

**Ethics & Governance in Lebanon**  
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‘Bad governance’, the concealing of information along with inadequate monitoring and supervision, fraud and the dissemination of incorrect and deceitful information on financial status and corporate actions, underlies the demise of Enron, WorldCom, Tyco, Vivendi, Marconi, Ahold and Arthur Andersen and more recently Shell and Parmalat. In Lebanon, we have lived similar episodes with the spectacular sagas of the Bank Al-Madina, while our media fill their pages with the tales of corruption, waste and bribery in government Ministries, bureaucracies, State Owned Enterprises and semi-public agencies. The international capital markets have severely punished listed companies with ‘bad governance’. Governments, politicians and the judiciary are not as forceful in their actions and judgment in combating bribery and corruption in government!

**Bribery & Corruption**

A recent report by the World Bank has advanced some startling numbers on the extent of bribery and corruption in the world. It estimates that on annual basis some US\$1,000 billion (a trillion dollars!) is exchanged in bribes, or a staggering \$2.7 billion per day is paid in bribes in both developing and rich countries! This compares with an estimated total size of the global economy of about \$30 trillion. The evidence also suggests that the economic crimes associated with bribery and corruption, are not limited to poor countries, a particular political ideology, rightist or leftist regime, specific cultures, religions or geographical regions. The cancer of corruption and bribery is a world-wide phenomenon.<sup>1</sup> Whether “Grand” or “Petty”, “Active” or “Passive”<sup>2</sup>, corruption and bribery, constitute one of the most challenging obstacles to investment, economic growth and development.

A recent study provides an eloquent summary:” Systematic research conducted recently by a number of authors finds that the more corrupt a country, the slower it grows. There are several channels through which corruption hinders economic development. They include reduced domestic investment, reduced foreign direct investment, overblown government expenditure, distorted composition of government expenditure away from education, health, and the maintenance of infrastructure, towards less efficient public projects that have more scope for manipulation and bribe-taking opportunities.”<sup>3</sup>

In this context, a recent report on Global Corruption from Transparency International<sup>4</sup>, Lebanon ranks 78<sup>th</sup> out of 133 countries surveyed; an unenviable ranking! According to

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Transparency International<sup>5</sup>, systematic corruption can add 20 to 25% to the cost of government procurement. Further, the quality of the goods and services fails to meet the required standards. In Lebanon, when asked about the “Percentage of contract value that companies would typically offer in additional or unofficial payments to secure a contract with the government” 57% of the surveyed companies admitted that a range stretching from 5% to 20% or higher is common<sup>6</sup>! These are wasted resources that could have had been channelled into education, health and infrastructure leading to higher productivity growth and higher living standards.

### **Empirical Evidence on Governance**

The World Bank (WB) has developed six governance indicators including the dimensions of Voice and Accountability, Political Stability, Government Effectiveness, Regulatory Quality, Rule of Law and Control of Corruption. Lebanon scores were relatively low on all 6 indicators. For example, 68% of the world countries rated higher than Lebanon in the Voice and Accountability dimension, 72% in Political Stability, 57% in Government Effectiveness, 63% in Regulatory Quality, 49% in Rule of Law and 54% in Control of Corruption.

More alarming however is that except for the Voice and Accountability dimension, Lebanon’s scores were lower than those of MENA regional averages.

Take the Government Effectiveness indicator for example. This indicator assesses the quality of public service provision, the quality of the bureaucracy, the competence of civil servants, the independence of the civil service from political pressures, and the credibility of the government's commitment to policies. Lebanon ranked 10<sup>th</sup> well behind each of the United Arab Emirates, Qatar, Oman, Tunisia, Jordan, Kuwait, Morocco, Saudi Arabia and Egypt.

Summarizing the evidence, a recent World Bank report on Governance in the MENA countries reveals that Lebanon falls below the average for the MENA countries as well as the Upper Middle Income Countries on indices of public accountability, quality of administration and the overall quality of governance!

