

## CHAPTER V. GOVERNANCE, POST-CONFLICT RECONSTRUCTION AND DEVELOPMENT \*

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### Introduction

#### *Governance, post-Conflict Reconstruction and development*

For Lebanon the decade of the nineties opened with the promise of stability, reconstruction and growth. The Taif Agreement signaled an end to fifteen years of wars and violent conflict that had destroyed Lebanon's physical infrastructure, increased poverty and inequality in the distribution of income and wealth, reduced real per capita income by some 40 percent compared to pre-war levels, tore apart its social and political institutions, generated macroeconomic instability with accompanying inflation and currency depreciation, and led to internal displacement of population and outward migration of skilled human capital. In 2005, some fifteen years on, security has yet to be fully restored; critical infrastructure (water, power, transport, and telecommunications) has been partially restored –though unevenly across different regions of the country– and wage and price inflation stabilized through an exchange rate stabilization policy, with a tight peg to the US dollar.

Reconstruction and initial stabilization have come at a high cost in terms of a large build-up of debt, exceeding US\$ 35 billion by mid-2005, some US\$ 9,200 per head, one of the highest levels of public indebtedness in the world, with debt service consuming most of government revenue. The Paris I and II meetings were intended to gather international support to remedy the unsustainable debt dynamics and public finances by offering a debt restructuring package to extend the lifetime of debt at lower interest rates, in addition to long-term financing for reconstruction projects<sup>38</sup>. The domestic and international consensus (as expressed by international organizations such as the IMF and the World Bank) is that reducing debt service costs is only one strand of a required comprehensive reform package encompassing structural reforms, political, public sector and civil service reform, tax and fiscal reform; investment in infrastructure and in modernizing logistics and physical capital. Other sustained policy measures are required, aimed at improving the competitiveness of the Lebanese economy and the ability of its productive sectors to compete in the face of opening up of the economy through a number of bilateral and multilateral trade liberalizing agreements.

However, it is increasingly clear that Lebanon has only partially, at best, succeeded in its post-conflict reconstruction. Increasingly, the consensus, both internal and external, is that successful post-conflict rebuilding and sustainable growth and development are intimately linked with 'good governance'. The implementation of political, economic and financial reforms aiming at creating a dynamic, democratic society and economy are a priority in Lebanon. We take the view that macroeconomic stabilization, structural reforms and reconstruction cannot be successful with the implementation of a strategy for 'good governance'. Public sector and civil service reform to improve governance, combat bribery and reduce waste, corruption and inefficiencies are urgent imperatives. Lebanon continues to live under the inefficient, retarding yoke of a public administration and bureaucracy that are legacies, inherited from past occupation and colonialism: the Ottoman Empire and the French Mandate. Little has been done over the past sixty years –apart from timid efforts at administrative reform– to render government and the public sector an efficient provider of goods and services, to achieve good governance in the public sector. Similarly, corporate governance has not evolved, with the corporate governance framework, including laws and regulations governing the private sector and its economic and social interactions, largely unchanged since the 1950s and 1960s.

While efficiency and effectiveness are the quantitative aspects of good governance, there also are qualitative ones. The adoption of "good governance", defined as the traditions and institutions by which authority is exercised, policy conducted and government managed, is crucial, for countries like Lebanon that are in a post-conflict rebuilding and transition

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Ce chapitre est rédigé à partir des contributions du Dr Nasser Saïdi, ancien Ministre et Premier Vice-Gouverneur de la Banque centrale du Liban et Zeina Zein El Abidine, Analyste<sup>38</sup> Participating countries subscribed to the issue of a 15-year Eurobond holding a semi-annual coupon of 5 percent and a 3 to 5-year grace period on principal repayment.

phase. The lessons to be learnt from Lebanon's experience would seemingly be applicable to countries like Iraq that is attempting to emerge from war and violent conflict<sup>39</sup>.

The UN definition of 'governance' states that it is "the exercise of economic, political and administrative authority to manage a country's affairs at all levels. It comprises the mechanisms, processes and institutions, through which citizens and groups articulate their interests, exercise their legal rights, meet their obligations and mediate their differences"<sup>40</sup>. A governance system is a rich mosaic of policies, laws and regulations, public and private institutions, self-regulated organizations, corporate practices and enforcement mechanisms that will not only determine how a country is being governed, but also underlies its economic and social performance, development and prospects.

Measures to improve governance, institutional capacity and informational infrastructure are key requisites to a successful national reform program in areas of trade, investment, economic and social development, employment and job creation, government efficiency and democratic practices. Closely interrelated with economic performance and at the root of higher productivity and income levels<sup>41</sup>, good governance is a fundamental factor underlying citizens' higher standards of living.

#### *Governance in Lebanon, an overview*

By governance standards, Lebanon shares many characteristics with developing, emerging and transitional market economies. It also shares common features with post-conflict countries and/or countries blighted by persistent wars and violent conflicts. The challenges to institute good governance faced by Lebanon include: a bloated public sector, highly centralized government administration, complex regulatory structures, limited development of institutions, and limited attention to promoting voice, transparency and accountability. The long period of war and violence resulted in under-developed financial markets (though the banking sector is developed), lack of respect of contracts and commercial obligations, lack of separation between ownership and management and archaic commercial codes. Rent seeking<sup>42</sup> and state capture<sup>43</sup> practices and corruption add to the severity of the situation.

For Lebanon to rebuild reformers and policy makers must bridge the governance gap, with the aim to attract investment and address the country's economic, political and fiscal problems and improve welfare<sup>44</sup>. Instituting "Good Governance" is a prerequisite for the execution of Lebanon's overriding national priorities. While good governance does not guarantee instant budget deficit reductions nor an immediate end to political tension, it nevertheless paves the way by providing a favourable infrastructure in terms of providing enabling economic, financial, fiscal, commercial, political, democratic and legal regimes.

Understanding the Lebanese governance model requires a review of the country's institutions and their interaction with economic fundamentals. This chapter examines the country's constitutional, legal, judicial and regulatory frameworks, and focuses on public and private (corporate) governance. The chapter reviews various indicators of governance in Lebanon, as measured by the World Bank's governance indicators. An overview of the market and information infrastructure is also included as a prelude to an examination of

<sup>39</sup>

See the discussion in Nasser Saidi, "Labour and Employment in Reconstruction: Iraq in Transition, Liberalization and Reform", paper prepared for the ILO, November 2004. <sup>40</sup> UNDP's definition of Good Governance.

<sup>41</sup>

World Bank's Report: "Better Governance for Development in the MENA", provides a discussion on the estimations of the effects of governance on growth, by investigating 5 models: (1) Sachs and Warner (1997); (2) Barro (1991); (3) King and Levine (1993), (4) Mankiw, Romer and Weil (1992), and (5) De Long and Summers (1991).

<sup>42</sup>

The use of real resources in an effort to secure the rights to economic rents that arise from government policies, such as tariffs, quotas, subsidies and other barriers. The term was introduced by Anne Krueger, (1974). "The Political Economy of the Rent Seeking Society," American Economic Review 64, (June), pp. 291-303.

<sup>43</sup>

See "Confronting the Challenge of State Capture in Transition Economies", by John Hellman and Daniel Kaufmann, IMF, Finance and Development, September 2001, Volume 38, Number 3.

<sup>44</sup>

In a recent survey (2004) conducted by Mercer Human Resource Consulting, Beirut ranked 12th among 21 cities surveyed in the Middle East and North Africa Region in 2005. The study which evaluated the overall living standards of cities around the globe, bases its evaluations on 10 categories including political, economic, socio-cultural, environment, housing, entertainment, health care, education, transportation and other public services parameters.

governance and institutions in Lebanon. The chapter includes a list of active and or potential governance and institutional agents and their respective role in promoting governance, and concludes with a set of recommendations for structural reforms and policy changes to promote better governance in Lebanon.

## 1. Governance Indicators

### 1.1. WorldBankgovernanceindicators

The World Bank has launched an international research program on governance and publishes on an annual basis indicators of governance (see World Bank Institute). The World Bank team (D. Kaufman, et. al) has constructed six quantitative indicators of governance based on country-based surveys of governance perceptions. Governance, as the set of traditions and institutions by which authority in a country is exercised, is analysed along three dimensions:

\_ The process by which those in authority are selected and replaced, measured by::

- \* Voice and Accountability, and
- \* Political stability and Absence of Violence/Terrorism

\_ The capacity of government to formulate and implement policies, measured by

- \* Government effectiveness
- \* Regulatory quality

\_ The respect of citizens and state for institutions that govern interactions among them, measured by:

- \* Rule of law
- \* Control of corruption

From the database of 209 countries in 2004, governance indicators are available for the years 1998 to 2004, allowing analysis of a cross-section of countries and inter-temporally.

The regional average indicators (percentile rank) for the MENA region are summarized in Table 1 below. There is, of course, substantial cross-country, variance in the indicators, as well as variance in the responses to each of the indicators for individual countries. The range, as indicated by the maximum and minimum for each indicator is particularly large for the MENA countries confirming and reflecting the large cross-country variance. Nevertheless, the indicators represent summary measures of the above-noted dimensions of governance.

Table 5.1.: Governance indicators for Middle East and North Africa -Regional Average

Percentile Rank			Estimate	Standard	Number of
Governance Indicator	Year	(0-100)	(-2.5 to +2.5)	Deviation	surveys/ polls
Voice and Accountability	2004	24.9	-0.89	N/A	-
Political Stability	2004	38.8	-0.38	N/A	-
Government Effectiveness	2004	50.8	-0.01	N/A	-
Regulatory Quality	2004	39.0	-0.35	N/A	-
Rule of Law	2004	50.0	-0.05	N/A	-
Control of Corruption	2004	52.0	-0.02	N/A	-

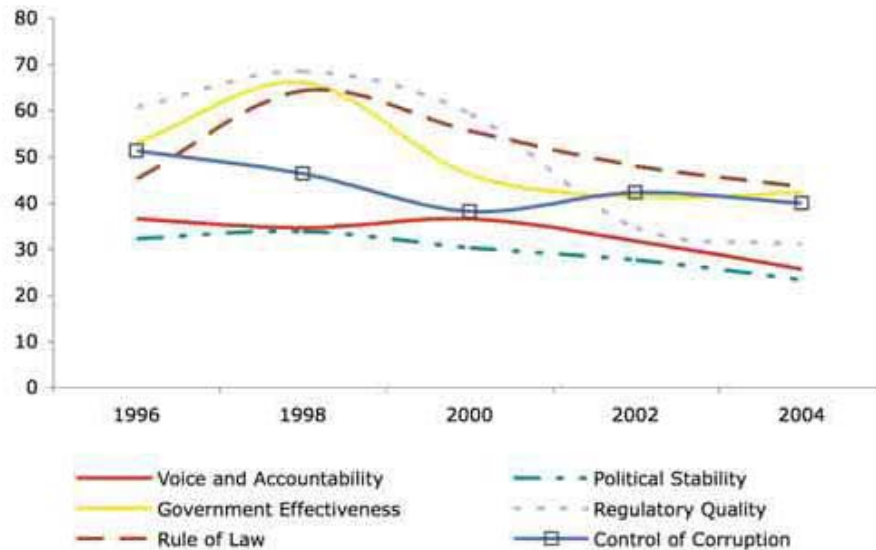
Source: [Kaufmann D., A. Kraay, and M. Mastruzzi 2005: Governance Matters IV: Governance Indicators for 1996-2004.](#)

Voice and accountability being the process by which governments are selected, monitored and replaced clearly is the weakest point in good governance for the region. Political participation is limited and citizens' ability to participate in the selection of government is restricted. Regulatory quality and the control of corruption are also areas of weakness for the MENA countries. The 'good governance' indicators and other empirical evidence, suggests that the establishment of a democratic culture and, in parallel, the institutional framework required to live democracy on a day-to-day basis, should be high on MENA governments' policy reform agendas.

