

# BTI 2008 | Lebanon Country Report

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This report is part of the Bertelsmann Transformation Index (BTI) 2008. The BTI is a global ranking of transition processes in which the state of democracy and market economic systems as well as the quality of political management in 125 transformation and developing countries are evaluated.

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## Key Indicators

Population	mn.	<b>3.6</b>	HDI	<b>0.77</b>	GDP p.c.	\$	<b>4,968</b>
Pop. growth <sup>1</sup>	% p.a.	<b>1.0</b>	HDI rank of 177	<b>78</b>	Gini Index		-
Life expectancy	years	<b>73</b>	UN Education Index	<b>0.86</b>	Poverty <sup>3</sup>	%	-
Urban population	%	<b>86.6</b>	Gender equality <sup>2</sup>	-	Aid per capita	\$	<b>68.1</b>

Sources: UNDP, Human Development Report 2006 | The World Bank, World Development Indicators 2007 | OECD Development Assistance Committee 2006. Footnotes: (1) Average annual growth rate 1990-2005. (2) Gender Empowerment Measure (GEM). (3) Percentage of population living on less than \$2 a day.

## Executive Summary

The assassination of Lebanese Prime Minister Rafiq Hariri in 2005 marked a turning point in Lebanon's history and led to a succession of political events from which the country is still reeling. The assassination triggered an outpouring of grief, which quickly unfolded into a large popular uprising that resulted in the withdrawal of Syrian troops from Lebanon, the holding of free legislative elections, the peaceful assumption of power by the opposition, and an international investigation into the murder of Hariri. These changes have come at a very heavy price, including a string of booby-trapped car bombs and assassinations that targeted some of Lebanon's top journalists, intellectuals and politicians, and have destabilized the country. Lebanon's tourist revenues – a mainstay of the economy – have been on the decline, the rift between the various sectarian groups has widened to alarming levels, and crippling debt has spiraled to new heights. The beginning of 2007 saw rounds of youth violence reminiscent of the dark days of Lebanon's civil war in the 1970s. In July 2006, Lebanon suffered a 33-day assault by Israeli forces that have cost it \$3.2 billion in direct damages, left 1,200 dead, and set the country back years economically. The high GDP growth of 2004 has become a distant memory as the summer's war and the subsequent sit-ins by the Hezbollah-led opposition to force the resignation of the U.S.-backed government have paralyzed the economy. Despite the gloomy political mood, the government managed to organize a donor conference in Paris, where it secured pledges of more than \$7 billion to help finance its debt. At the time of writing, the political standoff has resulted in a quasi-paralysis of state institutions controlled by the opposition, including major ministries. Until an exit out of the crisis is found, the parliament will remain unable to meet.

## History and Characteristics of Transformation

Since independence in 1941 and its first parliamentary elections in 1943, Lebanon has been a parliamentary democracy based on a relatively strong rule of law, free press and civil consciousness since independence in 1941. However, Lebanon's political system has always been seriously flawed. Although formally a consociational democracy with a constitution, a parliament and regular elections, real political power in Lebanon derives from the informal networks governed by the various sectarian elites.

Lebanon is a consociational (or sectarian) democracy based on agreed mutual political concessions among various religious communities. The distribution of power among the country's largest religious groups is a key problem in Lebanon. There are 18 denominational communities, including Muslim, Christian and Druze, among a population of 3.4 million on a mere 10,542 square kilometers of land that compete for resources, influence and cultural hegemony. Estimates of each denomination's percentage are vague, as there has been no official census since 1932. In fact, there are no concrete figures on the actual size of the population because statistical proof of demographic shifts could quickly cast doubt on the electoral system of proportional representation, which has its roots in the unwritten National Pact of 1943. According to this system, seats in parliament were distributed between Christians and Muslims at a ratio of 6-5. This system also dictates that the office of president is always held by a Maronite Christian, that the post of prime minister be held by a Sunni Muslim, and that the speaker of parliament be a Shi'ite Muslim. The posts of deputy prime minister and deputy speaker are reserved for the Greek Orthodox. This proportional distribution of offices, which is based on demographic data from the 1930s, runs throughout Lebanon's entire public administration.

During peace negotiations in Ta'if, Saudi Arabia, at the end of the civil war in 1989, it was agreed that the distribution of power would be adjusted in favor of Muslims. The new 5-5 distribution of seats in parliament is somewhat closer to the demographic reality in Lebanon than was the previous ratio. No other major changes were made to the prewar system of proportional representation, except that much of the (Maronite) president's authority was shifted to the (Sunni) prime minister. The persistently sectarian nature and behavior of Lebanon's institutions, and the ensuing low quality of its governance, will continue to define the context of Lebanon's development .

There are other factors affecting the country as well. There is the economic and political legacy of Lebanon's 16-year civil war, as well as that of the long years of Israeli occupation of the south, which came to an end only in May 2000. There is also the continued conflict with Syria over the neighboring country's involvement in Lebanese affairs. In the years since the Ta'if accord (which ended the civil war),

Lebanese foreign policy has been made in Damascus, as have been decisions about Lebanon's political leadership. Syria has not shied away from direct intervention if it believed its interests were threatened. The most recent example of this was the pressure Syria exerted on the Lebanese parliament in September 2004 to extend President Lahud's term in office for another three years – effectively circumventing the Lebanese constitution. It remains to be seen whether this problem will be solved with the withdrawal of Syrian military troops from Lebanon.