Importantly, the WB report concludes that “simulations find that if MENA had matched the average quality of administration in the public sector for a group of good-performing Southeast Asian countries (Indonesia, Malaysia, the Philippines, Singapore and Thailand), its growth rates would have been higher by about one percentage point a year.”<sup>7</sup>

Having devoted the past eleven years of my life to public service, I have no doubt that Lebanon would have more than doubled its post-conflict reconstruction growth rate, reaching an average 6% to 8% per year with better public governance!

The empirical evidence and experience is clear: human capital and innovation, well-performing institutions, an enabling legal infrastructure, incentive-compatible regulatory regimes and enforcement, what is now called “good governance”, are major contributors to economic growth & prosperity and democracy.

## **Developing a Programme for Governance**

How do we move forward? We need to invest in building institutions –laws, organizations, rules-of-the game, and a framework for economic activity- that will allow us to have political and economic governance at a par with international codes and standards, to create a modern and democratic Lebanon, allowing us to compete in regional and world markets, putting the forces of globalization on our side in order to face the challenges of international economic integration.

## **Public Governance**

Improved public governance implies improved public accountability and the quality of administration, and addressing the problem of bribery and corruption. Combating corruption requires an *anticorruption strategy*. It is not a matter of isolated actions or decisions. Nor is it simply a matter of passing an anti-corruption law and creating anti-corruption committees, though those will help!

Lebanon's experience and evidence from other countries have shown that an anti-corruption strategy requires leadership that is willing to pay a political price to combat corruption. It requires strong enforcement by an independent judiciary, and requires widespread conviction among politicians, the executive & administration that bribery and corruption are costly to the country, to their interests and to economic and social development. So what do we need to do?

At the level of government, awareness should be raised that addressing the issue of corruption, bribery and waste are a priority, and that –similar to Anti-Money Laundering- Lebanon should comply with international standards and conventions. Although we have signed the '*UN Convention against Trans-national Organized Crime*' in December 2001, it has not yet been ratified. More important, we have to sign and enact the important '*UN Convention against Corruption*' which was approved and signed by 106 countries in Merida, Mexico in December 2003.

The Republic of Lithuania is an example to follow. That is the example of a nation that is "determinably" serious about addressing corruption. Its government has assumed the responsibility to implement and reinforce good governance practices at the country level. The country's rank has soared from 50<sup>th</sup> in 1999 to 38<sup>th</sup> in (2001) on the Corruption Perception Index<sup>8</sup>. It has passed a *Prevention of Corruption law on 2002*. The law covers the problem of corruption to the minute details. It includes legislation tackling issues like: analysis of the risk of corruption, anti-corruption assessment of existing legislation, education and formation of the public, establishment of corruption preventive bodies and others. Lithuania's government supplemented its updated legal framework with a strategic approach by instituting a *National Anti-Corruption Programme*.

A major area for improvement is **public procurement**, the process of supplying goods and services to government. There are three parts to the answer. First, we need to reduce the size of government, the total amount of resources available to be spent through government. This reduces the scope for bribery and corruption. Let the private sector produce more of the goods and services, including public utilities and infrastructure.

The second part of the answer lies again in the forces of competition: establish government procurement policies that are transparent and open to many bidders, to the forces of supply and demand. This is why I advocate passing a modern *Government Procurement Law*, including e-Procurement.

For the same reasons, we should also support the rapid, comprehensive introduction of *e-government* in Lebanon, as an important tool for administrative reform, reduced cost of delivery of government goods and services and of government procurement, and to help in removing much of the corruption and bribery that are rampant in the private and public sectors.

The third part of the answer is to advocate and work for the application of corporate governance (CG) principles to all our State Owned Enterprises (SOEs). Consider the improvements in management, transparency, accountability, efficiency and productivity that would result!

### **Corporate Governance**

We care about CG because it is part of the institutional infrastructure (laws, regulations, institutions and enforcement mechanisms) underlying sound economic performance.