## 1.2. Lebanon's Governance Indicators

Our discussion and review of Lebanon's perceived governance status, is complemented by a presentation of a national governance survey findings, to gain local insights to the governance culture and the realities of doing business in Lebanon.

Graph 5.1.: Lebanon -Governance Indicators (1996 -2004)



Source: The World Bank, <http://www.worldbank.com> Note: The governance indicators presented here reflect the statistical compilation of responses on the quality of governance given by a large number of enterprise, citizen and expert survey respondents in industrial and developing countries, as reported by a number of survey institutes, think tanks, non-governmental organizations, and international organizations.

Lebanon's ranking on all 6 indicators has fallen below the MENA regional average, which, as indicated above, lies in the bottom 50 percentile on an international basis. Further, the trend, as shown in Graph 1 is downward across all indicators. The improvements between 1996 and 1999 in the rule of law, government effectiveness and regulatory quality, have not been sustained.

In 1996, Lebanon ranked higher than 50 percent of total participating countries, on 3 out of 6 indicators, lagging behind on voice and accountability, political stability, and rule of law. Despite some improvements witnessed in 1998, the 2004 results show a significant deterioration in perceptions of governance across all indicators. Lebanon's rank on voice and accountability, for example, is 152nd out of a total of 204 countries and 7th out of 20 Arab countries. Political stability has weakened over the years, as well, with Lebanon ranking falling to 156th out of 204 countries in 2004 and 15th out of the 20 MENA countries. By the international average standards, government effectiveness is inferior as Lebanon ranked in the 117th place and 12th regionally. The country's ranking on the indicators of regulatory quality, rule of law and control of corruption is not better with Lebanon holding the 140th, 115th and 122nd places on an international scale, and the 11th, 12th and 13th at the regional level, respectively. The deterioration in security and political stability culminating in the assassination of Prime Minister Rafic Hariri in February 2005, appear to be a confirmation of 'mal governance'.

The evolution of the country's percentile rank, compared to the regional and income category (Upper Middle) average are summarized in Table 2. There are of course substantial variations across the years: Lebanon's quality on the Rule of Law, for example, is down by 32 percent from its highest achieved levels in 1998. Similarly, government effectiveness has also plunged (36 percent) over the same period coupled with a substantial decline in regulatory quality, down by more than 50 percent!

Table 5.2.: WB Governance Indicators: Lebanon -Regional and Income Category Average

Dataset	Voice and Accountability			Political Stability			Government Effectiveness			
	Rank (0-100)	Percentile	Regional Average	Income Category Average	Percentile Rank (0-100)	Regional Average	Income Category Average	Percentile Rank (0-100)	Regional Average	Income Category Average
2004	24.925.7			64.6	23.3	38.8	67.6	42.3	50.8	62.2
2002	28.531.8			64	27.6	39.7	65.4	41.3	49.9	61.4
2000	29.636.6			63.7	30.3	49	65.8	46.2	54	60.6
1998	28.634.6			63.3	33.9	46.9	64.5	66.1	52.6	58.5
1996	28.736.6			63.1	32.3	39	62.5	53.1	53.2	57

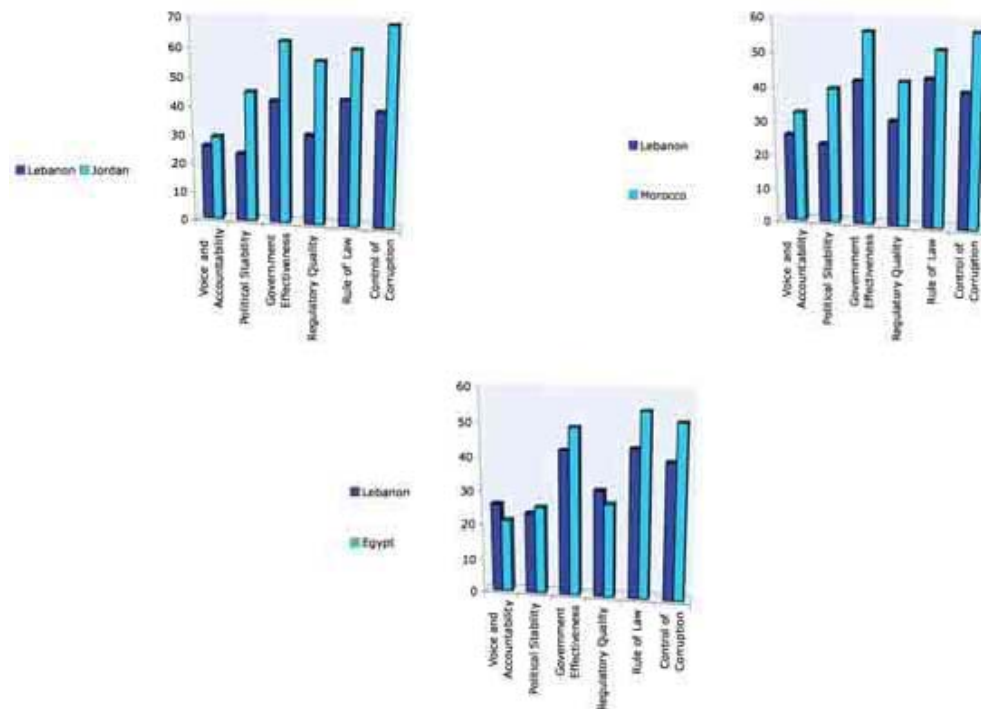
  

Dataset	Regulatory Quality			Income Category Average	Percentile Rank (0-100)	Rule of Law		Control of Corruption		
	Percentile Rank (0-100)	Regional Average	Income Category Average			Regional Average	Income Category Average	Percentile Rank (0-100)	Regional Average	Income Category Average
2004	31.0	39.0		63	43.5	50	64.4	39.9	52	63.4
2002	34.7	44.8		64.1	48	53.3	64.5	42.3	54.9	64.2
2000	59.4	49.0		62.7	55.6	58.4	64.4	38.2	54.3	62.8
1998	68.5	44.4		63.6	64.3	61.2	61.6	46.4	55.7	60.6
1996	60.8	46.4		60.5	45.2	54.4	63	51.3	51.5	56

1.3. Regionaltrendsandlocalrealities

Compared to its peer countries in the MENA region, Lebanon displays lower rankings with respect to 5 governance dimensions, while reaching the MENA average on voice and accountability. Thus Lebanon faces a governance gap even compared with the MENA countries. The perceived governance gap widens substantially with similar income country benchmark. Lebanon's governance is significantly below average for its income level (see Appendix).

Graph 5.3.: WB Indicators -Jordan, Morocco and, Egypt v/s Lebanon



Source : World Bank Governance Indicators 2004

A cross-country comparison will help better assess Lebanon's areas of strength and weakness. Three countries are identified for that purpose: Jordan, Morocco and Egypt. All four countries are emerging economies; they have signed EU partnership agreements and have undertaken economic reforms programs, with a focus on market liberalization and on attracting domestic and foreign investments. All four countries share similar legal origins, economic and cultural frameworks with a commitment to institute governance frameworks. These characteristics help control for common factors which may affect governance.

Jordan consistently outperforms Lebanon with respect to all governance dimensions. Its scores fall within the 3rd quartile on 4 governance dimensions, establishing a wide gap between the two countries. Its percentile rank falls within the 25 percent to 50 percent quartile range on the Voice and Accountability dimension (close tie with Lebanon on that indicator) and political stability (where

Lebanon has lately scored poorly).

Despite large differences in per capita income and other indicators of economic development, Morocco also scores higher than Lebanon on every single indicator, yet with a smaller gap differentiating the two countries. Lebanon shares the same quartile (2nd) on the voice and accountability and regulatory quality. Except for political stability, Morocco's percentile rank for the remaining 3 indicators falls within the 3rd quartile.

Compared to Egypt, Lebanon scores higher in terms of voice and accountability and on the regulatory quality indicators, sharing the same quartile. On the other hand, Egypt has ranked higher, with a significant difference gap, on the remaining 4 indicators, particularly scoring above average on each of the rule of law and control of corruption indicators, signaling Egypt's stronger commitment to structural economic reforms.

#### *1.4. EU Association "Agreement Pull Effect"*

The evidence from the Euro-Mediterranean countries allows us to tentatively conclude that countries intent on reform can improve their governance and that there is an EU Association Agreement (AA) 'Pull Effect'. This is similar to the pull effect for the EU Accession countries of the Former Soviet Union (FSU), where governance has improved for the countries (Tunisia, Egypt, Morocco, Jordan) that have signed EU AA, suggesting that the process of 'mise à niveau' could be effective in improving governance. Lebanon can gain from its AA with the EU by an effective process of 'mise à niveau'. The deteriorating trend of governance in Lebanon suggests that reforms and remedial action are required for the establishment and revival of its long-standing democratic political culture and, in parallel, the institutional framework required to restore public and corporate governance levels in the country.

#### *1.5. Local Survey, a national perspective*

In 2004, the Lebanese Transparency Association<sup>45</sup> has launched a survey –questionnaire to assess the quality of governance in Lebanon and to gain insight into its structure. The survey covered 1,265 companies roughly representing some two-third of economic activities in Lebanon. A validated sample of 298 companies was compiled and direct interviews with the firms' CEOs were conducted. The focus was on the corporate sector represented by: trade, banking, industry, construction and non-financial services. State Owned Enterprises and public sector organizations as well as other stakeholders were not included. The survey was conducted from November 2003 through May 2004.

In line with the World Bank indicators, the country specific questionnaire-survey highlights areas for improvement in the Lebanese governance model. Business leaders (CEOs) responses identified a number of reforms as being "very important":

##### *\_ Legal and Judiciary Environment*

- \* Stress on enforcing laws, rules, and procedures: 82.8 percent
- \* Stress on tax and financial disclosure: 76.6 percent
- \* Stress on independent judiciary: 75.8 percent
- \* Stress on boardroom de-politicization: 47.7 percent

##### *\_ Reforms: Financial Environment*

- \* Stress on accounting standards: 67.2 percent
- \* Stress on financial market regulation: 57.8 percent

##### *\_ Implementation*

- \* Stress on monitoring bodies to ensure compliance: 68.8 percent
- \* Stress on privatization of state owned enterprises: 28.9 percent

<sup>45</sup> Affiliated with Transparency International (TI), [Transparency International](http://www.transparency.org).

## 2. The Constitutional framework

Lebanon is a republic based on a parliamentary regime, highly centralized and explicitly stipulating the separation of the legislative, executive and judicial branches. The prevailing system is a multi-party one, based on multiple religious groups. The 1926 initial constitution was amended in 1927 and 1943. An important amendment was undertaken in 1990, in light of the Taif Agreement, which signalled the end of violent conflicts and paved the way for political reforms.