The power struggle between Lebanon and Syria ultimately led to Prime Minister Hariri's resignation in October 2004. Syria accused him of having used his excellent personal connections to bring about U.N. Security Council Resolution 1559 of September 2004, which demanded a full withdrawal of all Syrian forces from Lebanon. It is not surprising that many in Lebanon and in the international community blame Syria for the assassination of Hariri in downtown Beirut on 14 February 2005. The assassination managed to unite Lebanese across all sectarian boundaries in protest and ultimately led to the resignation of the Syrian-friendly Karami government. On 28 February 2005, following the first day of a highly controversial parliamentary debate over the course of investigation into Hariri's death, then-Prime Minister Umar Karami read out the following statement, transmitted via loudspeaker to some 250,000 protesters gathered in Beirut's Martyrs' Square: "I announce the resignation of the government over which I had the honor of presiding so that it does not pose an obstacle [to the investigation into the killing]." (Karami had been forced out of government once before by public demonstrations in 1992.) In the following weeks, domestic and international pressure on Syria to abide by resolution 1559 and withdraw from the country intensified. Although most observers were skeptical that Syria would leave without a fight, the withdrawal of Syrian troops seems to have been completed. As for economic transformation, Lebanon has a long-standing tradition of facilitating a liberal economic framework. Trade in particular has never been subject to significant constraints and Lebanon is seeking to recapture its former role as the region's financial hub. However, the civil war did set the country back significantly in its development. At the end of the war, the state as the institution responsible for ensuring order, supplying public services and distributing resources had, de facto, ceased to exist, and hundreds of thousands of Lebanese – particularly members of the educated middle class – left the country.

Although not a member of parliament, self-made millionaire Rafiq Hariri was nominated prime minister in 1992, following the first post-war elections. Hariri gave highest priority to rebuilding the country's infrastructure and stabilizing the Lebanese currency. Rapid reconstruction – first of Beirut and in particular of the financial district in the old city – was funded largely by heavy borrowing, mostly from domestic banks. During this time, the nation's domestic and foreign debt ballooned five-fold and twenty-fold, respectively, while the government's uncompromising neoliberal growth policy intensified social inequalities and concentrated income among a small

percentage of the population. At the same time, however, policymakers were able to cut inflation from more than 120% to just 2-3% by the end of the 1990s. The infrastructure was returned to working order, garbage collection and mail delivery were up and running again, and the state's monopoly on the use of force was restored in most areas of the country. Control over the Israeli-occupied south was regained in May 2000. Hariri governed Lebanon with five successive cabinets, from 1992 until 1998, and again from 2000 until his resignation in October 2004.

Hariri's assassination dealt a blow to the country, for Hariri's international standing and even his private fortune were seen by many international lenders as Lebanon's only guarantee. Dealing with its massive debts will remain one of the pivotal challenges to Lebanon's economic development. Other challenges include disentangling private and public economic interests, modernizing Lebanon's economic institutions and production facilities as well as countering growing inequalities.

# Transformation Status

## I. Democracy

### 1 | Stateness

Following the end of the civil war, the Lebanese state re-established control over the entire Lebanese territory with the exception of the land occupied by Israel, which was returned in May 2000 after the withdrawal of Israeli forces. A sliver of land called the Shebaa farms on the borders with Syria and Israel remains occupied and the subject of claim by the Lebanese government. Though the state controls in principle all of the territory and a Demobilization, Disarmament and Reintegration (DDR) program was effectively implemented following the civil war to disband all militias, there remains a number of armed Palestinian factions in pockets surrounding the refugee camps dispersed throughout the country. In late 2006, new armed Palestinian factions emerged, especially in the northern regions, challenging the state's authority. There is also Hezbollah, which, until the summer of 2006, controlled southern Lebanon militarily and has managed to keep a large arsenal of weapons under the pretext of defending Lebanon and resisting Israeli violations of Lebanese sovereignty. Though the military presence of Hezbollah was severely curtailed in the south following the July 2006 war and the UNSCR Resolution 1701, the party is still in control of its weapons caches. Hezbollah also controls security in the predominantly Shi'ite southern suburbs of Beirut, which generally remains off-limits for the state's security apparatus.

Monopoly on the use of force

There is no official or systematic discrimination in Lebanon. In fact, compared to other countries in the region, Lebanon has managed to integrate minorities both into society in general and the political arena in particular. The Armenians of Lebanon are a case in point, as are new sectarian groups such as the Alawites, who acquired a seat in parliament in the past decade. The Lebanese nation is actually composed of 18 different sects with guaranteed freedoms of religious practice, beliefs and speech among others. However, since the Lebanese system is structured on apportionment of seats based on sectarian and communal quotas, an inherent discrimination is practiced within the system, since confessional background rather than merit determines the appointment of individuals. Lebanon

State identity

is also home to more than 400,000 Palestinian refugees, some of whom arrived in 1948 and are denied citizenship as well as equal access to jobs and a decent living.

Lebanon functions more or less like a secular state, but with the strong influence of religious leaders on political and other aspects of life. Officially, in a pluralist society like Lebanon, civil marriage and a civil status law are absent. Prevented by religious leaders, the absence of such a law demonstrates the power that religious leaders wield in Lebanese politics, though no laws or state regulations are based on religious texts and scriptures. The sectarian nature of the system provides that politicians make their decisions in coordination with religious leaders or at least in a manner that does not conflict with the latter's interests. This places strict limitations on individual beliefs and choices particularly outside their community.

No interference  
of religious  
dogmas

Lebanon has a reasonably well-functioning administrative structure that is particularly strong in major cities and less efficient in peripheral and rural areas. There are, however, persistent accusations of corruption and favoritism against the state's administration. In certain areas of the country, the state infrastructure is unable to perform its duty and levy taxes including collection of utility bills, or enforcement of equitable resource allocation such as water.

