	23.5	22.0	22.9	23.5	23.5
o/w. tax revenues	19.4	20.0	18.5	17.7	18.0	18.5	18.5
Total expenditure and net lending	32.8	30.4	29.2	31.5	32.1	31.7	31.8
Current	31.2	28.6	27.4	29.4	29.1	28.1	28.0
o/w Interest Payment	11.1	10.5	9.4	8.4	8.2	8.2	8.3
Capital & Net Lending (excluding foreign financed)	1.6	1.8	1.8	2.1	3.0	3.6	3.8
Overall balance (deficit (-))	-8.2	-7.7	-5.7	-9.4	-9.2	-8.3	-8.3
Primary Balance (deficit (-))	2.9	2.9	3.6	-1.0	-1.0	-0.1	0.0
External sector							
Current Account Balance	-19.5	-20.4	-12.1	-14.4	-15.7	-16.4	-16.9
o/w Export (GNFS)	24.3	24.1	32.2	28.7	28.9	29.4	30.0
o/w Import (GNFS)	48.4	50.2	50.0	49.2	49.3	49.7	49.8
o/w Remittances	4.8	7.2	6.4	6.8	6.8	6.9	7.0
Trade Balance (GNFS)	-24.1	-26.1	-17.7	-20.6	-20.4	-20.3	-19.8
Trade of Goods Balance	-31.7	-31.5	-30.7	-30.1	-29.9	-29.9	-29.6
Gross Reserves (months of imports GNFS)	18.4	18.4	18.4	18.3	17.9	17.3	16.6
Total Public Debt							
Total Debt Stock (US$ billion)	51,152	52,602	53,656	57,700	61,798	65,898	70,299
Debt-to-GDP ratio (percent)	147.6	141.7	133.8	134.4	134.2	132.9	132.9
Memorandum Items:							
Nominal GDP (in billion LBP)	52,236	55,965	60,442	64,740	69,420	74,724	79,727
Exchange Rate, Average (LBP/US$)	1,507.5	1,507.5	1,507.5	1,507.5	1,507.5	1,507.5	1,507.5
GDP (in million US$)	34,651	37,124	40,094	42,945	46,050	49,568	52,887

Source: Government of Lebanon data, World Bank staff for estimates and projections.

TABLE 3.
Lebanon at a Glance

Key Development Indicators	Lebanon	M. East & North Africa	Upper middle income
(2011)			
Population, mid-year (millions)	4.3	331	2,452
Surface area (thousand sq. km)	10	8,775	59,328
Population growth (%)	0.7	1.7	0.7
Urban population (% of total population)	89	58	57
GNI (Atlas method, US$ billions)	39.2	1,283	14,429
GNI per capita (Atlas method, US$)	9,200	3,874	5,884
GNI per capita (PPP, international $)	*14,090*	*8,068*	9,970
GDP growth (%)	3.0	4.3	7.8
GDP per capita growth (%)	2.3	2.5	7.1
(most recent estimate, 2005–2011)			
Poverty headcount ratio at $1.25 a day (PPP, %)	..	3	..
Poverty headcount ratio at $2.00 a day (PPP, %)	..	14	..
Life expectancy at birth (years)	..	72	73
Infant mortality (per 1,000 live births)	..	27	17
Child malnutrition (% of children under 5)	..	8	3
Adult literacy, male (% of ages 15 and older)	93	82	96
Adult literacy, female (% of ages 15 and older)	86	66	91
Gross primary enrollment, male (% of age group)	105	106	111
Gross primary enrollment, female (% of age group)	99	98	111
Access to an improved water source (% of population)	..	89	93
Access to improved sanitation facilities (% of population)	..	88	73



Net Aid Flows	1980	1990	2000	2011 [a]
(US$ millions)				
Net ODA and official aid	298	286	200	449
Top 3 donors (in 2010):				
United States	3	12	32	84
France	16	26	31	60
European Union Institutions	5	29	36	53
Aid (% of GNI)	..	*2.6*	1.1	1.2
Aid per capita (US$)	114	90	53	106

Long-Term Economic Trends	1980	1990	2000	2011	1980–90	1990–2000	2000–11
					(average annual growth %)		
Consumer prices (annual % change)	..	-99.7	-0.8	5.7			
GDP implicit deflator (annual % change)	..	*97.4*	-2.1	4.9			
Exchange rate (annual average, local per US$)	..	695.1	1,507.5	1,507.5			
Terms of trade index (2000 = 100)	..	*91*	100	79			
Population, mid-year (millions)	2.6	3.2	3.8	4.3	1.9	1.7	1.1
GDP (US$ millions)	..	*4,690*	17,260	40,094	..	8.8	5.0
		(% of GDP)					
Agriculture	..	*7.3*	7.1	5.9	..	*7.0*	0.9
Industry	..	*25.5*	22.8	20.6	..	*5.2*	5.1
Manufacturing	..	*14.4*	13.0	8.2	..	*6.4*	1.2
Services	..	*67.2*	70.1	73.5	..	*6.4*	5.0
Household final consumption expenditure	..	124.5	84.1	74.1	..	8.0	3.8
General gov't final consumption expenditure	..	14.0	17.3	13.8	..	14.7	3.3
Gross capital formation	..	29.3	20.4	29.8	..	9.9	10.4
Exports of goods and services	..	12.5	14.2	32.2	..	24.1	9.6
Imports of goods and services	..	79.9	35.9	50.0	..	11.8	7.2
Gross savings	..	-10.5	-12	17.7			