### *2.1. The legislative branch:*

The legislative powers are vested in the parliament, whose members (128) are voted into office every 4 years through direct elections. Electoral law (see Box: 1) stipulates confessional representation, with an equal number of Muslims and Christians and proportional representation within each religious community. The parliamentary by-laws specify that the Parliamentary Bureau Board consists of the Speaker, the Deputy Speaker, two Secretaries, and three Commissioners. The Speaker is elected by MPs for a four-year term.

The Lebanese Parliament (Majless el Nouwab) convenes every year in two ordinary sessions for two and a half months: the first session begins on the first Tuesday after 15 March and concludes by the end of May; the second session begins on the first Tuesday after 15 October and concludes by end of the year (December). The main object of these sessions is to legislate and to study the government draft budget law.

Members of the Lebanese National Assembly enjoy substantial immunity and a wide spectrum of authority in legislations and oversight. They are responsible for reviewing and passing the budget, questioning the government on policy issues, requesting a confidence debate and amending the constitution.

#### Box 5.1.: Lebanese Constitution Article 24 [Electoral Laws]

The Chamber of Deputies is composed of elected members; their number and the method of their election is determined by the electoral laws in effect. Until such time as the Chamber enacts new electoral laws on a non-confessional basis, the distribution of seats is according to the following principles:

- (i) Equal representation between Christians and Muslims.
- (ii) Proportional representation among the confessional groups within each religious community.
- (iii) Proportional representation among geographic regions.

Exceptionally, and for one time only, the seats that are currently vacant, as well as the new seats that have been established by law, are to be filled by appointment, all at once, and by a majority of two thirds of the Government of National Unity. This is to establish equality between Christians and Muslims as stipulated in the Document of National Accord [The Taif Agreement]. The electoral laws will specify the details regarding the implementation of this clause.

Three factors are considered to underpin a strong parliament: constitutional safeguards<sup>46</sup>, popular support and the members' technical capacity. The Lebanese National Assembly suffers weaknesses in these fundamental pillars. Parliamentary effectiveness and governance are hindered by internal factionalism which finds its roots in the electoral law and tradition, in a system based on proportional, geographical and confessional representation, as compared to party based political representation. Such structural weaknesses translate into ineffective monitoring of the Executive, delay in the enactment

Parliament may be dissolved by the Council of Ministers, acting by vote of a two-thirds majority of the Ministers, upon request of the President of the Republic only on the basis of one of the following grounds: (1) if the Parliament fails to meet during one ordinary session or two extraordinary sessions (except in the event of force majeure); (2) if the Parliament fails to pass a budget law.

of legislation and extensive 'pork barrel politics'. Parliamentary committees do not have the expert and technical support and capacity to assess and review existing and proposed legislation or to assess the impact of laws and regulations. As a result, the ability of Parliament to effectively monitor and supervise government, instituting the constitutionally required separation of powers is impaired.

Box 5.2.: The Constitutional Council and the Supreme Council: internal accountability mechanisms.

Internal accountability is the responsibility of the Constitutional Council and Supreme Council.

The *Constitutional Council*, formed in 1994, rules on matters related to the constitutionality of laws. Settling litigations over presidential and parliamentary elections falls under the Council's set of responsibilities. The President of the Republic, Prime Minister, and Speaker of the Parliament; any ten deputies or heads of legally recognized communities are entitled to the right of recourse to the Constitutional Council.

The *Supreme Council* is the body constitutionally allowed to sit in judgment of the President, Prime Minister, Speaker of the Parliament and the ministers. Constituted in 1996, it is composed of seven members elected by the parliament and eight of the country's highest ranking judges.

## 2.2. The Executive branch:

The President of the Republic is elected by Parliament for a 6 year-mandate; The Prime Minister is appointed by the President following mandatory consultations with Members of Parliament. Both, the President of the Republic and the Prime Minister, supported by the ministerial cabinet (Majless el Wouzara), assume the executive power. The revised (1989) Taif constitution deems executive power to reside within the Council of Ministers. Ministerial representation in the Council of Ministers seeks to establish balance between the country's religious confessional denominations and sects, major political factions and regional considerations. The majority of cabinets formed are drawn from MPs, with Ministers retaining their MP status and related immunity. In the absence of Party-based parliamentary representation, the tendency is for governments to be based on coalitions, which tends to diminish accountability to Parliament. The Cabinet determines overall policy, appoints senior civil service administrators and submits draft legislation to the Parliament.

## 2.3. The Judiciary branch:

Lebanon's judicial system is mostly based on the Napoleonic Code. Article 20 of the Lebanese Constitution ensures an autonomous judiciary branch. The court system is made up four Courts of Cassation (3 courts for civil and commercial cases, and one court for criminal cases), a Constitutional Council (instituted per the terms of the Taif Agreement), and a Supreme Council (which hears charges against the President of the Republic, Prime Minister and the Speaker of Parliament). The government, in consultation with members of the Supreme Council of Justice undertakes the task of appointing judges<sup>47</sup>. For personal status issues, communities rely on their own religious courts to rule on matters such as marriage, divorce and inheritance.

## 2.4. System of Checks and balances:

Established and inspired, in large part, by the French Mandatory power, the order of compliance and accountability, of "Checks and Balances", in Lebanon has evolved considerably since independence. Today, it is the executive branch represented by the Ministry of Finance, the Court of Accounts, the Civil Service Council, Central Inspection and the General Disciplinary Council which are the main agents driving compliance and

<sup>47</sup> All, except a number of members of the Constitutional Council.

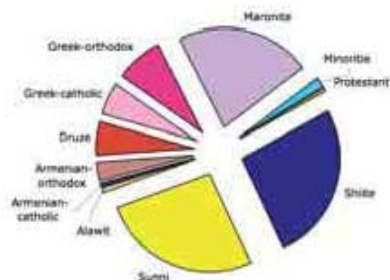


accountability in Lebanon. Parliament has yet to assert an effective role in monitoring the executive and enforcing transparency and accountability.

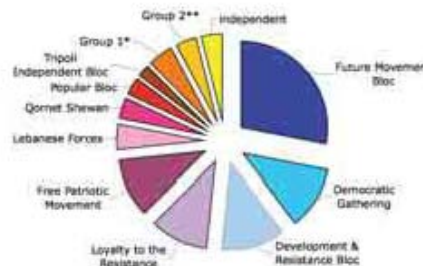
Registered Voters by Confession Allocation of Parliamentary seats

**BOX 3.3: Lebanon Elections 2005**

Registered Voters by Confession



Allocation of Parliamentary seats



\*Group 1 includes: the Syrian National Socialist Party, the Kataeb Reform Movement, the Tachnaq Party, each has won 2 seats. \*\*Group 2 includes: the Democratic Renewal Movement, the Democratic Left, the Nasserite Popular Movement, the Ba'th Party, the Kataeb Party, each has won 1 seat. Source: European Union Election Observation Mission. Parliamentary Elections, Lebanon 2005.

The latest legislative elections in Lebanon took place between May 29 and June 19, 2005, per the year 2000 election law (Law No. 171). The elections covered 5 governorates: Beirut, South Lebanon, Mount Lebanon, Biqaa and North Lebanon. The total number of registered voters was 2.8 million, of whom 1.2 million did vote. The rate of participation was 42.9%. It ranged from 36% in Beirut to 55.5% in Mount Lebanon. 432 candidates competed for 111 out of 128 parliamentary seats because 17 seats were not contested and the winners were declared before the voting took place in Beirut, South Lebanon and Mount Lebanon. All major political parties, groupings and personalities ran in the elections. The elections were characterized by unprecedented alliances and coalitions across the political board that left very small chance for independent candidates to win. The opposition coalition won the majorities of seats, gaining the power to pass any legislation and to nominate the prime minister and the speaker. Election results carried 61 new deputies into the parliament while keeping out many prominent political leaders. Female membership in the parliament doubled from 3 to 6 female deputies representing 4.7% of deputies. The elections were monitored by several missions of foreign observers, including 62 observers representing the European Union.

*2.5. Elections, manifestation of the confessional patchwork*

While the electoral system is perceived as fair, compared with other countries in the MENA region, observers have noted a number of lacunae. Nonetheless, significant doubts are cast on the adequacy of representation and independence of the electoral process questioning its effectiveness as an external accountability<sup>48</sup> tool. No national census has been undertaken since 1932, though partial data and demographic trends indicate a clear numerical preponderance of Muslims, with the Shi'a emerging as the single largest community. Similarly, suffrage is set at 21 years resulting in disenfranchisement of the young population. However, the electoral laws do not reflect underlying demography and trends and sect-composition of the population<sup>49</sup>. Further, electoral laws are frequently amended in Lebanon, often being passed shortly before elections, with voters, incumbents and candidates not being able to ascertain electoral districts until late in the electoral process. Considerably shaped by geopolitical interests and foreign direct intervention, electoral success relies on individuals' networks and political-communitarian affiliations,

Accountability is the exercise of holding officials liable for their actions and decisions. It is of two forms: external -as exercised by the citizens-and internal -as instituted by the government through powers separation and systems of independent checks and balances.<sup>50</sup> For example the Shi'a represent some 40% of the population but only get 28 seats in the 124 seat Parliament.

often at the expense of merits. Local religious leaders have and continue to exercise a high degree of political activism and influential power over the political sphere. Additional challenges arise as a result of the failure of successive election laws to broaden the span of inclusiveness<sup>50</sup> and contestability at the national level. This could be only accomplished through the transformation of the closed sectarian political system to a merit and performance based democracy: this is a main goal of the Taif Agreement but is yet to be realized. Parliamentary seats, though more equally allocated among Christians and Muslims<sup>51</sup> after the Taif accord, are still based on the characteristic of religion and political confessionalism, with loyalty to traditional and feudal leaders, militias that emerged during the civil war or political families that gained prominence under the rule of the Ottoman Turks or the French Mandate. In this context, citizens' freedom of choice is restricted. During the recent Parliamentary elections (May-June 2005), nine out of 19 seats were won by default in Beirut, reflecting the absence of contestants to a list expected to prevail. Inclusiveness is also hampered by the absence of efficient and effective channeling of youth participation into the country's polity, whereby and despite a large base of support for change, 21 continues to be the minimum required age for voting, as opposed to 18 for civil rights and duties.

The EU Election Observation Mission to Lebanon's 2005 Parliamentary elections issued a number of recommendations (see Box: 4) that summarize widely held views concerning necessary political reforms relating to political representation through the institution of Parliament.

#### Box 5.4.: EU EOM Recommendations

\_It is widely recognized in Lebanon that the system of political representation and the election framework need to be overhauled. The Taif Agreement and the Constitution foresee reforms which would reduce the role played by confessions.

\_According to the Lebanese Constitution and the Taif Agreement, Parliament should be divided into two houses, the Chamber and a Senate.

\_The electoral law should be completely revised. Discussion on a new electoral law should start soon and must be inclusive, engage state institutions, political representatives, civil society and citizens. It should take into account the Constitution, national laws and international obligations for elections.

\_While the choice of the election system is a matter of domestic debate, the number of constituencies should allow for a large enough number of seats in each constituency in order to have representatives from each of them reflecting all major political views in respective region. (...) For a diverse society as the Lebanese it is crucial to have as many different views as possible represented in Parliament. Delimiting electoral district boundaries should be done in such manner that it serves best the principles of equal vote, and adequate political representation.