Basic  
administration

## 2 | Political Participation

Universal suffrage is practiced in Lebanon and parliament is elected through legislative elections every four years. The president serves for six years and is elected by parliament for one term only. Legislative and local elections have been held regularly since the civil war. However, the Syrian army played a major role in tailoring the laws overseeing these elections, thus ensuring victory for their allies. The Syrians have also twice prevailed on parliament to amend the constitution and extend the mandate of two presidents, including the incumbent Emile Lahoud. The 2005 legislative elections were free and transparent, but the laws regulating these elections were in violation of international norms, inherently discriminatory, and provided ample opportunity for manipulation, voter intimidation and fraud.

Free and fair  
elections

Governance in Lebanon is based on consensus politics with each member of the governing troika - the prime minister, president and speaker of parliament - having a de facto veto power. The president, for example, is needed to pass laws and can block these laws by refusing to sign a council of ministers' decree, hence effectively blocking any implementation. For example, in 2006, the government appointed foreign service officers, whose appointments were then denied by the president. The speaker can prevent parliament from holding session by not calling

Effective power  
to govern

it to session, and thus has the power to stall the legislative process. At the time of writing, eight months have passed since the parliament last met, and the speaker has been avoiding the government's demands to pass important legislation, thereby blocking the latter's ability to govern.

Lebanon's association law, which dates to the Ottoman era, appears very liberal when compared with that of neighboring countries, as it allows for the freedom to form new associations and groupings of various kinds. The law has been abused by previous ministers of the interior, who have chosen to restrict certain freedoms and curb the formation of rights-based civil society associations. But in general, the freedom of assembly and association is unrestricted, and the fact that more than 1,400 NGOs registered with the Ministry of Interior testify to this freedom. During the period under review, there have been increased NGO activities observed. Particularly during fall 2006, a number of NGOs were founded in accordance with the July 2006 law, with registration notice being acknowledged by the Ministry of Interior.

Association /  
assembly rights

In principle, freedom of the press and freedom of expression more generally is unhindered, albeit within the limits of restrictive regulations such as the audiovisual media law passed in the 1990s, which restricts the number of TV and radio stations giving airtime to influential politicians and community leaders. Also, the legal interpretation of slander has been abused and one TV station was closed permanently in 2001. The fact that both the Ministry of Information and a Media Higher Council have a regulatory presence in these matters creates overlap and confusion in oversight mechanisms.

Freedom of  
expression

### 3 | Rule of Law

In Lebanon's parliamentary system, the elected parliament elects a president every six years and parliamentary blocs designate a prime minister-elect, who in turn is to be officially nominated by the president. The prime minister forms a cabinet, which must then gain the parliament's vote of confidence. While the above system of separation of powers is codified in the Lebanese constitution, things operate differently in practice. Because of the confessional system and the necessity to generate consensus on major decisions, a compromise between the governing troika (president, speaker, prime minister) is always required, which blurs the lines of clear checks and balances between the executive and legislative branches.

Separation of  
powers

An independent judiciary exists in Lebanon, and all citizens enjoy relative equality in access to this system. The Lebanese system is very well organized and enjoys a large margin of maneuver and freedom. It is, however, open to abuse by parochial political interests. This is particularly true in the case of the

Independent  
judiciary



Constitutional Court and the Higher Judicial Council, whose seats must be confessionally divided and whose members are appointed by the executive. There have been several cases in the past decade where influential Syrian-backed politicians exerted pressure on certain judges. There have also been allegations of corruption, though it appears not to be rampant. In the past decade, the attorney general could often be seen visiting with the president and other politicians, which is no longer the case. No substantiated major complaints have been registered to protest the judiciary's lack of independence during the period under review.

In a system where compromise is always necessary to maintain a balance of power between various sectarian groups and protect confessional spheres of influence, enforcing accountability and integrity in office becomes very difficult. While there are legally mandated disciplinary councils that produce yearly reports about abuse and corruption and the need to take action, in practice, it is very rare to see public officeholders adequately prosecuted for corruption. In the late 1990s, a minister was imprisoned on charges of corruption but was set free a couple of years later after influential figures in his community intervened and lobbied for his release. During the July 2006 war, a scandal about a public servant selling donated rations appeared in the newspapers and then quickly disappeared following the intervention of influential politicians.

Prosecution of  
office abuse

Civil liberties, including the right to practice religious beliefs freely, are unrestricted and guaranteed by the constitution. However, depending on who is holding office, civil liberties can be easily restricted, as witnessed throughout the 1990s, up until 2005 when Syrian forces withdrew from Lebanon. Since then, freedoms of association, assembly and demonstration have been practiced freely. At the time of writing, sit-ins and protests were ongoing and protected by the law. The judiciary remains the main guarantor of civil liberties and the legal medium through which to seek redress. It is important to note, however, that violence against women, as well as other forms of non-legal discrimination, continue unhindered with no clear measures or legal provisions to protect them. "Honor crimes" in which the perpetrators receive light sentences, or no punishment at all, are certainly not unheard of, especially in rural areas.

Civil rights

#### 4 | Stability of Democratic Institutions

In general, Lebanon's institutional framework works adequately but is frequently set back by conflicting authorities between institutions and bureaucratic red tape. Institutional operations have been restored in the aftermath of the civil war of the 1970s, but the rentier system and the confessional apportionment of jobs and positions hinders the efficiency of institutions.