Better CG is highly correlated with better operating performance and market valuation of companies. By preserving and protecting property rights –in particular those of minority and foreign shareholders- it encourages innovation and long-term investment in human and physical capital, foreign direct investment, as well as the creation of intellectual property. By stimulating performance, generating higher returns and profitability of companies, it encourages higher total factor productivity growth, a major source of economic growth. By limiting the abuse of power by corporate insiders, it creates an efficient mechanism for transferring wealth between generations. By monitoring managers of companies in both the financial and ‘real’ sectors and making them accountable for their actions, it protects investors’ interests; in turn, this encourages both domestic and foreign direct as well as portfolio investment.

Progress has been achieved in the corporate governance of our banking sector in Lebanon, by complying with the Core Principles for Effective Banking Supervision –as issued by the BIS- and related prudential and regulatory measures, modernizing our payment system in compliance with international standards<sup>9</sup>, applying international accounting standards, by instituting an effective and independent Banking Control Commission, and acting to ensure market integrity through Anti-Money Laundering and Terrorist Financing legislation and instituting a Special Investigation Committee,. The result has been a performing sector, able to attract deposits and investments from the domestic and international markets, able to list shares and issues securities internationally. This experience provides an example for other business sectors.

On a practical level, however, we should be aware that our small and medium enterprises (SME’s) will have difficulty enforcing the principles & standards of corporate governance. Thus, the question of how to reduce the cost of compliance and transparency must be addressed.

In Lebanon there is a common perception and misconception that corporate governance is of little importance, since we have a small number of companies of publicly listed on the Beirut Stock Market and without widely traded shares. The evidence, however, is that improved CG -including at the level of SMEs- facilitates *access* to credit and ensures the availability of finance at better terms and lower cost. As a result, SMEs and larger companies are able to finance the investment in real assets, physical, human and new technology, at improved terms and conditions leading to better performance and financial results.

### **Advocating Good Corporate Governance in Lebanon: Institution Building and an Agenda for Action**

As a country emerging from conflict, Lebanon faces the challenges that virtually all developing, transition and emerging-market economies now face: how to create institutions and respect their rules. We need to move from discretionary-management and relationship based policy making and governance to institution and rules-based policy-making and governance. Economic security and performance are based on the twin pillars of good public and corporate governance.

The Lebanese Transparency Association (LTA) has established a **Lebanon Corporate Governance Task Force (LCGTF)**. Its objective is to raise awareness on CG issues, work with all stakeholders in the private and public sectors for the adoption and effective implementation of CG principles in our companies and businesses, private and State Owned Enterprises (SOEs) and professionals. The LCGTF, which am pleased to chair, will focus on important building blocks that insure institutional and market infrastructure, namely the OECD Principles of Corporate Governance and the supporting pillars of the implementation of International Accounting Standards (IAS), and International Standards on Auditing (ISA).

The LCGTF National Action Plan includes:

1. Undertake a Survey of Corporate Governance in Lebanon
2. Develop set of Core Principles for the Corporate Governance of large and exchange listed companies, based on the OECD CG Principles. A different set of CG principles will be developed for family-owned enterprises, SMEs and SOEs.
3. The LCGTF will propose and seek amendments to the Commercial Code and other legislation relating to:
  1. Strengthen Minority & Foreign shareholder protection
  2. Identify the responsibilities of the Board of Directors and individual directors
  3. Accounting and auditing
  4. Transparency of Ownership and Control
  5. Regulatory Environment
3. Laws & Institutions; amend laws to:
  - Introduce a modern *Securities Law*
  - Introduce a *Competition (Anti-Trust) Law*
  - Modernize & Reform *Insolvency & Bankruptcy Law*
  - Introduce a comprehensive *Capital Markets Law*