\_Voters should be registered in their place of actual residence and changes of residence should be taken into consideration according to a transparent and accessible procedure, without the right of a discretionary veto from the Council of Ministers.

\_Official uniform ballots should be adopted to enhance the secrecy of vote and to enhance the accountability of the tabulation process, as they would allow reconciling numbers of voters and votes cast.

\_Financial disclosure should be mandatory for all candidates, and should be audited by an independent body at the end of the elections. Campaign spending limits should also be considered.

\_Voting should take place during one single day, to allow for equal campaigning opportunities all through the country.

50

Inclusiveness means that all citizens are equally guaranteed certain basic rights such as equality before the law and the right to participate in the governance process.

51

Sectarian criteria rule: The president can only be a Maronite Christian, Prime Minister a Sunni Muslim and the Speaker of Parliament a Shiite Muslim.

## Election and other Laws

\_ Limitations on the electoral rights for army and police officers should be abolished and other restrictions of suffrage regarding professions should be limited as much as possible.

\_ A vast number of Lebanese citizens in the Diaspora are still registered in Lebanon.

This leads to uncertainties about the actual numbers of voters. This question should be carefully studied in order to find an adequate and balance solution taking into account that some countries allow out-of-country voting for their citizens living abroad.

\_ It could be considered to lower the age of eligibility for voting to 18, in line with the age of legal majority (attainment of full age) age of 18 years.

\_ There is a need for legislation related to political parties including their legal status, rights of establishment, their rights and obligations, the byelaws necessary for their internal work, etc. Such a reform should include a revision on the regulations concerning non-governmental organisations... It should guarantee the implementation of the recognised right to form, belong to

\_ There should be a campaign silence during the last day of the campaign and on Election Day itself, especially in and around polling sites (There should be an obligation for the elections administration to promptly publish all election related laws, sub-legal acts, decrees and decisions. This could be done on a daily updated official website of the future election authorities. This issue could also be addressed in broader legislation related to access to public information. Source: Final Report of the European Union Elections Observation Mission: The Lebanese Elections 2005 | Documents | CGGL.org

## 3. Information infrastructure

### 3.1. Central Office for Administrative Information

Public governance and good administration entail serving citizens and improving the mechanisms through which their complaints are heard and due care is exercised in handling their applications and transactions. The Central Office for Administrative Information was established with the objective of ameliorating the quality of the services offered to citizens. It provides citizens with the guidelines and information related to the administration via the telephone or the Internet. Additionally, a website has been established to provide information and guide citizens to concerned central or regional departments where he or she can submit applications. The Central Office for Administrative Information aims to increase citizens' satisfaction by addressing issues such as: reducing number of visits and time spent in getting the right forms filled and obtaining the requested information.

The Office of the Minister of State for Administrative Development (OMSAD) considers the initiative as a step towards the ultimate "Transparent administration". An assessment is required to measure the success of the center in view of the rationale behind its establishment.

### 3.2. Finance and the Budget law<sup>52</sup>

Institutional reforms are essential to enhance government policy credibility. The adoption of an Organic Budget Law (OBL), as recommended by the IMF, complemented by a fiscal accountability law, would increase transparency, efficiency, and budget control. Currently, the budget preparation, discussion and adoption related activities are based on provisions

<sup>52</sup> See Lebanon's Fiscal ROSC (2004) for an extended discussion of the issues in this section.

of the Constitution and the Law on Public Accounting. Accordingly, the task of preparing the budget is entrusted to the Ministry of Finance. The budget is then discussed at the Council of Ministers and eventually sent to the Parliament for review and approval. The Ministry of Finance publishes the yearly budget reports and the media broadcasts the parliamentary sessions live. The Ministry of Finance has also taken the initiative to publish quarterly financial statement, a monthly statistical table and an annual economic and fiscal report in an effort to promote transparency.

The parliamentary debate focuses mainly on the composition of expenditure. By law, Parliament cannot increase the aggregate level of expenditure proposed in the draft budget. The Constitution allows parliamentarians to increase expenditures only if they agree on equal expenditure cuts in other areas. Currently, debt service absorbs more than 60 percent of public expenditures, so that room for amendments is narrow. Lack of specialized support and technical staff and resources hampers the quality of parliamentary budget work.

In the fiscal area, the distribution of tasks and responsibilities between the different branches of the government follows traditional constitutional rules. The executive is in charge of preparing and implementing the budget and tax laws. The Council of Ministers (COM), chaired by the Prime Minister or the President, adopts the annual budget by a majority of two thirds of the cabinet members. Within the executive, the MoF has a very prominent role during both the preparation and implementation phases. The COM is mandated to resolve the difficulties that may arise between the MoF and the line ministries. *The legislature* (Parliament and its Finance Committee) is responsible for voting and controlling the budget.

There is no budget system law (BSL) or OBL in Lebanon to lay out the requirements of the annual budget process, implementation of the annual budget law and monitoring of outcomes. Fiscal management is governed by the Lebanese Constitution and by the Public Accounting Law (PAL). The PAL includes some elements of a BSL but also contains provisions commonly found in texts of a lower legal status in other countries, such as provisions for procurement. The PAL is not a comprehensive document, which impedes the scope for reforms in the area of financial management. It defines all budget preparation and execution procedures, including provisions on timing, and accountability. However, it does not include provisions relating to the content and structure of the annual budget law, nor does it specify a resource allocation strategy taking into account macroeconomic and fiscal constraints. There are no provisions for monitoring and ensuring compliance with the PAL, except those relating to the Court of Accounts. The budget does not consolidate important government activity, in particular, reconstruction activities undertaken by the Council of Development and Reconstruction (CDR) or those of the Municipalities are not integrated. The Ministry of Telecommunication (MOT) provides another example of the problems that emerge. The MOT fails under its current practices to separate its operational and commercial activities from its administrative and regulatory tasks. The IMF report reveals that administrative and other expenditures of the Ministry are presented in an annex budget only to be deducted from commercial receipts before the net amount is transferred to the Treasury account. This results in a loss of transparency and accountability.

Quasi-fiscal activities are extensive and are not cost accounted. In 2003, for example, the BdL provided loan facilities in the amount of US\$200 million to the Electricité du Liban (EdL) to cover operating losses. Part of these losses was due to inefficiencies, but a main reason was that EdL and other public enterprises (e.g., water distribution) are required to provide their services below cost. The BdL also encourages lending in the housing market and in microfinance, by lowering reserve requirements for banks that provide such loans. Similarly, it intervenes on a selective basis in the Treasury Bill (TB) allocation and pricing process, providing incentives for subscription to TBs. Another instance, following the Paris II meeting, involved the BdL offsetting its holdings of government debt against a book revaluation of its gold holdings, though the gain was not realized. The costs of these various quasi-fiscal activities are not estimated, and therefore not consolidated into the budget documents or presented to Parliament. In 2003, public outlays to EdL to cover operational losses and debt repayment obligations amounted to 2 percent of GDP. But direct transfers represent only part of the picture, as to the full cost of such activities also includes any accumulation of arrears at the level of each public entity and forgone profit for investment or transfer to the government.

### 3.3. Availability and Dissemination of Statistics

The war period in Lebanon destroyed statistical capacity and infrastructure as well as “institutional memory”. The Central Administration of Statistics was burned in 1984–85 with most of the documents and statistical records. In addition, information and records available in most Ministries and government agencies were not maintained. The loss of institutional memory implies a loss of efficiency, accountability and transparency. Since the end of the war, Lebanon has under-invested in the production of economic information, with insufficient resources provided to rebuild statistical capacity. The consequence is that the quality and reliability of economic and financial information is not up to international standards. The private sector has attempted to fill the gap by producing some statistics such as price indices. Overall, therefore, there is less information and it costs more to produce, than if Lebanon had invested in its statistical capacity.

What are the implications for governance? Governance includes the capacity of government to use its resources and implement policies in a sound fashion, implying good management of available resources. Good governance has to be based on functional knowledge and information, by the leadership and policymakers, as well as collective action by all concerned. In the absence of knowledge and information, sound policies cannot be designed and implemented and good governance cannot be achieved.

Lebanon's laws do not guarantee citizens the right to access public information or to data privacy. Recently, some efforts are underway to redress the situation. Lebanon has joined the IMF's General Data Dissemination System (GDDS Home Page), a program focusing on improving data quality, and aiming to ensure comprehensive, timely, accessible and reliable economic, financial and socio-demographic statistics and their dissemination to the public. Bridging the informational infrastructure gap is important to improve policy formulation and analysis and governance.

To move forward Lebanon needs to modernize and rebuild its statistical capacity:

\_ A National Statistics Action Plan should be formulated and implemented. It should be based on assessment of the institutional, of the institutional, personnel, IT systems and other component required to rebuild the capacity of Lebanon's statistical systems.

\_ Lebanon needs a new, modern legal framework to support its statistical system. This requires a new law on statistics that would amend the existing decree relating to statistics and provide independence and adequate budget and resources for Central Administration of Statistics, ensure transparency in the process of collecting, compiling and disseminating statistics in accord with internationally recognized scientific standards and maintain their integrity and wide availability.

\_ Priority must be given to produce the “core” National Income and Product Accounts (NIPA) on a regular, systematic basis on an annual basis to be followed as early as possible with the production of quarterly NIPA. The NIPA should be produced in accord with international (UN) standards to provide necessary coverage, accuracy, detail, quality and timeliness. Lebanon needs a full set of national economic accounts to include income, production, consumption and investment<sup>53</sup>.

\_ Lebanon should rapidly produce social and demographic statistics, covering in particular population, labour force, employment, unemployment, productivity and labour costs and other basic labour statistics.

### 3.4. Official Gazette

The Ministry of Justice publishes the Official Gazette every Thursday. It contains the full text of new legislations. Newly enacted legislations are also available through two privately-issued publications, *As-Sadr*, and *Society*. Court decisions are available only through private sources: *Cassandra* publishes all decisions by the Court of Cassation and major decisions by the lower courts. *Al-Adl*, which has been published since 1967, includes major court decisions; *Hatem* summarizes important decisions by all courts; *Baz* has recorded all Court of Cassation decisions since 1950.

Partial national account statistics were published in 2005. However, it is not clear that the methodology is consistent with UN international standards.

## 4. Government effectiveness

### 4.1. Public Governance

Improved public governance implies improved public accountability and the quality of administration, and addressing the problem of bribery and corruption. In Lebanon, it implies changing the inherited public administration and traditions of Ottoman and French codes and decrees organizing the Lebanese public sector. Combating corruption requires an anticorruption strategy. 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 and bribery. It requires strong enforcement by an independent judiciary. It requires widespread conviction among politicians, the executive and the public administration that bribery and corruption are costly to the country, to their interests and to economic and social development. According to Transparency International, systematic corruption can add 20 to 25 percent 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 percent of the surveyed CEOs of companies admitted that a range stretching from 5 percent to 20 percent or higher is common! Indeed, Information International conducted a Benchmark Poll on corruption in Lebanon back in 1999, in which the population attributed corruption to the following causes:

(i) 64% to the inefficiency of controlling and inspection mechanisms; (ii) 55.3% to the non-existence of citizen protection laws; (iii) 58.8% to the weakness of civic education; (iv) 56.6% to leniency in law enforcement; (v) 65% to foreign interference; (vi) 64.8% to political feudalism; (vii) 54.3% to the non-independence of the judiciary; (viii) 63.5% to the non-existence of a clear and continuous program for administrative reform; (ix) 51.4% to the low wages of public employees; (x) 57.6% to the devastating effects of war on Lebanese society; and (xi) 52.8% to the reluctance of Lebanese citizens in denouncing and reporting on cases of corruption.