Performance of  
democratic  
institutions

Following the Ta'if Accord that ended the civil war, the restoration of state institutions has been generally accepted by all major players in Lebanon. In the past, power plays and occasional foreign interference in these institution's operational activities have been common means of maintaining the balance of power between various actors and maintaining a weak central authority. The reform plans provided under the Ta'if Accord, particularly the plans for administrative decentralization, have been stalled. Also, full confidence in state institutions is far from being restored.

Commitment to democratic institutions

## 5 | Political and Social Integration

Lebanon's political party system is replete with organisms that call themselves political parties but are in essence sectarian-based entities. This is true of the major political parties, with the exception of transnational parties, and fundamentally ideological parties, such as the communist party. Political parties are active around elections and in the service of the party leader, who typically has gained this position by inheritance and/or rubber-stamp elections. The parties' usefulness in elections generally centers on their ability to organize voters, rather than the ability to advance a political platform or accountable political programs for candidates. Additionally, parties are subject to drastic changes as dictated by their leaders.

Party system

Lebanon has an entrenched patron-client system that is fueled by the apportionment of state resources and benefits on the basis of confessional identity. This system wields power to community leaders, religious figures and key figures representing sectarian or communal interests. They become the mediators between the state and community or sect, and they are perceived as the main vehicle for favoritism and the conduit for a clientelist system that is constantly at risk of polarization. Community leaders enjoy significant power as a result of this system to the point that they are able to mobilize their "clients" around important political issues at any given time.

Interest groups

The Lebanese consent to democracy following the major constitutional amendments of the 1989 Ta'if Accord is generally high. As evidenced from successive parliamentary elections, the latest of which was in 2005, participation is generally high. In 2005, voter turnout was 42.9%, marking the highest Lebanon has seen in decades. There are no figures or official referenda in Lebanon beyond occasional polls by private firms, but demonstrations and the turnout of street demonstrations is usually a determinant of what proportion of the population is in favor of any given issue. The higher voter turnout and the larger sizes of demonstrations are a new phenomenon that may be attributed to Syria's withdrawal from Lebanon in 2005.

Consent to democratic norms

There are several forms of self-organization and interest groups and a vibrant civil society sector representing a large variety of issues including cultural, environmental, gender and rights-based issues, among others. Forms of associations are also found in villages and center around cultural or sports activities. Lebanon's 1,300 officially registered NGOs testifies to the importance and size of civil society, particularly as it is estimated that there are at least as many unofficial, unregistered organizations operating.

Associational  
activities

## II. Market Economy

### 6 | Level of Socioeconomic Development

Lebanon's fast drive to rebuild the country after the civil war focused on heavy borrowing and reconstructing the capital city, Beirut, to the exclusion of balanced and equal regional development. The reconstruction plans included a major overhaul of the tourism sector, which meant that the agriculture and small industry sectors were neglected as well as plans for staving off poverty and increasing employment. In principle, all Lebanese have equal access to education and jobs and there is no institutional discrimination or exclusion based on gender or other factors. But in practice, full gender equality is absent. Heavy borrowing by the government for over 15 years has failed to translate into economic growth or job creation and included only minimal attention to social safety nets and other similar schemes. Only in 2006 did government reform begin to focus on social issues, when the new reform plans included a comprehensive plan to overhaul the education and social security systems, and attend to the poor and needy. Despite such efforts, unemployment however remains as high as 24% by the latest estimates and wealth is concentrated in the hands of a few.

Socioeconomic  
barriers

Economic indicators		2002	2003	2004	2005
GDP	\$ mn.	18,712	19,798	21,663	21,944
Growth of GDP	%	3.2	4.2	6.3	1.0
Inflation (CPI)	%	-	-	-	-
Unemployment	%	-	-	-	-

		2002	2003	2004	2005
Foreign direct investment	% of GDP	7.1	14.5	8.8	<b>11.7</b>
Export growth	%	13.3	6.5	19.4	<b>2</b>
Import growth	%	-2.2	6	18.3	<b>-8.3</b>
Current account balance	\$ mn.	-4384.9	-4997.0	-4121.8	<b>-1881.3</b>
Public debt	\$ mn.	13,833.3	14,784.9	17,455.9	<b>17,912.0</b>
External debt	\$ mn.	17,081.5	18,604.9	22,172.9	<b>22,373.0</b>
External debt service	% of GNI	12	17	20.7	<b>16.5</b>
Cash surplus or deficit	% of GDP	-13.0	-13.4	-8.4	-
Tax Revenue	% of GDP	14.8	15.6	16.1	-
Government consumption	% of GDP	17.1	16.7	15.1	<b>15.5</b>
Public expnd. on edu.	% of GDP	2.7	2.6	2.6	<b>2.6</b>
Public expnd. on health	% of GDP	2.9	3.4	3.2	-
R&D expenditure	% of GDP	-	-	-	-
Military expenditure	% of GDP	4.4	3.9	3.8	<b>4.5</b>

Sources: The World Bank, World Development Indicators 2007 | UNESCO Institute for Statistics | Stockholm International Peace Research Institute (SIPRI), Yearbook: Armaments, Disarmament and International Security

## 7 | Organization of the Market and Competition

Lebanon's economy is based on laissez-faire liberalism. The country's economic system is the only major attribute of governance that has generated and maintained consensus between major leaders, who generally seem committed to protecting it and preventing its collapse. Almost 76% of the economy is dollarized, and moving capital in and out of the country is relatively simple. There are no restrictions on pricing, but Lebanon's anti-trust laws are ineffective. It is estimated that 60% of Lebanon's economy is made up of oligopolies, which are rarely regulated or kept in check. The government's 2006 reform plans, which were submitted at the Paris donor conference, include a new package of anti-trust laws which, if passed in parliament, will regulate and prevent unfair monopolies. Lebanon's heavy borrowing to finance postwar reconstruction has burdened both the local banks and the government's treasury. The national debt - currently \$41 billion - amounts to almost 190% of the country's GDP. Opening and registering a business in Lebanon is practically free and open to all but bureaucratic red tape

Market-based  
competition

and rampant petty corruption stand in the way. It is estimated that in Lebanon, opening a business requires 26 days while in advanced countries it takes 11 days. The July 2006 war has dealt a severe blow to the country's economic prospects.