- Right to Know & Right to Tell: prepare and enact a ‘*Freedom of Information Act*’ and a “*Data Privacy Act*”
- 4. Develop a **Public Credit Registry** to report on sources and uses of credit (market-base, bank, non-bank & supplier credit). More and improved credit information leads to lower borrowing costs, improves access to credit, develops a credit rating system, improves the ‘good standing’ of companies, encourages investment and facilitates access to export markets.
- 5. Set-up a national ‘**Companies House**’ that will complement and expand the Commercial Register by centralizing financial reporting and disclosure of corporate actions.
- 6. Encourage set-up of **Local Rating Agencies** to ease compliance with Basel II banking standards.
- 7. Lobby and seek the adoption and implementation of the **12 Key Standards for Sound Financial Systems**, developed by the Financial Stability Institute. These cover standards for the conduct of Macroeconomic and Monetary Policy, Data Transparency; Institutional and Market Infrastructure, and Financial Regulation and Supervision.<sup>10</sup>
- 8. Develop incentives and rewards for information disclosure and good CG:
  - Set-up create web links and national networks of CG complying companies
  - OECD-WB to set-up National CG Gateways that would provide an international network for CG complying companies

Our LCGTF efforts have started to pay off. Earlier this month, the OECD requested the LCGTF to head the Regional Working Group on Corporate Governance, which will work with representatives of the OECD, the World Bank Group, Transparency International, and the Center for International Private Enterprise!

In line with the objectives of the LCGTF, The « Rassemblement de Dirigeants et Chefs d’Entreprises Libanais » (RDCL) has launched the “Code of Business Ethics”<sup>11</sup>. The code is a voluntarily instrument that aims to promote business ethics, professional integrity, transparency in conduct and transactions, and the respect of contracts and commitment.

The stakes are high: better corporate and public governance lowers the cost of doing business, improves the investment environment and leads to better institutions and higher, sustainable economic growth. We need to create incentives for good governance, rewards for integrity and ethical behaviour that are self-reinforcing mechanisms. One way is to publicly recognize firms implementing CG principles: the media have an important role to play in this context.

However, we need to be clear about the issues, our vision and objectives. The important issue is the development and application of the principles and institutions of corporate governance. It is the challenge of moving from institutions of economic and political governance that tend to be heavily relationship-based to institutions that are more effectively rules-based.

Good corporate governance requires good political governance, and vice versa. Political and Public Governance and Corporate Governance must move in tandem to improve the business environment. As Juvenal asked: “Quis Custodiet Ipsos Custodes?” Who watches the Watchmen?

### **Conclusions**

Our generation –indeed several generations- have endured the inferno of violent conflicts, civil and uncivil wars and their bitter consequences for our economy and its institutions, for our social and political fabric and their foundations. We need to rebuild trust and confidence. We need to provide economic security and reduce the barriers to prosperity facing our children.

The thirteen years since 1991 have focused on the reconstruction of physical infrastructure, to the detriment of nation-building. However, the central issue is not reconstruction, but re-building the nation. Physical reconstruction, rebuilding destroyed infrastructure, is important, costly and takes time. But, the post-conflict countries like Lebanon and the ‘transition’ countries of the former Soviet block are discovering that building political infrastructure, restoring the social fabric and the infrastructure of economic governance, is more complex and important. The focus in Lebanon was on physical reconstruction, as though that were the avenue for nation-building. The result was failure in both physical reconstruction, which remains incomplete, and in nation-building.

To build a state, one needs to know what state to build: an agreement among partners and stakeholders leading to a stable, representative constitutional structure and an effective rules-based system of political governance that will ensure political stability. ‘Democracy’ and effective political representation, ‘voice, transparency and accountability’, ‘combating bribery and corruption’ should not be empty slogans in the mouths of politicians who exercise the contrary. They cannot be imported; they have to be built by all the national stakeholders. The challenge is to break the web of mistrust spun during conflict. The challenge is to break out of the vicious circle of the conflict trap that gets created: the political leadership & organizations invest in skills specialized in and only relevant for conflict. Even language and vocabulary and political discourse get affected: “كسر عظام جبهة صراع خصم معركة”، elections and voting are described as ‘battles’ with ‘enemies’ whose ‘bones will be broken’.

We are trying to compete in an increasingly global business and policy environment and govern our economy while carrying the bureaucratic legacy and shackles of the Ottoman Empire and the additional ‘red-tape’ of the French colonial administration and the vested self-interest of political and commercial interest groups and elites.