At the level of government, awareness should be raised that addressing the issue of bribery, corruption and waste are a priority, and that –similar to Anti-Money Laundering and Anti-Terrorist Financing legislation and programmes-Lebanon should comply with international standards and conventions. Although Lebanon signed the '*UNConventionagainstTrans-nationalOrganizedCrime*' in December 2001, it has not yet been ratified. More important, is to sign and enact the important '*UNConventionagainstCorruption*' which was approved and signed by 106 countries in Merida, Mexico in December 2003.

A major area for improvement in an anti-corruption strategy is public procurement, the process of supplying goods and services to government. First, one needs 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 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 requires passing a modern *GovernmentProcurementLaw*, including *e-Procurement*. For the same reasons, government should support the rapid, comprehensive introduction of *e-government*, as an important tool for administrative reform, reduced cost 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 in State Owned Enterprises (SOEs), resulting in improvements in management, transparency, accountability, efficiency and productivity.

The introduction of e-Government services and business process re-engineering is at its beginnings in Lebanon. The Ministry of Finance –with support from UNDP-has modernized and automated the General Directorate of Customs, Land Registry and public sector payments and tax systems to reform fiscal administration. For that purpose, a number of programs have been implemented: Cadastral Operations Modernization and Automation Project (COMAP) developed and implemented a system of administering land records in Lebanon, while preserving existing, records of ownership. NAJM focuses on Customs Clearance with an Automated Information System with the objective to facilitate Lebanon's international trade while complying national laws and regulations and aims at reducing the cost and time of clearance procedures. NOOR (NAJM On line Operations) is set to secure electronic delivery of customs services.

#### *4.2. Overview of public entities*

The majority of the 70 national public entities inclusive of 24 administrative public bodies, such as the Council for Reconstruction and Development (CDR) and the Investment Development Authority of Lebanon (IDAL), which fall under the control of the central government. A small number of administrative bodies operate on the basis of extra budgetary funds, the most prominent being the National Social Security Fund (NSSF) responsible for health care, family allowances, and pensions. The government's state-owned enterprises include the state electricity company (EdL) and four water authorities. A number of other state-owned enterprises operate under private law. These include telecommunications, postal services, casino, national lottery, and transportation infrastructure (e.g., ports). The local governments comprise 905 municipalities ('baladiat'), which are run by elected assemblies and have their own autonomous budgets.

Other public bodies are regulated in accordance with the provisions for administrative and commercial entities laid out in Decree 4517 of 1972, which sets out their management structure as well as their authority and financial operations. It also defines supervisory bodies and control mechanisms. Several agencies, such as the BDL, municipalities, and the NSSF are exempted, and operate on the basis of special legislation.

Besides SOEs, the government has considerable assets, held either directly or through the BDL and INTRA, a holding company having the government, BDL and foreign investors for shareholders. The assets include Middle East Airlines (MEA), the Finance Bank, the Casino du Liban, a variety of service and real estate companies. The government investment in these companies is not transparently reported and disclosed. Restrictions on management autonomy of public entities, and inadequate enforcement of financial reporting, blur the financial relationship between the central administration and the rest of the public sector.

#### *4.3. Public Services*

The quantity, quality and equitable delivery of public services are a matter of mounting concern for both the government and citizens in Lebanon. Some improvements have been noted. One example is Lebanon's rate of infant DPT immunization which rose from almost zero percent in 1980 to 93 percent in 1993. Yet a significant gap in the public services industry continues to widen especially when it comes to the provision of public utilities – including water, electricity and transport-affecting all major stakeholders: government officials, service providers – whether public service agencies or outsourced to private entities and the beneficiaries of these services.

In addition to the high cost – low quality characteristic of provided public services, many of the public utilities are generating losses, increasing the government's budget deficit. The Electricity du Liban (EdL), for example, has been experiencing chronic operating losses. Losses have been the result of production inefficiencies, poor tariff structure, mismanagement, theft and diversion of power, and the inability of the public utility company to collect revenue. Governance problems have contributed to bad performance, with a lack of transparency as to the administrative and commercial relations between the management and Board of EDL and the supervising Ministry of Energy and Water Resources. Government has been covering EdL losses either directly or through BDL financing (USD 300 Million in loans since June 2003)<sup>54</sup>. The financial subsidy burden rose to 2.6 percent of GDP in 2003 and estimated to be higher in 2004 and 2005! The National Social Security Fund has also posted a deficit amounting to about 1.1 percent of GDP (2003). The deficit was covered from social security reserves and was masked by a pension fund surplus of 1.8 percent of GDP.

<sup>54</sup>The USD 300 Million constitute a contingent liability for the government if EDL fails to repay its debt to the Central Bank, which is the most likely outcome.

#### 4.4. Decentralization

The 15 years of civil war negatively impacted local governments. The Taif Agreement brought back decentralization to the forefront. Nine years later, Lebanese municipal elections took place in May and June of 1998 for the first time in 35 years. The elections stretched over a 4 week period during which citizens voted for closed-party lists with proportional representation of the different confessional communities and elected some 7,662 representatives to 700 municipal councils. 2004 witnessed another round of municipal elections.

Municipalities in Lebanon are entrusted by law with a wide range of responsibilities and could constitute, in that capacity, a new tool for institutional reform. In practice, most municipalities are providing only a fraction of these functions in the absence of decentralization. Some 6 ministries and public agencies have control over municipalities (see list below). Major reforms are therefore required – both at the level of the governments and the municipalities themselves -if municipalities are to carry out their mandated functions and roles. Around half of Lebanese municipalities have revenues and expenditures of between USD 6,000-60,000 per year. Less than 30 percent have a telephone line; and estimates suggest that only 30 out of 700 have an adequate tax base to provide local services. It is then not surprising that with the exception of a few, municipalities suffer in general from weak municipal tax management and administration. Consequently, local governments have become increasingly<sup>55</sup> reliant on the central government for the bulk of their income, with limited local sources of revenue.

At the national level, Law 118 was enacted in 1997, increasing municipal financial autonomy. The applicability and the effects of the law on enhancing municipalities' autonomy are questionable, in the absence of independent financial resources.

##### Box 5.5.: Government control over municipalities

The following list illustrates the level of control that the government through its ministries and independent public agencies exert on municipalities; despite their claimed moral personality and administrative and financial autonomy.

*\_Ministry of the Interior and Municipal Affairs (MOIMA):* Responsible for planning, budgeting, and spending municipalities' revenues as well as for providing technical and financial support to municipalities when needed.

*\_Civil Service Board (CSB):* Responsible for overseeing all municipal decisions related to employees, administrative organization, and salaries.

*\_Bureau of Accounts (BOA):* Responsible for financial control over large municipalities, including pre-and post-audits.

*\_General Directorate of Urbanism (GDU):* A unit of the Ministry of Public Works, is responsible for urban planning. Its authorization is required for any real estate or infrastructure development.

*\_Central Inspection Agency (CIA):* Although article 137 of decree 118 excludes the legislative and executive powers in municipalities from the control of the CIA, this does not prevent Ministry Of Municipalities and Rural Affairs from delegating the CIA to inspect the municipality.

*\_Ministry of Justice:* The control of the Ministry of Justice is restricted to a single issue in financial control that is Conciliation, unlike the financial control exercised by the General Controller or Bureau of Accounts.

\* *General Financial Delegation:* This new control system over the fiscality of municipalities was created by the decree 1937 of 1991, responsible for infringements related to tax laws.

\* *Committees of Objections:* These committees enjoy a judicial character. Responsible for studying the objections presented by the taxpayers, which represent an indirect control on the rightness of the municipal fees.

See the Lebanese Centre for Policy Studies for additional information, [LCPS -Scope of Research - Decentralization and Local Government](#)



Major economic, political and social benefits can be achieved through decentralization in Lebanon as elsewhere. Decentralization can increase the efficiency and responsiveness of local governments. This is especially true because locally elected leaders tend to assess the needs of their voters more effectively than centralized governments. Decentralization strengthens inclusiveness and empowers citizens to participate in the decision making process, the delivery of services and to hold their direct leaders accountable for their decisions and policies. Additionally, decentralization heightens competition among political party representatives, and ensures that everyone who wishes to be part of the governance process is offered that chance.

#### *4.5. The Privatization Program*

The legal framework for privatization is in place following: (i) the enactment of the 2000 Privatization Law (Law No. 393) which established the legal basis for the privatisation of state owned assets (SOAs) and SOEs and provided sound principles for the process itself;

(ii) Government commitments at the Paris II donor conference coupled with international recognition and support for the process of privatisation; (iii) the establishment of a Higher Council for Privatisation (HCP), headed by the Prime Minister, with the mandate to set, execute and supervise the privatisation process in a transparent fashion. Successive Cabinets have reasserted their commitment to implement privatisation. Privatization, if properly executed, can attract substantial investments into the country, improve efficiency and economic productivity, create jobs and boost both growth and the quality of the delivered goods and services. The delay in undertaking privatisations is mainly political, with politicians opposing the privatisation process for fear of the loss of power and influence, resulting in their loss of the 'capture of the State'.

The privatisation of the two mobile phone networks and the launch of Liban Telecom were postponed despite commitments made under Paris II, negatively impacting on the perception of the ability of the country to deliver on its commitments. The main reason behind the delay is political, occasioned by the lack of agreement on the establishment of a regulatory authority to oversee the telecom liberalisation process, and the main 'challenge' of nominating independent management and staff to the authority's board.

Similarly, a law on the regulation of the electricity sector was passed in 2002 to prepare the sector for privatization. Three years later, the sector does not appear fit for privatization, as experts from the IFC, World Bank and IMF believe that the company requires substantial restructuring before attempting to privatize it. The case of the water sector is similar. Other entities, such as Middle East Airlines and LibanPost, appear viable and managed according to commercial principles, and are candidates for privatisations. However, Lebanon needs to put in place the requisite regulatory authorities for a sound privatisation process.

#### *4.6. Civil Servants, Institutions and Code of Conduct*

Allegations of nepotism, corruption, incompetence and red tape have resulted in the loss of the competitive employment edge of the public service. Nevertheless, holding a public position in Lebanon still allows access to economic benefits in the form of tips, bribes and the ability to work in non-governmental part-time jobs. There are three control agencies in Lebanon:

##### *\_ Civil Service Council*

Established in 1959, the main functions assigned to the Council are: determining personnel needs for all government departments and helping in the preparation of the personnel budget; Conducting examinations and approving lists of eligible candidates for all civil service jobs; Supervising and approving promotions and transfers in the civil service. The council is criticized as limiting itself to the basic functions of keeping records and conducting exams. Vacant positions are not well advertised, and few people know about openings. The selection process is perceived to be considerably affected by political and religious interferences.