While the anti-trust laws currently in force are insufficient insofar as the formation of monopolies and oligopolies is inconsistently regulated, more laws and regulations are being prepared. The government's new reform plans include legislation that would create a Competition Authority to reduce the formation of new monopolies and regulate existing ones. In 2005, the Ministry of Trade enacted and passed in parliament a new Consumer Protection Law that went into effect in May 2005. Legislation on intellectual property rights is in its final stages with the Ministry of Economy and Trade.

Anti-monopoly  
policy

Foreign trade is liberalized, and state intervention is kept to a minimum. Having gained observer status in 1999, Lebanon is preparing for full membership to the WTO in 2007. The Euro-Mediterranean Interim Trade agreement that Lebanon signed with the European Union went into effect in March 2003, while the Association Agreement signed with the European Union, Lebanon's largest trading partner, followed suit in April 2006. In general, the country's trade policy is directed toward cutting customs and increasing trade, whether through bilateral agreements with neighboring Arab countries or through other accords.

Liberalization of  
foreign trade

There are strong institutional foundations for Lebanese banks that meet international standards and qualifications. The fact that nearly 49% of the government's debt is borrowed from local banks has imposed a significant burden on local financial institutions. The local banking sector is considered well protected against liquidity shocks. On average, more than half of the banks' assets are liquid in the form of securities, short-term treasury bills, and other assets that could be quickly converted into cash. Capital inflows contributed to the rapid growth of deposits held with locally-based commercial banks. Private sector deposits totaled \$57 billion at the end of 2005.

Banking system

## 8 | Currency and Price Stability

Lebanon's independent central bank pursues a consistent inflation and currency stabilization policy in line with the economic priorities of the country. In 2006, inflation remained at a low of 2% which is consistent with the same figure over the past decade. Currency rates have also been stabilized, following an increase of the central bank's foreign currency reserves to \$9.8 billion, with total foreign assets totaling \$14.6 by the end of 2005. The country's gold stock of 9.22 million troy ounces accounts for about one-third of foreign assets. The central bank often intervenes to stabilize the Lebanese pound by selling foreign currencies. The fiscal system has successfully withstood two major shocks, one in 2005 after the

Anti-inflation /  
forex policy

Hariri's assassination, who had been, by virtue of his personal fortune and the trust put in him by investors, a guarantor of stability, and after the July 2006 war. In both instances, capital flight from Lebanon was high, reaching \$1.8 and \$1.3 billion respectively.

The government's fiscal and debt policies are always in line with efforts to stabilize debt and manage public finances in a way that will continue to attract investment and spur economic growth. However, internal political feuding and deeply entrenched sectarian interests have frustrated this goal over the years, as interest rates have been subject to sudden change to meet debt maturity payments or to swap debt with T-bills. The government's privatization plans have been hindered by the internal political climate, but the latest reform plan includes concrete and sequenced measures to proceed with privatization and increase state revenues. In spite of the state's revenues from taxation and an improved collection in 2006, the July 2006 war has set back plans for economic reforms and stabilization.

Macrostability

## 9 | Private Property

Property rights and their regulation are well-defined in terms of acquisition, benefits, use and sale, and are limited only by the basic liberal rights. This goes in line with the laissez-faire character of the economy and is further cemented by plans to finalize the country's accession to the WTO. It is important to note, however, that property ownership legislation prevents Palestinians living in Lebanon from owning land – for fear that this ownership might lead a large Palestinian population, officially considered “refugees,” to settle in Lebanon and not return to Palestine.

Property rights

The private sector forms the backbone of the economy. Foreign investors may fully own and manage their business and private assets without any restriction. The freedom of entrepreneurial activity does not oblige investors to engage in any particular sector or project. Resource allocation is a business decision which public authorities may not influence through direct intervention. The state may not interfere with private enterprise investment and management. The business sector is characterized by unhindered competition and there is no legislation that favors the interests of any business entity, group or sector of activity. Competition is not impeded by any discriminatory tax breaks, incentives or levies. In May 2000, parliament adopted a privatization law that established a framework for the privatization of state-owned enterprises. The law also established a Higher Privatization Council and stipulates that the proceeds from privatization be applied toward debt repayment. Privatization of state institutions has been delayed because of political in-fighting. New privatization plans have been laid out in the government's master plan for reform and include the privatization of the two

Private  
enterprise

mobile phone companies, the Fixed Line Liban Telecom, the Electricity Sector, the Water Sector, the National Airline as well as other sectors. A chairman for the newly-formed Telecom Regulatory Authority was appointed in January 2007.