Note: Figures in italics are for years other than those specified. 2011 data are preliminary. .. indicates data are not available.
a. Aid data are for 2010.
Development Economics, Development Data Group (DECDG).

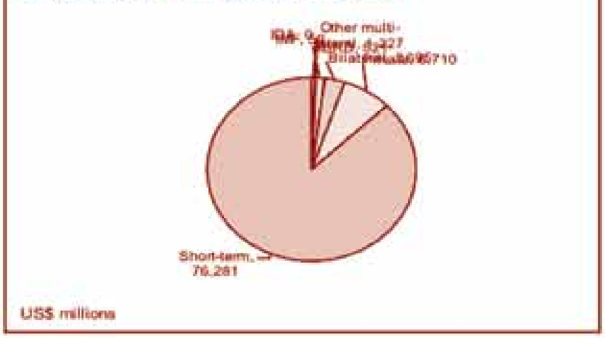
TABLE 3 (CONT.):
Lebanon at a Glance

Balance of Payments and Trade	2000	2011
(US$ millions)		
Total merchandise exports (fob)	1,050	5,318
Total merchandise imports (cif)	5,988	20,158
Net trade in goods and services	-3,774	-7,116
Current account balance	-3,754	-4,866
as a % of GDP	-21.7	-12.1
Workers' remittances and compensation of employees (receipts)	*2,544*	*7,558*
Reserves, including gold	8,273	45,216

Central Government Finance		
(% of GDP)		
Current revenue (including grants)	18.6	23.5
Tax revenue	14.6	18.5
Current expenditure	38.9	28.0
Overall surplus/deficit	-23.4	-6.4
Highest marginal tax rate (%)		
Individual	..	..
Corporate	..	..

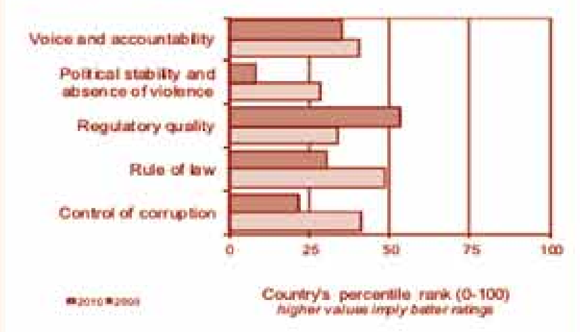
External Debt and Resource Flows		
(US$ millions)		
Total debt outstanding and disbursed	29,137	87,493
Total debt service	812	1,084
Debt relief (HIPC, MDRI)	–	–
Total debt (% of GDP)	168.8	218.2
Total debt service (% of exports)	29.4	6.3
Foreign direct investment (net inflows)	..	..
Portfolio equity (net inflows)	..	..

Composition of total external debt, 2011



Private Sector Development	2000	2011
Time required to start a business (days)	–	9
Cost to start a business (% of GNI per capita)	–	75.0
Time required to register property (days)	–	25
Ranked as a major constraint to business	2000	2010
(% of managers surveyed who agreed)		
Access to/cost of financing	..	*16.5*
Electricity	..	*12.5*
Stock market capitalization (% of GDP)	9.2	33.9
Bank capital to asset ratio (%)	6.4	7.3

Governance indicators, 2000 and 2010



Source: Worldwide Governance Indicators (www.govindicators.org)

Technology and Infrastructure	2000	2010
Paved roads (% of total)	*84.9*	..
Fixed line and mobile phone subscribers (per 100 people)	35	89
High technology exports (% of manufactured exports)	2.3	12.8

Environment		
Agricultural land (% of land area)	58	*67*
Forest area (% of land area)	..	..
Terrestrial protected areas (% of land area)	0.5	0.5
Freshwater resources per capita (cu. meters)	*1,241*	*1,144*
Freshwater withdrawal (billion cubic meters)	..	..
CO2 emissions per capita (mt)	4.1	*4.1*
GDP per unit of energy use (2005 PPP $ per kg of oil equivalent)	6.6	*7.5*
Energy use per capita (kg of oil equivalent)	1,311	*1,580*

World Bank Group portfolio	2000	2010
(US$ millions)		
IBRD		
Total debt outstanding and disbursed	311	411
Disbursements	42	24
Principal repayments	17	20
Interest payments	14	4
IDA		
Total debt outstanding and disbursed	–	0
Disbursements	0	0
Total debt service	–	0
IFC *(fiscal year)*		
Total disbursed and outstanding portfolio	218	194
of which IFC own account	127	194
Disbursements for IFC own account	20	100
Portfolio sales, prepayments and repayments for IFC own account	25	10
MIGA		
Gross exposure	–	–
New guarantees	–	–

Note: Figures in italics are for years other than those specified. 2011 data are preliminary. 3/20/13
.. indicates data are not available. – indicates observation is not applicable.