##### *\_ Central Inspection Commission (CIC)*

Established in 1959, CIC is attached to the office of the Prime Minister. The commission conducts inspections and investigations throughout the public sector, imposing limited disciplinary punishments on offending employees. The Commission also cooperates with various government departments on the development of their organization structure, work methods and procedures. It also checks and supervises public tenders for works commissioned by all public agencies with the exception of the army and the general and internal security forces.

The commission can impose disciplinary penalties and may refer offending employees to the Court of Accounts, the General Disciplinary Council or other regular courts of law for further prosecution. It is noteworthy that civil servants are rarely charged with corrupt practices.

#### \_ The General Disciplinary Council

The General Disciplinary Council is probably the most important institution for ensuring proper conduct by public officials through the prosecution and punishment of offending employees. The Council is an independent body responsible for trying government employees accused of violating existing laws and regulations and imposing appropriate penalties. The Council is empowered to impose any administrative penalty it sees fit, including dismissal from the service.

#### \_ Code of Conduct

The Office of the Minister of State and Administrative Reforms published in February 2002 a code of conduct for civil servants. The Ministry of Finance is developing an internal code of conduct as well as a citizen's charter for a reformed public administration. The code comes as a supplement to the Law No. 112 of 1959 which stipulates the rights and duties of civil servants. Additional laws and codes addressing matters such as illicit enrichment and use of public money are currently being prepared to update and supplement existing legislation. A key factor to secure compliance is to update the 1943 penalties law to meet international practice requirements, addressing for example insider trading and conflict of interests.

### 5. The regulatory framework

Public sector reform, privatisation and improvement of the public procurement process require the set-up and development of a sound market and regulatory infrastructure. In turn the effectiveness and independence of regulatory authorities depends on political acceptance and respect of the role of regulatory authorities. While such recognition is accepted for the monetary and bank supervisory authorities, it has not evolved into a similar acceptance for public utilities, such as power, water, communications and telecommunications.

#### *5.1. Cost of Doing Business*

Businesses are mainly driven by financial incentives, costs and constraints which determine whether an attractive and sound business environment is in place for investments to flourish. The establishment of an enabling regulatory framework, as opposed to a cost increasing regulatory burden framework, necessitates both good policy formulation and good policy administration. Despite some efforts, burdensome bureaucracy and 'red tape' still weight heavily on the business climate. To open a business in Lebanon, 6 procedures are required. The whole process takes an average 46 days, as compared to a regional average 39 days, despite a greater number of required procedures (10 procedures). In terms of getting credit, investors in Lebanon, enjoy lower costs in creating collaterals (2.2 percent of income per capita versus 18.5 percent for the region). The legal rights index is consistent with that of the region, though Lebanon posts better than average scores on the credit information index and the public credit registry coverage index. Weaknesses in the regulatory framework are apparent, notably in terms of investors' protection and contract enforcement, whereby the disclosure index is att one third that of the region and around one sixth of the OECD average. Similarly, on the enforcement of contracts, Lebanon has the same number of procedures with that of the region, yet judicial system deficiency translates into an average 721 days for contract enforcement, compared to 437 for the region, and high collection costs, measured as a percentage of debt: 27 percent locally, versus 18 percent, regionally.

Closing a business also comes at a substantial cost, especially when it comes to the recovery rate. Investors closing a business in Lebanon will recover 19.3 cents on each dollar invested, compared to average of 28.6 regionally and 72.1 in OECD countries (See tables in Annex 2).

## 5.2. Sectors' Supervision

### *The Banking Sector:*

Lebanon's Banking Control Commission (BCC) at the Banque du Liban<sup>56</sup> (BDL) has aligned the banking sector regulatory framework with international standards. Progress resulted from the application of international standards such as the Basel I Core Principles for Effective Banking Supervision<sup>57</sup> including capital adequacy standards and related prudential and regulatory measures<sup>58</sup> and the framework for internal control systems in banking organizations<sup>59</sup>. In line with international trends and to ensure market integrity, Lebanon has introduced Anti-Money-Laundering and Terrorist Financing legislation. Additional regulations were issued relating to the implementation of the law enforced by a Special Investigation Committee.

The BCC has issued a number of regulations in line with the Basel core principles of banking supervision requiring the creation of independent audit units reporting to the board in an attempt to regulate and mitigate information asymmetry problems. It has also recently set a general framework for risk management consistent with Basel II guidelines. The new regulation will also encourage foreign-currency asset diversification. Lebanon which is expected to adopt Basel II standards, has managed with the help of the IMF to upgrade its financial risk monitoring capacity through the implementation of an Early Warning System (EWS) for the financial sector. The policy decisions support the growth of financial institutions and diminish systemic and market risk. The banking sector has benefited from the application of international codes and standards, whereby the sector seems immunized among the risks that threaten the stability and development of banks in emerging markets. The main risk faced by the banking sector is its exposure to government debts (constituting more than 35 percent of total assets by the end of 2004).

### *The Insurance Sector:*

Compared to the MENA countries, Lebanon's insurance sector with more than US\$ 135 in insurance premiums per year per capita, or USD 450 million in absolute terms, appears large. However, total insurance premiums accounted for 2.8 percent of GNP, substantially below levels in OECD and upper middle countries, where premia stand in the range of 6-8 percent and above.

The sector is regulated by the Ministry of Economy and Trade, according to the insurance law (Decree No. 9812, May 1968) revised and amended in 1993 and 1999 (Law No. 94). The new law raised minimum capital requirements, introduced a solvency margin as well as increased the minimum technical provision required, introduced regulations for new insurance products, while establishing an independent Insurance Control Commission. Despite the positive reforms, the sector still suffers from a lack of transparency and disclosure of operations, financial and risk reporting. A new law has been drafted, inspired in large by international best practice and the core principles of the international Association of Insurance Supervisors. The law has yet to be submitted to the Council of Ministers for debate.

## 5.3. Financial Reporting: Accounting and Auditing

Matters related to accounting and auditing regulations, fall within the responsibility of the Higher Council of Accounting (HCA). The Council, presided by the Director General of the

<sup>56</sup> Central Bank of Lebanon.

<sup>57</sup> Basel Committee Publication Number 30.

<sup>58</sup> Basel Committee Publication Number 41.

<sup>59</sup> Basel Committee Publication Number 40.

Ministry of Finance, includes major stakeholders as members<sup>60</sup>. The government and the Minister of Finance have in 1996 (Ministerial Order No. 1/6258), adopted IAS (International Accounting Standards) as the national standard for financial statements. However, in the absence of formal enforcement and monitoring mechanisms, the widespread use of IAS and ISA remains more an aspiration than a reality. Similarly, there are still compliance gaps of varying degrees in both accounting and auditing practices. There is less of an 'accounting and reporting gap' for listed companies, for multinationals with a base or representation in Lebanon or companies with strong international links and banks. A greater gap appears in for SMEs and family-owned enterprises (FOEs) and depending on the firm undertaking the audit. These gaps stem primarily from shortcomings in professional education and training in Lebanon. When the Lebanese Association for Certified Public Accountants was established in 1994, an inclusive 'grandfather clause' was admitted, whereby all applicants, who sought license to practice, were certified without examination. More importantly, no enforcement mechanism exists to ensure IAS compliance, except in the banking sector. Although many audit firms make effort to perform audits in accordance with International Standards on Auditing (ISA), the quality of audits varies significantly.

Finally, the legal framework fails to include any provisions as to the professional standards that auditors are required to adopt. The Order on Auditing, issued by the Minister of Finance, does not cover regulation or supervision of the auditing profession and does not mention enforcement regulations or the monitoring of ISA compliance. However, a draft Ministerial decree aims to require all auditors to follow ISA. Until then, the "Auditor's Report on Financial Statements", remains the official format for audit reports in Lebanon (Ministerial Order 742, 2002).

A recently (2003) completely Accounting ROSC provides some major recommendations intended to lead to an upgrading of accounting and auditing standards, as well as in professional standards (see Box 6), but which have yet to be implemented.

The Court of Accounts is the authorized agency to conduct the auditing of State Owned Enterprises (SOEs). However, given the limited resources of the Court of Accounts, the Ministry of Finance has recently issued a decree requiring all public entities to undertake annual independent audits by large auditing firms.

#### Box 5.6.: Accounting and Auditing Policy Recommendations

\_ Amend or legislate laws dealing with accounting, auditing, corporate financial reporting, and the accountancy profession in the country, through the enactment of a new Financial Reporting and Accountancy Profession Act

\_ Enforcement: Strongly enforce the publication and filing of legal entity and consolidated financial statements. \_Redefine the role of the Higher Council of Accounting. \_Reform the Higher Council on Accounting with the following three committees:

- \* Accounting and Auditing Standards Committee.
- \* Financial Reporting Monitoring Committee.

\* Auditors' Practice Review Committee \_Upgrade the procedure of licensing accountants and auditors in public practice. \_Ensure effective continuing professional education and development of the

accountants and auditors in public practice.

\_Strengthen the capacity of the Lebanese Association of Certified Public Accountants by establishing twinning arrangement with a professional accountancy body. \_Take steps for improving curriculum and teaching in accounting programs of universities and colleges.

Representatives from the auditing and accounting profession, Chamber of Commerce and Industry and the Banks Association. Also members are the President of the Lebanese Association of Certified Public Accountants, (LACPA), head of Revenue Department, Chairman of the Banking and Control Commission, as well as 3 accountants appointed by the Ministry of Finance.

\_Provide meaningful theoretical and practical training in International Accounting Standards. Source: Republic of Lebanon, ROSC, Accounting & Auditing, World Bank, May 2003. [http://www.worldbank.org/ifa/rosc\\_aa\\_lbn.pdf](http://www.worldbank.org/ifa/rosc_aa_lbn.pdf)

The Lebanese private sector follows a number of laws and decrees as well as Ministerial Decrees in carrying out accounting and auditing functions. However, a number of provisions in the Code of Commerce (1954) and its amendments, for example, which govern joint stock companies, limited liability companies and partnerships with regard to appointment of auditors and audits of financial statements, are in conflict with IAS standards!

Moreover, the requirement to apply IAS standards, are waived in the case of SMEs which constitute the bulk of the country's private sector-. Not only is the size limit relaxed when compared to other countries, but the waiver poses serious challenges in terms of the need of these companies to implement IAS and ISA standards to raise capital for expansion.

The banking and financial system on the other hand, is subject to the regulations set forth in the Code of Money and Credit (1963) and other related decrees which specify banks' and other financial institutions' chart of accounts templates . Banks and financial institutions have formally adopted the ISA.

The Beirut Stock Exchange enjoys discretionary power to regulate listed companies and require the application of IAS standards. BSE and the Banking Control Commission have been successful in establishing special measures to enforce compliance. On a more general level, no regulatory authority is able or entitled to require and monitor compliance or conduct a performance review of public accountants and auditors.

#### *5.4. InsolvencyFramework*

There is no modern bankruptcy law in Lebanon. Bankruptcy and insolvency are dealt with in the provisions of the Code du Commerce. Similarly, there is no law to deal with corporate mergers and acquisitions. Both laws and related legislation is required to deal with the consequences of war on the corporate sector and provide a sound base for corporate governance. The drafting of a modern insolvency and bankruptcy law is considered a priority by government. Meanwhile, the commercial and penal codes apply whereby, typically, a judge meets with all recognised creditors. Bankruptcy schemes vary, but approval of a final scheme is subject to the discretion of the court for reasons of public and creditors' best interest.