## 10 | Welfare Regime

Lebanon currently has only rudimentary measures in place to avert social risks, and there are wide socioeconomic disparities between regional territories and social strata. This status quo is expected to change drastically in the coming months, based on the new reform package that the executive branch has sent to parliament. Planned reforms include restructuring the National Social Security Fund and the appointment of external auditors, as well as plans to devise a new legal framework and plans for financial sustainability of the fund. The percentage of citizens with health coverage ranges between 47.5% – 52.5%. Almost half of the population has no health coverage but benefits from services by the Ministry of Health, which supports the treatment of chronic diseases requiring expensive medicine. Direct government transfers are up by 20% in 2006 from the previous year, reflecting efforts to sustain the deteriorating financial situation of the fund. The government is also developing a new plan to overhaul the public pension system and integrate the existing end-of-service indemnity along with that of the civil servants and the armed forces to form a single, fully funded defined-contribution scheme by 2008. The new fund is expected to provide equity among contributors, relieve fiscal burdens, increase social protection and widen the outreach. Informal family networks and relationships also play a significant role in bridging the existing gaps of financial protection and safety.

Social safety nets

Equal opportunity exists to some extent in Lebanon but income disparities and poverty have been on the rise. Institutions compensate for the indifferences, but there are no special mechanisms, laws or policies that focus on the advancement of women. There is equal opportunity for women, particularly in education and jobs, but the rate of women holding senior positions is still far from equaling that of men. No official discrimination exists in access to education, but the difference in educational quality between the public and private schools is profound and the latter sector remains prohibitively expensive for the poor. Following the July 2006 war, the government exempted all public school students from registration fees and offered – with the help of donor countries – assistance in the purchase of books and school needs.

Equal opportunity

## 11 | Economic Performance

The July 2006 war has changed all of the government's previous economic expectations. Far from fulfilling the 5% growth rate projected for 2006, growth for that year will be zero or negative. The July 2006 war has also seen an increase in debt by \$1 billion and an \$800 million increase in government spending, accounting for 3.7% of GDP. The war also has registered a \$920 million decrease in state revenues and tax collection, and a \$1.6 billion loss in public finance. Following the war, state revenues amounted to 20% of GDP, rather than the 23% that had been expected prior to the war. Expenditures, in contrast, increased from a projected 19% to 24%.

Output strength

## 12 | Sustainability

Though Lebanon is a signatory to major treaties on environmental protection, environmentally-compatible growth receives only sporadic consideration. The Minister of the Environment is usually a political appointee and is frequently not interested in environmental legislation. In general, little or no consideration is given to environmental issues when formulating major policies. There have been several scandals over the years regarding the illegal licensing of environmentally damaging quarries, but no significant action is taken until years after the fact, and is not enforced properly. The July 2006 war caused the largest-ever oil spill in the Mediterranean sea along the Lebanese coastline and it is estimated that Lebanon will require no less than five years to recover from the damages of that spill. The July 2006 war has also left southern Lebanon littered with over two million cluster bombs and anti-personnel explosive devices, disrupting plans for the development of eco-tourism there.

Environmental policy

Although the government spends close to 4% of GDP on education, more improvements in the quality of education and the number of students are needed. The total spending on education by both private and public sectors reached 11% of GDP in 2005. While education is accessible for all, and the rate of enrollment officially stands at 98%, truancy and grade repetition brings this figure down to 77% in real terms. The quality of primary, secondary and tertiary education is very high in private schools, and not so high in public schools. Institutions for research and development are present in key sectors.

Education policy / R&D



# Transformation Management

## I. Level of Difficulty

Although the government's prospects for enhancing its governing capacity improved after the withdrawal of Syrian troops from Lebanon and the restoration of the country's sovereignty, high constraints remain. These include the fact that the country's economic growth – which depends heavily on the service sector – has been declining for the past two years and suffered a severe setback by the July 2006 war and the string of destabilizing bombings the year before. Also, armed groups like Hezbollah and other Palestinian factions remain strong. Deployed in areas such as the southern suburbs of Beirut and the Palestinian camps, they have created zones that are effectively off-limits to the government. Skilled labor and the highly educated classes continue to emigrate, depriving the state of highly valuable human resources and potential assets. The sectarian system and its inability to reinvent itself to adopt a merit-based system remains the most severe impediment to the expansion of the political leadership's governing capacity.

Structural  
constraints

Lebanon's strong civic traditions date back to the days of the civil war when civil society groupings replaced state institutions in providing basic services and relief operations. This tradition made qualitative progress after the war, and the country now boasts a vibrant civil society that remains the only serious challenger to the archaic sectarian system of political apportionment. Civil society institutions champion important causes of reforms, development, environmental protection and freedoms through a series of advanced advocacy strategies that cut across sectarian divisions. Following the withdrawal of Syrian troops from Lebanon, civil society activity multiplied and initiatives to press for more freedoms and reforms increased. In the July 2006 war, several civil society institutions worked hand-in-hand with the government, the Red Cross and other international relief organizations to provide aid and manage relief operations for the one million displaced from the war.

Civil society  
traditions

The nature of the sectarian/confessional system in Lebanon keeps sectarian and religious sensitivities alive and always alert. Society and the political elite are polarized along sectarian and religious differences. Radical political actors show

Conflict intensity

increasing success in mobilizing sectarian, religious and social groups. The latest confrontation between the Shi'ite Hezbollah-led opposition movement and the manipulation of the Confederation of the Labor Union is a case in point. Hezbollah's supporters, who are overwhelmingly Shi'ite, are mobilized along sectarian lines to wage demonstrations, sit-ins and at times violent clashes with the government's supporters, who are largely Sunni, and are backed by some Druze and Christians. Inter-Christian confrontations have also been common over the past year.