We need to break the chains, the waste, corruption and bribery that are increasing the cost of doing business in Lebanon, encouraging the underground economy and acting against our national interest. The WB (IFC) estimates that the cost of starting up a business in Lebanon rises to reach 131% of Gross National Income (GNI) per Capita. This figure is 2.5 and 16 times greater than the average cost figures in MENA and the OECD countries respectively. On the efficiency side, 46 days are needed to startup a business in Lebanon while in UAE the process is carried out in 29 days! We can and should do better! This requires advocating good governance as a national priority.

I am now increasingly convinced of the important role that the LIBC, our NGOs and civil society can play as agents for change and reform. I hope you will join me in advocating good governance, in fighting bribery, waste and corruption. It is a strategic venture and investment we owe our children and grand-children, and for which they will thank you.

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<sup>1</sup> See Kaufmann, D. et al., (2004).

<sup>2</sup> Grand corruption is corruption that pervades the highest levels of a national Government, leading to a broad erosion of confidence in good governance, the rule of law and economic stability. Petty corruption can involve the exchange of very small amounts of money, the granting of minor favors by those seeking preferential treatment or the employment of friends and relatives in minor positions. Active bribery usually refers to the offering or paying of the bribe.

Passive bribery refers to the receiving of the bribe. This is the commonest usage. In criminal law terminology, the terms may be used to distinguish between a particular corrupt action and an attempted or incomplete offence. For example, "active" corruption would include all cases where payment and/or acceptance of a bribe had taken place. It would not include cases where a bribe was offered but not accepted, or solicited but not paid

Source: United Nations, The Global Programme Against Corruption: Anti Corruption Toolkit.

<sup>3</sup> Wei, S-J, (2002).

<sup>4</sup> See the Global Corruption Report 2004

<sup>5</sup> [http://www.transparency.org/knowl\\_intro.html](http://www.transparency.org/knowl_intro.html)

<sup>6</sup> INFOPRO Governance Survey

<sup>7</sup> World Bank (2003), p.9.

<sup>8</sup> Index published by Transparency International

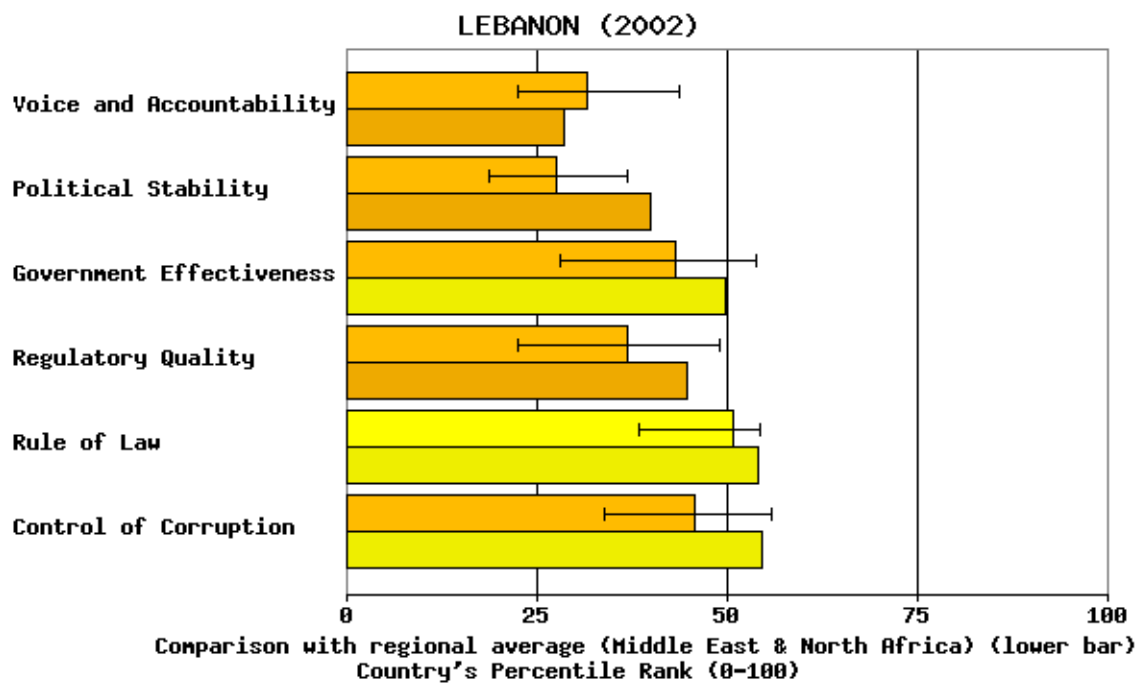
<sup>9</sup> The Core Principles for Systemically Important Payments, as issued by the Committee for Payment and Settlement Systems, of the Bank for International Settlements