## 6. Market infrastructure

### *6.1. MarketOverview:a'LaissezFaire'liberaleconomictradition*

Lebanon has a long standing tradition of a market oriented, open economy with liberal trade and investment policies. Successive governments have advocated their commitments to the empowerment of an autonomous private sector, despite the internal andexternals shocks affectingLebanon andthe requirements of reconstruction. The private sector has grown to constitute some 80 percent of aggregate demand and to cover all major sectors of the economy.

Lebanon's multilingual and entrepreneurial skilled workforce, its relatively high accumulation of human capital constitutes the country's main source of comparative advantage, underlying a services-based economy. Geography, location and openness, along with other factors including banking secrecy<sup>61</sup>, moderate tax rate regimes, freedom of establishment, unrestricted entry of foreign investments<sup>62</sup> and a free foreign exchange

<sup>61</sup> Instituted by the Banking Secrecy Law in 1956.

With the exception of conditions pertaining to foreign investments in infrastructure and/or public utilities, foreign ownership of Lebanese banks and land ownership by foreign firms.

regime, allowing unfettered current and capital account payments are mainstays of Lebanon's economy.

## *6.2. Business organization and ownership structure*

### *Business Entities*

A wide range of business entities is provided for in Lebanese Law. The list extends to include: sole proprietorship, partnership, joint-stock companies, limited liability companies, holding companies and offshore companies. All companies established in Lebanon must abide by the Lebanese Commercial Code and related regulations.

Lebanon's laws do not discriminate between foreign and domestic investors with respect to rights of establishment, with the exception of limitations on land and property ownership. Similarly, there are licensing and related restrictions on work permits for foreigners. Registering a business is, for example, conditional upon the foreigner possession of residence and work permits.

### *Size and Ownership*

The business sector in Lebanon, similar to many emerging market countries, is characterised by a preponderance of Small and Medium Enterprises (SMEs), representing more than 85 percent of all firms. Similarly, ownership is highly concentrated either with single-owner firms or in Family Owned Enterprises (FOEs) constituting the majority of businesses. FOEs, per se, do not necessarily imply poor governance structures<sup>63</sup>. Some FOEs in the financial and industrial sector have adopted modern corporate governance structures and principles and have been rewarded for embracing best international practices as they transitioned to listing on the stock market. Nevertheless, the high level of control exerted by families remains a concern leading to a lack of transparency and disclosure, limited access to finance and credit for expansion and constraining the efficient transmission of wealth across generations. FOEs put a premium on control –for example, by allowing employment of family members and relations-to override over other considerations, including profitability, accountability of management, protection of minority shareholders, and lowering the cost of capital by opening equity capital and allowing the firm's expansion and diversification of activities.

### *Families and control mechanisms*

Family control extends to both management and board representation. The participation of independent board members is rare and non-executive members – whenever found, mainly in banks, -constitute a minority in a "rubber stamp" style board, driven in essence by the power of controlling families.

Lebanese Commercial Law allows corporations to issue shares with unequal voting rights. Families, in this context, enjoy two major control mechanisms: pyramid structures<sup>64</sup> and ownership of a majority of outstanding voting shares. Such a provision in the law not only causes serious imbalances between ownership and control, but also significantly impedes efforts to protect minority shareholders and reflects adversely on the country's investment climate.

### *Financial markets*

The Beirut Stock Exchange (BSE) is currently managed in conformity with the rules and regulations stipulated in legislative decrees No. 120 (September 1983), No. 30 (March 1985) and updated in No. 7667 (December 1995). These cover regulation of brokers, trading operations, fee setting and sanctions for members, brokers and issuers. Some

<sup>63</sup>

See the discussion in N. Saidi (2004), Corporate Governance in MENA Countries: Improving Transparency and Disclosure.

<sup>64</sup>

Ownership of a small equity percentage in businesses allowing families to gain control of a number of holding companies and their subsidiaries.

changes have been introduced through laws and decrees to supplement the Stock Market law, including a fiduciary Operations Law (1996), the setting up of a central securities depository, MidClear, and regulations issued by the BDL to regulate brokers, financial intermediaries and mutual funds.

There is a strong consensus among both policy makers and investors on the significance and urgency to develop the stock markets as a source of risk diversification and equity financing, to help finance reconstruction and development and for the listing of FOEs. In addition, a thriving stock market would allow Lebanon, through cross-border listing to regain prominence as a financial hub for the region. This requires decisive action by policy makers and investing in the infrastructure – technological, legal and regulatory-of the capital markets and setting up an independent Capital Markets Authority. Draft legislation to set-up an independent capital market authority and to privatise the stock exchange has been prepared but has been awaiting review and approval by government and Parliament. The re-development of Lebanon's capital markets is conditional on a comprehensive approach; one that will bridge the gaps in the institutional and legal structures, provide enforcement of laws and regulations and effective supervision. Absent capital market reform, the Beirut Stock Exchange will remain marginalised. Only 16 companies are listed and trade on the BSE<sup>65</sup>. Six companies, namely Solidere (accounting for about 65 percent of total capitalization), Bank of Beirut, Byblos Bank, BLOM Bank, and Holcim make up the bulk of the market capitalization valued as of the 31st of July 2005, at USD 3.326 billion.

## 7. Rule of Law

### 7.1. LawMakingProcess

Draft laws are referred by the Speaker of the Parliament and initially reviewed by concerned Parliamentary committees<sup>66</sup>. The Committees prepare reports and send these to the Parliamentary Bureau to be included in the Agenda of the General Assembly meetings.

Members of the Parliament might return the draft law to the Committees for additional review and amendments as required. Once the law is voted upon, the law is referred to the Council of Ministers for it to be signed by the Prime Minister and the concerned Ministers. The Law is then sent to the President of the Republic for endorsement. Accordingly the law is published in the Official Gazette and becomes law. At his discretion, the President may return the law to the Parliament for reconsideration after which the enactment requires a majority vote of the Deputies.

### 7.2. Legal and Judicial System

The legal and judicial sector in Lebanon was severely weakened by war, leading to structural and institutional deficiencies. In particular, there was a breakdown of institutions and breach of ethical standards raising serious doubts concerning the independence of the judicial system in Lebanon. Legal and judicial system reforms remain conditional upon political willingness, consensus and determination to effect and enable change and modernisation.

A recent assessment by the World Bank of the Legal and Judicial sector in Lebanon<sup>67</sup> identified several areas as being important for enabling reform of the legal and judicial sector. These include:

\_ Technical training for court staff in case management techniques and the start of continuing education for judges.

<sup>65</sup> For a complete list of companies trading on the BSE, see <http://www.bse.com.lb/companies.htm>

The current Lebanese legislature has fifteen standing committees working in the following areas: budget and finance (17 members), administration and justice (17 members); foreign affairs and emigrants (17 members); displaced persons (12 members); agriculture and tourism (12 members); economy, trade, industry and planning; public works, transport, electric and hydraulic resources (17 members); defense, internal affairs and municipalities (17 members); education, higher education and culture; media, post and telecommunications (12 members); youth and sports, environment (12 members); public health, labor and social affairs (12 members); human rights (8 members); women and children (12 members). (Source: UNDP – POGAR). <sup>67</sup> See World Bank, "Lebanon: Legal and Judicial Sector Assessment", Washington, D.C. May 2004.

\_ Ongoing commitment for legal and judicial reform, particularly related to the independence of the judiciary.

\_ Update legislation both for the judiciary as well as to promote private sector development, which requires an enhanced capacity to draft and review proposed legislation.

In line with the above, implementing reforms is mainly driven by the Ministry of Justice together with the judicial sector in the form of: (i) Raising awareness regarding the role and function of the judiciary aimed at improving the perception of the judiciary and facilitating access to the courts; (ii) increasing the availability of training for judges, court clerks, recorders, bailiffs and others; (iii) computerize and introduce IT and associated training for judges and court staff and making decisions available to judges on-line;

(iv) training court staff in administration and court management; (v) altering the program of training for new law graduates to incorporate a national exam; (vi) improving the legislative process as well as the capacity to draft legislation according to international standards.

#### Box 5.7.: Recommendations for Legal and Judicial Reform

\_ Improvement in the independence of the judiciary, as well as legal reforms to improve overall government accountability.

\_ Resume continuing education for judges and training for court staff. Improve management of courts.

\_ Enhance the capacity of the Legislation and Consultation Department of the Ministry of Justice to fulfill its mandate for legislative review.

\_ Monitoring by the Judicial Inspection Unit (JIU) of qualitative and quantitative factors in the performance of the judiciary. Revise the performance review system based on criteria for evaluation articulated by the JIU, working with input from recently appointed and long-serving judges.

\_ Investigate allegations of corruption in a transparent and public process and based on a written code of conduct for judges.

\_ Computerize in stages, as part of a larger strategy for modernizing overall court administration.

\_ Expand legal representation available for the indigent in civil and criminal cases.

\_ Revise eligibility criteria for court fee waivers and legal representation to reflect income levels, not employment status.

Source: Lebanon: Legal & Judicial Sector Assessment, World Bank, 2004.

### 7.3. Protection of Property Rights

The Lebanese Real Estate Law governs the acquisition and disposition of all property rights (for Lebanese nationals), real estate acquisition by foreigners is governed by Law No. 296 (April, 2001). Mortgages are a common practice in Lebanon. Security interests are required to be recorded in the Commercial Register and the Real Estate Register. As a result, interests, both movable and real, are formally protected.

Lebanon is a member of the Paris Convention on Patent Rights Protection, the Bern Convention on Literary and Artistic Property and the Madrid Convention on the False Declaration of the Origin of Goods. Typically, transferable and assignable patents are issued for a 15-year period, in Lebanon. Similarly, trademarks are provided for a 15-year period with the option to extend this period for another 15 years. New laws have been passed: a modern Copyright Law in 1999, largely complying with WIPO and WTO regulations and recommendations as to best practice. A modern Patent Law approved in 2000.

Intellectual Property Rights' legislation dates back to 1946. But like many other rules and regulations, enforcement of the Intellectual Property Rights legislations has long been deficient. However, compliance and protection improved following the passage of the new Law in 1999 governing intellectual property rights. The new law provided the necessary tools to guarantee enforcement and combat software piracy in the country and provided incentives for inward investment by IT companies.



#### 7.4. Corporate Governance Framework

Corporate governance (CG) in Lebanon –as in many of the MENA countries-remains subject to commercial laws and regulations dating from the 1950s and 1960s and inherited from the French commercial code<sup>68</sup>. The need to implement a Corporate Governance framework is acknowledged both at the government and corporate level. Indeed, recently, increased awareness of the importance of CG have led to changes in corporate culture, albeit slowly and without incentives for adoption. A contributory factor to the slow adoption rate is the preponderance of FOEs and SMEs in the economy that face a high cost of compliance with modern corporate governance principles and/or who are unfamiliar with the requirements and benefits. The government acknowledges the urgency to improve the legal and institutional frameworks for corporate governance and develop an environment where international best practice can flourish. The corporate sector needs to 'buy-in' to the process along with heightened public awareness. The absence of an independent judiciary, capable of investigating complaints and prosecuting violators is a major challenge. Judges need to be well versed in commercial and securities law.