## II. Management Performance

### 14 | Steering Capability

Over the past two years, the government has attempted to pursue long-term aims but has been forced on more than one occasion to postpone them in favor of short-term political benefits. The July 2006, which disrupted plans and forecasts for high growth rates and forced a change in the government's spending agenda and economic priorities, is a prime example of this trend. The war created one million refugees who are now in need of major housing and basic needs provisions. The war has also destroyed basic physical infrastructure such as bridges and power plants. The government's reform plans, submitted at the Paris donor conference, focus on building a healthy democracy and market economy, but its figures and forecasts are not necessarily consistent with realities on the ground. Only now has the government taken into account the need to increase spending on social development issues, which were previously neglected. Also, plans for privatization and other economic reform measures were always the subject of forced or voluntary compromise in the interest of short term gains.

Prioritization

The government is committed to democracy and a market economy, but has only limited success in implementing its announced reforms due to heavy political deadlocks that usually get in the way. Implementation is also complicated by the need for consensus within the council of ministers – which often represents major parochial, sectarian interests. Currently, the government seems to have the best of intentions in its plans to implement reform, but the fact that one-third of the government has resigned and that sit-ins had paralyzed the country for months at the time of writing, prevents it from effectively achieving its aims. The opposition follows through on threats of refusing to implement government decisions or to follow its directives.

Implementation

While its commitment to liberal economic ideals and a free market remain unshaken, there is evidence that the government is willing to learn from past shortcomings and modify its course. Unlike previous reform plans, the new plans give substantial attention to social development policies and to the need to increase spending on education, health care, poverty eradication and other similar issues. The new plans also seek more balanced development in the country. However, learning from past errors is not always the mark of improving reform policies. Effectiveness in reform policies requires always a political consensus between the major players, which may not always be available.

Policy learning

## 15 | Resource Efficiency

The government wastes state resources, and constant political interference by the elites hampers the development of a meritocracy in the state's administration. While competitive recruiting procedures exist in some state institutions, in reality, appointments are carried out on the basis of a sectarian balance of power criteria, and they depend on a specific confessional balance quota. This practice also gets in the way of establishing accountability and taking disciplinary action against employees. Dismissals as well as appointments are politically motivated. The bureaucracy remains slow, inefficient and highly centralized. Plans for administrative decentralization were not carried through. Although the municipal elections of 1998 – the first after a 32-year freeze – have revived local government services, it is still very common for citizens from remote villages to come to Beirut to demand services. State resources, such as water, electricity and many others, are wasted. It is estimated that \$1 billion is wasted on financing the electricity sector, which remains inefficient and suffers from weak collection and dated distribution networks that cannot meet demands for electricity. The July 2006 war has worsened the situation and electricity rationing has been on the rise. A lack of catchment pools and water dams mean that water, which is abundant in underground aquifers, as well as melted snow and generous rainfall go to waste. Tax collection has improved during the period under review, but debt servicing is on the rise and most state revenues go toward financing it.

Efficient use of assets

Although Lebanon's consensus-based are characterized by resilience and compromise, the attempt to juggle different and sometimes incoherent policy priorities often results in deadlock. Some ministries within the government often compete with each other and some policies counter the effects on other policies. A prime example of this is the fact that over \$1 billion in government spending goes to Electricité du Liban (the state electricity company) every year, while plans for its privatization have been temporarily shelved.

Policy coordination

Most integrity mechanisms and tools to curb corruption are virtually nonexistent in Lebanon. As in similar issues, fighting corruption remains a political decision

Anti-corruption policy

and is directly related to the sectarian balance of power between major players. Lebanon lacks any legislation allowing access to information, and the only way the public hears about corruption is when something is leaked to the press or is publicly declared by a state official. Officeholders are rarely held rarely accountable; accountability is provided for by a controversial and ambiguous asset declaration law that is not enforced. There is no legislation preventing officeholders from holding private jobs or clearly defining conflicts of interest. Lebanon does not have legislation to protect whistleblowers and the regulation of party financing is rarely, if ever, enforced. Political parties are financed by unknown sources and in undisclosed amounts. Hezbollah's formidably-financed institutions are a case-in-point, since no official figures are published about the amounts and sources of the financing. Some state institutions like the Council of the South or the Funds for the Displaced are not audited, though they take up a sizable share of the annual state budget.

## 16 | Consensus-Building

All political actors agree on the need to build a market-based democracy but differ on their role in it and their position in dividing the spoils of this system. While the commitment to market-based democracy is often clear, it is belied by the behavior of various members of the elite, who are often in competition with each other and work tirelessly to strengthen their position and protect their gains. The general commitment to a market-based democracy also contradicts the fact that cronyism and favoritism is practiced openly.

Consensus on goals

Following the legislative elections of 2005 and the formation of a new government, a new opposition front formed that is led by Hezbollah. The opposition intensified its rejection of government policies and legitimacy first by resigning from the government and then by staging permanent sit-ins and refusing to compromise. It is clear that, as veto powers, are capable of besieging the government and severely disrupting its operation, but they are not capable of toppling it. The opposition standoff has also prevented parliament from convening. The legislative process has thus been disrupted as the government cannot co-opt the opposition and continue to implement its reform plans. Backed by Syria, the opposition counts the president and the speaker of parliament among its members. It rejects the government's reform policies not for their content, but for political reasons that have nothing to do with the reforms per se. The central authority is too weak to resist stalling the reform process or to exclude such powerful actors as Hezbollah.

Anti-democratic veto actors

The political leadership does not reduce existing divisions or prevent cleavage-based conflicts, nor is it capable of doing so. The crisis in Lebanon stems from a mangled web of poor leadership qualities, parochial sectarian interests and

Cleavage / conflict management

competing political agendas driven by regional interests. The Hezbollah-led opposition benefits from the full support of Syria which is looking for ways to regain its influence in Lebanon, and from the backing of Iran which sees the Hezbollah, the "Party of God" as an extension of its influence in the Middle East. The government is backed by the international community, the United States and anti-Iran and anti-Syria Arab countries. The absence of charismatic, trustworthy and articulate leadership renders conflicts irreconcilable and cleavages impossible to reconcile without outside mediation.