<sup>10</sup> See the Appendix for a note on Lebanon's compliance with these standards. For the latter see the FSF - Financial Stability Forum: 12 Key Standards for Sound Financial Systems

<sup>11</sup> <http://www.rdel.org.lb/>

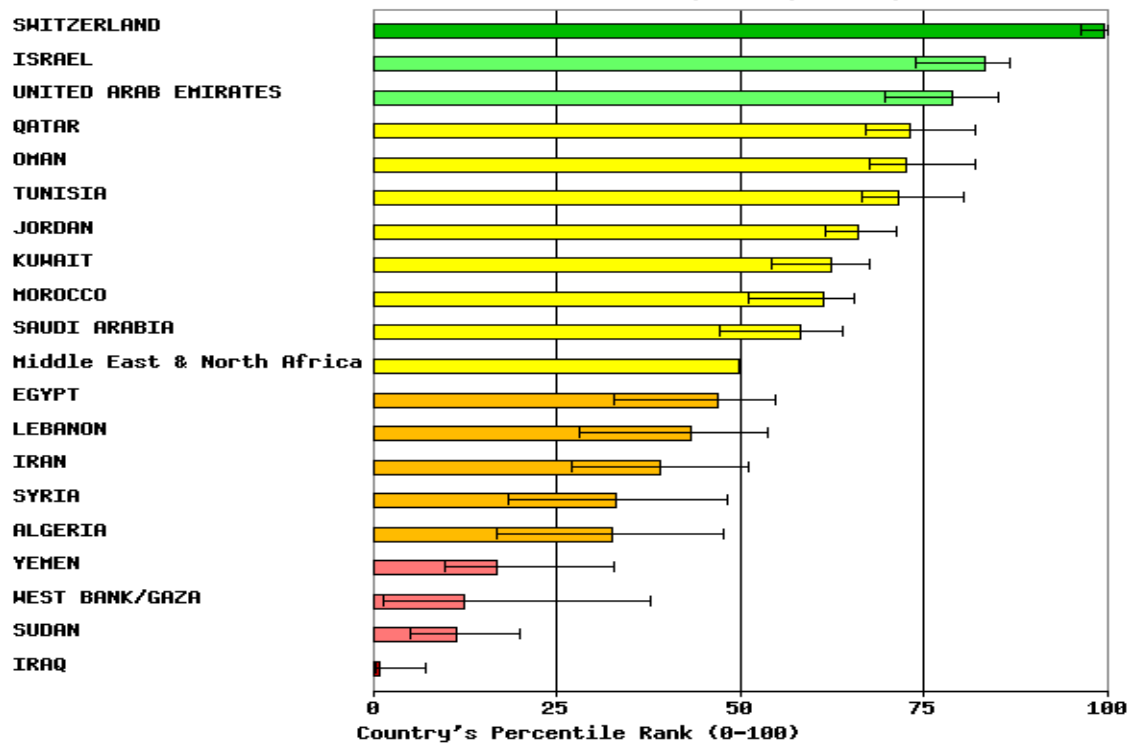


## Annex



Source: D. Kaufmann, A. Kraay and M. Mastruzzi, 2003: Governance Matters III: Governance Indicators for 1996-2002 (<http://www.worldbank.org/ubi/governance/pubs/govmatters3.html>)