Development Economics, Development Data Group (DECDG).

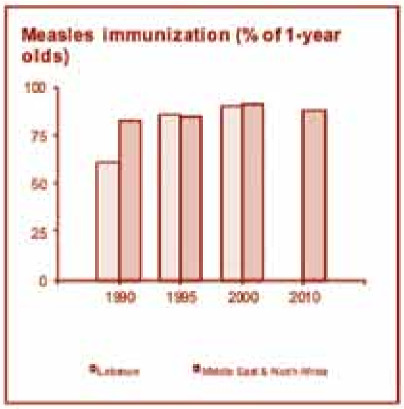
TABLE 4.

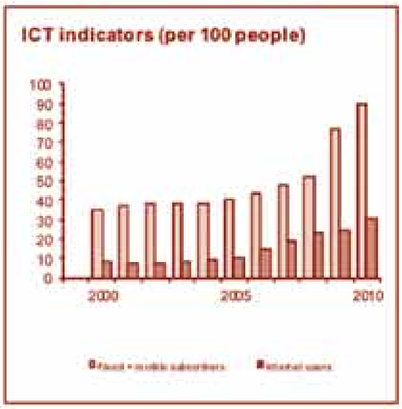
Lebanon: Millennium Development Goals, 1990-2010

With selected targets to achieve between 1990 and 2015

(estimate closest to date shown, +/- 2 years)

	Lebanon			
Goal 1: halve the rates for extreme poverty and malnutrition	**1990**	**1995**	**2000**	**2010**
Poverty headcount ratio at $1.25 a day (PPP, % of population)	..	..	..	..
Poverty headcount ratio at national poverty line (% of population)	..	..	..	..
Share of income or consumption to the poorest qunitile (%)	..	..	..	..
Prevalence of malnutrition (% of children under 5)	..	*3.0*	..	..
Goal 2: ensure that children are able to complete primary schooling				
Primary school enrollment (net, %)	..	*76*	90	..
Primary completion rate (% of relevant age group)	..	*83*	*102*	87
Secondary school enrollment (gross, %)	*61*	66	*77*	81
Youth literacy rate (% of people ages 15-24)	..	..	..	..
Goal 3: eliminate gender disparity in education and empower women				
Ratio of girls to boys in primary and secondary education (%)	..	..	..	..
Women employed in the nonagricultural sector (% of nonagricultural employment)	..	..	..	..
Proportion of seats held by women in national parliament (%)	..	..	..	..
Goal 4: reduce under-5 mortality by two-thirds				
Under-5 mortality rate (per 1,000)	37	34	32	..
Infant mortality rate (per 1,000 live births)	32	30	28	..
Measles immunization (proportion of one-year olds immunized, %)	61	85	90	..
Goal 5: reduce maternal mortality by three-fourths				
Maternal mortality ratio (modeled estimate, per 100,000 live births)	..	..	150	..
Births attended by skilled health staff (% of total)	..	*89*	..	..
Contraceptive prevalence (% of women ages 15-49)	..	..	..	..
Goal 6: halt and begin to reverse the spread of HIV/AIDS and other major diseases				
Prevalence of HIV (% of population ages 15-49)	0.1	0.1	0.2	*0.1*
Incidence of tuberculosis (per 100,000 people)	..	..	..	..
Tuberculosis case detection rate (%, all forms)	*91*	91	91	71
Goal 7: halve the proportion of people without sustainable access to basic needs				
Access to an improved water source (% of population)	..	..	100	..
Access to improved sanitation facilities (% of population)	..	..	..	..
Forest area (% of land area)	..	..	..	..
Terrestrial protected areas (% of land area)	0.5	0.5	0.5	0.5
CO2 emissions (metric tons per capita)	3.1	3.9	4.1	*4.1*
GDP per unit of energy use (constant 2005 PPP $ per kg of oil equivalent)	*8.7*	6.8	6.6	*7.5*
Goal 8: develop a global partnership for development				
Telephone mainlines (per 100 people)	13.4	13.0	15.4	21.0
Mobile phone subscribers (per 100 people)	0.0	3.5	19.9	68.0
Internet users (per 100 people)	0.0	0.1	8.0	31.0
Computer users (per 100 people)	..	..	..	..





Note: Figures in italics are for years other than those specified. .. indicates data are not available.
Development Economics, Development Data Group (DECDG).

3/20/13

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