Occasionally, the political leadership assigns an important role to civil society actors in deliberating and determining policies. In late 2005, the government formed a national commission composed of leading scholars and civil society activists to reform the electoral law, and tasked with proposing a new electoral law. In June 2006, the commission submitted a draft law to the government, which in turn was to study it before sending it over to parliament. It is also common for professionals and experts from within civil society to testify before parliament's various committees. In the July 2006 war, the Ministries of Social Affairs, Health and Education worked closely with civil society associations and at certain times relied on them for help and information.

Civil society participation

The political leadership does not address past acts of injustice and does not initiate reconciliation. Following the civil war in 1990, a blanket amnesty was imposed on those who committed crimes during the war and a refugee repatriation program was initiated, but no peace-building or reconciliation process accompanied these measures. The issue of the 17,000 people who "disappeared" during the civil war has not been officially addressed, though there are organizations that call upon the state to acknowledge atrocities committed.

Reconciliation

## 17 | International Cooperation

The political leadership works with bilateral or multilateral international donors and tries to make use of international assistance, but this does not facilitate significant policy learning and improvement. The government's reform plans are a mixture of donor-driven and necessary reforms. The monetary and fiscal policies of the state are closely coordinated with the IMF and the World Bank, both of which maintain permanent offices in the country. Within key ministries and institutions, teams of UN- and World Bank-salaried Lebanese professionals are a common sight. The government has succeeded in attracting a generation of Lebanese expatriates to return to Lebanon and take part in the postwar reform process. Lebanon closely cooperates with the European Union on reform projects, but this cooperation is usually characterized by a lack of continuity and coherence.

Effective use of support

The government is considered credible and reliable by the international community, especially insofar as it is democratically elected and exercises its reclaimed sovereignty in the aftermath of the Syrian withdrawal from Lebanon. On critical reform issues, the government's plans seem credible and are strongly supported by the international community. In its fight against the Syrian-backed opposition, the government also benefits from international anti-Syrian backing and is hence seen by international actors as the only credible player to be supported and invested in. The government's efforts to improved data and statistics collection and its ability to conduct an official census still leave much to be desired.

Credibility

The political leadership cooperates with many neighboring states and complies with the rules set by regional and international organizations. However, because of the unstable regional situation and the fragility of the state, Lebanon remains unable to manage these relationships, particularly with Syria, effectively and with stability. Following the withdrawal of the Syrian forces from Lebanon in 2005, the need for a special relationship between the two countries became apparent when the Syrians refused to allow entry to Lebanese exports crossing its territory thus choking Lebanese land exports. Syria, however, refuses to establish sovereign diplomatic relationships or officially delineate the borders with Lebanon. Officially speaking, Lebanon is at war with Israel and no relationship exist between the two countries.

Regional cooperation

## Strategic Outlook

Almost two years after the Syrian withdrawal from Lebanon and the restoration of the country's sovereignty, the democratically elected government of Prime Minister Fuad Siniora, a close Hariri protégé, is besieged by crippling opposition sit-ins and a refusal to compromise. The opposition's agenda is closely allied with the Syrian and Iranian regimes, while the Siniora government is backed by all other international actors. At stake here is the need to establish an international tribunal to hold Hariri's assassins and the assassins of other leaders accountable. Also at stake is the need to establish a national unity government with a blocking minority vote for the opposition, as well as a host of other issues.

The political stalemate is an extension of an escalating regional situation between the United States and the international community on the one side, and Iran and Syria on the other. Once again, Lebanon finds its territory hijacked as a proxy for regional conflicts. Having stabilized the southern front following a destructive war in July 2006 and the deployment of UN troops there, the political situation remains a constant concern.

Lebanon faces a difficult year ahead, given the need to deal with the negative economic and social fallouts of the July 2006 war. Negative growth rates and the severe disruption of its GDP growth will be reflected in the months to come. It will be difficult to implement true reforms and stabilize the economic situation in the absence of political stability. Inflation is expected to rise to 7.5% in 2007, and the 2006 trade deficit of \$5.2 billion is expected to increase to \$6.1 in 2007. More central bank intervention to protect the Lebanese pound will increase pressure on its foreign currency reserves.

In order to successfully deal with these issues, Lebanon needs to respond immediately to international mediation efforts and find a solution to the political standoff, which will involve compromise between the various political forces on implementing a mid- to long-term political agenda. At the same time, Lebanon needs to benefit from the international support that has been shown to it and forge ahead with the necessary package of reforms presented at the Paris donor conference. For this to happen, the government needs to work closely with parliament on passing these laws and on implementing long-term macroeconomic plans.

More importantly, the political leadership faces the daunting task of stabilizing the political situation and lowering debt financing while ensuring that investors'

confidence and tourists return to Lebanon in the immediate future. The government needs to secure stable economic growth of no less than 6% annually for ten years in order to recover and develop its economy. Moreover, the government is faced with the urgent task of rebuilding the infrastructure that was destroyed by the July 2006 war, which will slow reform plans. Finally, violent clashes on the streets of Beirut between Lebanese youth at the beginning of 2007 are an ominous sign of a restless and deeply polarized youth population. The political leadership is faced with the medium-term task of promoting reconciliation and a sensible peace-building strategy between the various Lebanese communities and sects.