Government Effectiveness (World, 2002)



Source: D. Kaufmann, A. Kraay and M. Mastruzzi, 2003: Governance Matters III: Governance Indicators for 1996-2002 (<http://www.worldbank.org/wbi/governance/pubs/govmatters3.html>)

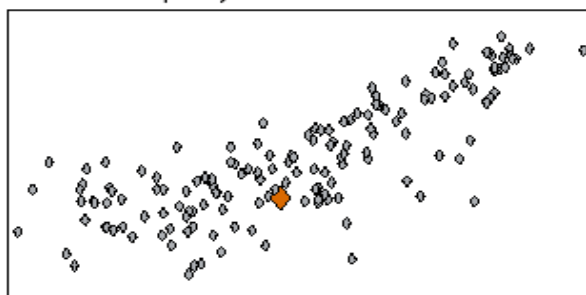
**Measures of public sector performance (2000 or most recent)**

|   | Lebanon | MENA13 | UMIC |
|---|---------|--------|------|
| Number of procedures to start business                    | 8       | ..     | 11   |
| Judicial efficiency (contract enforcement)                |         |        |      |
| Number of procedures                                      | 27      | 23     | 27   |
| Number of days  | 721     | 284    | 351  |
| Government expenditure (% GDP, 1999)                      | 35.7    | 31     | ..   |
| Public spending on education (% GDP, 1998)                | 2.1     | 6.7    | 4.2  |
| Public spending on health (% GDP, 1998)                   | 2.5     | 2.9    | 3.5  |
| Infant mortality (per 1,000 live births)                  | 28      | 31     | 24   |
| Maternal mortality (per 100,000 live births, 1995)        | 130     | 180    | 112  |
| Illiteracy (% population age 15+)                         | 14      | 28     | 9    |
| Female illiteracy (% female population age 15+)           | 20      | 38     | 10   |
| Ratio of girls to boys in primary and secondary education | 102     | 93     | 101  |
| Access to improved water (% population)                   | 100     | 83     | 88   |
| Access to improved sanitation (% population)              | 99      | 85     | 79   |
| Roads, paved (% total roads, 1999)                        | 85      | 65     | 51   |
| Telephone mainlines (per 1,000 people)                    | 195     | 123    | 192  |

**Measures of governance quality**

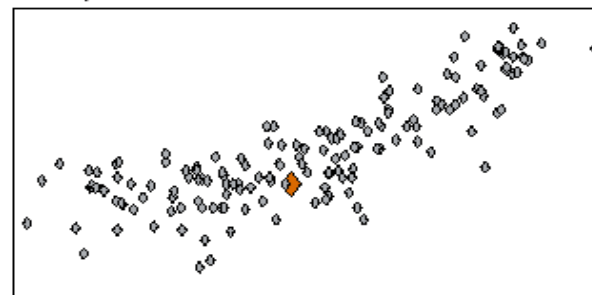
| (0–100, higher is better)                | Lebanon | MENA15 | UMIC |
|--|---------|--------|------|
| Index of public accountability (IPA)     | 42      | 32     | 65   |
| Index of quality of administration (IQA) | 35      | 47     | 56   |
| Index of governance quality (IGQ)        | 32      | 37     | 56   |

Governance quality



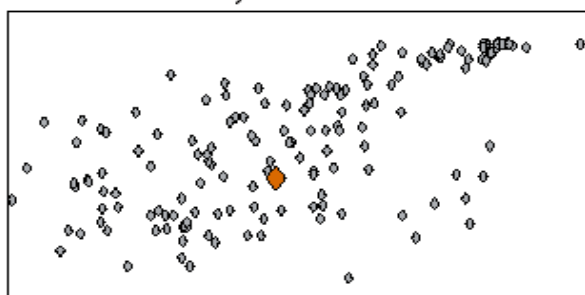
Per capita income

Quality of administration



Per capita income

Public accountability



Per capita income

## Lebanon's Compliance with the 12 Key Standards for Sound Financial Systems

| Codes and Standards   | Comments  |
|---|---|
| <b>Monetary and Financial Policy Transparency</b> —this standard is formulated in the form of a Code of Good Practices on Transparency in Monetary and Financial Policies, with the issuing body being the IMF.                                       | Lebanon is seeking to implement the Code.   |
| <b>Fiscal Policy Transparency</b> —the standard is the Code of Good Practices in Fiscal Transparency; the issuing body is the IMF.  | Lebanon is seeking to implement the Code.   |
| <b>Data dissemination</b> —the standards are the Special Data Dissemination Standard (SDDS)/General Data Dissemination System (GDDS), (both issued by the IMF).   | Lebanon has now entered the GDDS. A National Committee with the assistance of international institutions (IMF, WB, UN) is establishing the Lebanon Statistics Portal (LebStat), which will provide a statistics gateway, a single-access point to available economic, social, financial and real sector data. |
| <b>Insolvency and Bankruptcy Procedures</b> (World Bank)  | The Lebanese government is considering drafting a modern insolvency and bankruptcy law. Principles of bankruptcy are essential for the viability of corporate governance.   |
| <b>Principles of Corporate Governance.</b> (World Bank and OECD)  | The OECD-WB principles await formal adoption in Lebanon by relevant institutions, & business & professional associations. A Lebanon Corporate Governance Task Force has been set-up and an National CG Action Plan is being implemented.  |
| <b>Accounting</b> —the standard is the International Accounting Standards, issued by the IASB   | Lebanon recognizes the IAS, but there is no mandatory implementation by business or effective official enforcement.   |
| <b>Auditing</b> —the standard is enforcing the International Standards on Auditing, issued by the IFAC  | Lebanon recognizes the ISA, but there is no compliance mechanism for the auditing and related professions.  |
| <b>Payment and Settlement</b> —the standards are the Core Principles for Systemically Important Payment Systems and the Recommendations for Securities Settlement Systems, issued respectively by the BIS-CPSS and the BIS-IOSCO (BIS-IMF-World Bank) | Lebanon has, with the assistance of the IMF, modernized its payments media and systems, bringing them into compliance with BIS Core Principles and related recommendations. If payment systems are not safe, sound, and efficient, firms would not be able to conduct business properly.                      |

|   |  |
|---|--|
| <p><b>Market Integrity</b>—the standard is establishing the “40 Recommendations” and the “Eight Special Recommendations against Terrorist Financing”, issued by the Financial Action Task Force (FATF).</p> | <p>Lebanon has issued and enforces a modern Anti-Money Laundering Law (No. 318, April, 2001) and set-up a Special Investigation Committee.</p>   |
| <p><b>Banking Supervision</b><br/>Bank for International Settlements</p>  | <p>Lebanon is at the forefront among emerging economies in the application of the Core Principles for Effective Banking Supervision issued by the BIS and related measures, such as the creation credit and audit committees, general audit, and independent surveillance reporting that are directly accountable to the board of directors. It has a well-managed, professional and independent Banking Control Commission.</p>   |
| <p><b>Securities regulation</b>—the standard is the implementation of the Objectives and Principles of Securities Regulation, issued by the IOSCO.</p>  | <p>Lebanon cannot effectively enforce principles and regulations in this key area, until the government establishes an independent capital market authority with the relevant mandate. A modern Capital Markets Law has been waiting agreement by Government for the past five years! Recent experience highlights the importance of having a centralised, politically independent, accountable, well-funded and motivated securities commission which is endowed with adequate regulatory powers.</p> |
| <p><b>Insurance supervision</b>—the standard being the Insurance Core Principles (ICP), issued by the IAIS</p>  | <p>An independent Insurance Control Commission has been established as a result of passage of a Law (in 1999) leading to extensive reform of the insurance industry in Lebanon.</p>  |

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