In 2004 the Lebanese Corporate Governance Task Force (LCGTF) was established, in conjunction with the Lebanese Transparency Association (LTA) to promote corporate governance (see below). The introduction of good CG codes and principles is required for listed companies, SOEs and FOEs, with appropriate frameworks developed for each sub-sector.

#### 7.5. Corruption

According to Lebanese Law, it is a criminal act to give or accept a bribe. The penalty is imprisonment for up to three years, with hard labour in some cases, plus a fine equal to at least three times the value of the bribe. The Central Inspection Directorate and the Public Prosecutor are responsible for combating corruption in the public and private sector respectively. However, the absence of a strong judicial system and the lack of efficient enforcement mechanisms have made the law irrelevant in addressing the growing 'cancer of corruption'. Moreover, serious doubts are shed on the government's commitment to control corruption given that Lebanon has not signed the OECD Convention on Combating Bribery, or signed the UN Convention against Corruption – approved and signed by 106 countries in Merida, Mexico in December 2003.

Public awareness of the scope and widespread nature of corruption is strong in Lebanon from the anecdotal practice of 'bakhsheesh' to grand corruption which impregnates the State and its institutions. The extent and scope of corruption have contributed substantially to the high cost of reconstruction and resulting public debt. The Lebanese Research Company "Information International" has estimated bribery and corruption to cost some USD 1 Billion per year. Transparency International has ranked Lebanon among the most corrupt countries. The country ranks 97th out of 146 countries (146 being the most corrupt), according to the 2004 Corruption Perception Index.

In view of such unsustainable and damaging levels of corruption, a number of NGOs have opted to take the task into their own hands. "*Kulluna Massouh*" ("we are all responsible") as well as The Lebanese Transparency Association, "*La Fassad*" ("No Corruption") undertook a number of anti-corruption projects including national media campaigns and organized workshops and seminars.

A number of international development organisations have also come to support committed Lebanese in addressing corruption in all sectors. USAID has, for example, launched a USD two million Transparency and Accountability Grants Project (TAG). The project will allocate resources for civil society organizations and civic leaders to implement activities that would help addressing corruption and promote transparency, accountability

<sup>68</sup> See N. Saidi (2004).

and good governance. However, the State and its institutions have yet to design and implement a comprehensive anti-corruption programme.

## 8. Civil Society and Civil Liberties

Civil liberties include media free of censorship, open public discussion, freedom of assembly and demonstration, freedom of political organization, non-discriminatory rule of law in politically relevant cases, free trade unions, freedom to conduct businesses and cooperatives, freedom to establish professional and other private organisations, freedom to practice and establish religious institutions, personal social and economic rights (for example, the right to own property and to travel internally and externally), freedom from gross socio-economic inequality, and freedom from gross government indifference or corruption. On this understanding and according to the 2005 Freedom House Index, Lebanon scored poorly in terms of Civil Liberties and Political rights : 5/7 and 6/7 respectively (1/7 being the highest rating)

Increasing citizen's voice and public accountability is found to lead to greater efficiency in government action. Article 13 of the National Constitution guarantees freedom of meeting and freedom of association within the framework of the law. The law organising the formation of associations goes back to 1909 (issued by the Ottoman Turks) and requires that the Ministry of Interior be advised of the establishment of an association and internal structure. Importantly, it does not require licensing or consent, merely, 'prendre acte'.

1,100 associations were registered with the Ministry of Interior in Beirut by 1999. Associations vary in nature and contribute substantially to the richness of the country's communal life. The list include: a large number of religious associations, reflecting the social fabric in Lebanon, many professional associations and environmental, advocacy, and women's groups, and associations that cross confessional lines and favour the integration of national Lebanese civil society.

Most professional bodies are represented in the International Chamber of Commerce in Lebanon, the Beirut Chamber of Commerce and Industry, and the Association of Lebanese Industrialists. The Confederation of General Workers of Lebanon (CGTL) is the main trade union federation. The Rassemblement des Dirigeants et Chefs d' Entreprises Libanais (RDCL), is a lobby regrouping businessmen, bankers, and industrialists.

Family and local communal associations have a strong presence in Lebanon, the growth of which was substantially fuelled during war, at times where a humanitarian needs gap required consolidation of union and cooperation. Beirut, counts about 300 registered family associations and 60 neighbourhood associations. Charities and social welfare associations experienced exceptional growth during the war and its aftermath.

A Lebanese NGO Forum coordinates the efforts of humanitarian NGOs in the country and further collaborates with state institutions to complement their activities. Close collaboration and cooperation with UN agencies and foreign development and aid associations. The Collective of Lebanese Voluntary NGOs also plays an important role in social development. Areas of assistance include Lebanese legislation, representation before public, national, and international authorities, and establishes a civic forum for development.

Some associations are long established, with some dating back to the nineteenth century. Fifty of the 300 active NGOs in Beirut, are relatively large in size, operating across the country with more than 10 staff.

Since 2000, Beirut is the home of Amnesty International's regional office. Advocating human rights too, the Institute for Human Rights in Lebanon –part of the Beirut Bar Association– has established a strong local and on-line presence with international visibility. The legal organization publishes reports and has taken upon its responsibilities the strengthening freedom of expression and associations laws.

## 9. Media

The synergy between establishing and sustaining good governance and the role of the media cannot be stressed enough: "Markets create managerial discipline and induce efficacy through the exercise of choice, governments are principally disciplined through the exercise of voice" (Hirschman 1970). Media is perceived to be vocal in Lebanon, in comparison to other countries in the region. Major Parliamentary debates are broadcast in real time. Freedom of the press is provided for in Article 13 of the Constitution. Nevertheless, the Taif Agreement required all audio-visual and printed media to abide by the "principles of responsible freedom." Six major television stations and over 40 radio stations cover Lebanon and offer local and international news. Eight major Arabic daily newspapers are available online and a variety of others, including English and French language publications. An-Nahar and Al-Safir enjoy a regional as well as local readership, as does The Daily Star. Despite internal and external pressures, freedom of the press remains safeguarded in Lebanon to a large

extent, although there are no controls on concentration of ownership in the media.

Private media ownership, in theory, reduces direct government control and provides a substitute. However, in Lebanon, many of the media are dominated by single influential shareholders (often by politicians and people in power) or strongly supportive of high profile politicians. Other media channels are owned by strong and "categorical" opponents to government policies. In such a context, little guarantee is provided as to the independence, transparency, accountability and accuracy of public debate and information.

Pressure on the media has increased in recent years. The opposition TV station, MTV, was shut down in 2002, amidst angry demonstrations marches by civil groups and students. Political in nature, the decision to shut down the TV station followed its coverage of the elections where opposition was granted airtime to express openly its opinion and to criticize the political system. Recently action has been taken to re-open MTV, which is meant to resume by early 2006. More recently, in 2005, one journalist was assassinated and another suffered severe injuries from a car bomb.

#### 10. Governance at the forefront of the national development agenda, main Initiatives

Governance is the business of the government, civil society and the people. Their efforts are complementary and one reinforces the other. There are a host of channels through which efforts can be exerted, namely: parliamentary committees, constitutional courts, the media, independent audit agencies, public service agencies, political parties, business associations, labour unions, NGOs as well as civic advocacy groups. Public demonstrations, a right granted by law, is yet another manifestation supporting contestability.

The following section lists the major governance agents and discusses their role in building governance and institutions in Lebanon.

##### The Lebanese Association of Certified Public Accountants

The Lebanese Association of Certified Public Accountants (LACPA) is the only legally recognized professional body for accountants as detailed in the Act of Regularization of the Certified Public Accountants' Practice in Lebanon (August 1994). Membership is required from all practicing auditors. There are currently 1,700 registered auditors, 250 of whom are actively involved in auditing practice, while the rest are retirees or individuals occupying corporate financial positions. The association holds great potential as to the regulation of the accounting and auditing profession in the country such as the supervision of its members and the establishment of ethical standards and disciplinary procedures. However, for a variety of reasons including lack of adequate funding, LACPA has fallen short of meeting its goals and potential..

In theory auditors are required to abide by a professional conduct code. In practice, the situation is not as clear, given the absence of a detailed code of ethics. The Code of Commerce includes guidelines on the relationship between auditors and clients, however, the guidelines are too general and do not meet international standards.

##### Lebanon Corporate Governance Task Force (LCGTF)

The Lebanese Transparency Association (LTA) established the 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 companies and businesses, private and State Owned Enterprises (SOEs) and professionals. The task force serves as a model of private-public cooperation supported by strategic partnerships with civil society groups and international development organizations, including the parties in the Global CG Forum. It brings together, on a volunteer basis, lawyers, accountants, professionals, public sector officials, businessmen, academics and experts on CG, capitalizing on their involvement and ownership. LCGTF has initiated a dialogue at the national level, building capacity, disseminating CG knowledge and raising awareness among stakeholders.

The main objectives of the LCGTF (see Action Plan below) are (i) capacity and institutional development; (ii) initial assessment of corporate governance regime and (iii) the adoption and implementation of CG principles in the private and public sector. The LCGTF focus is on the building blocks that insure institutional and market infrastructure, namely the OECD principles of Corporate Governance and the supporting pillars of the implementation of International Financial Reporting Standards and International Standards on Auditing. The LCGTF has held a number of CG awareness raising seminars and conferences, has published a survey<sup>69</sup> on Corporate Governance in the MENA region, co-hosted the Second Middle East and North Africa Regional Corporate Governance Forum,

and conducted a survey of Lebanese Private Companies<sup>70</sup>. LCGTF also represents Lebanon in regional and international CG forums.

Box 5.8.: Snapshot -LCGTF Business Plan

\_ Undertake a Survey of Corporate Governance in Lebanon

\_ 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.

\_ The LCGTF will propose and seek amendments to the Commercial Code and other legislation relating to:

- \* Strengthen Minority & Foreign shareholder protection
- \* Identify the responsibilities of the Board of Directors and individual directors
- \* Accounting and auditing
- \* Transparency of Ownership and Control

\* Regulatory Environment Laws and

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*'

\_ Develop a Public Credit Registry to report on sources and uses of credit (market-based, bank, non-bank and 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.

\_ Set-up a national 'Companies House' that will complement and expand the Commercial Register by centralizing financial reporting and disclosure of corporate actions.

\_ Encourage set-up of Local Rating Agencies to ease compliance with Basel II banking standards.

\_ Lobby and seek the adoption and implementation of the 12 Key Standards for

<sup>69</sup> See Saidi, N. Corporate Governance in MENA Countries: Improving Transparency and Disclosure. See LTA, Corporate Governance related Webpage, survey conducted with InfoPro <http://www.transparency-lebanon.org/CG/CG%20task%20force1.htm>

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.

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

Rassemblement de Dirigeants et Chefs D'entreprises Libanais (RDCL)

The Rassemblement de dirigeants et chefs d'entreprises Libanais (RDCL), launched a "Code of Business Ethics"<sup>71</sup> demonstrating that business organizations and NGOs in Lebanon, are active, dynamic, resourceful and forward looking. The code constitutes a voluntary tool advocating business ethics.

## 11. Conclusions and Recommendations

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, respect their role and constraints and establish the rule of law. The country needs to move from discretionary-management and relationship based policy making and governance to institution and rules-based policy making and governance. These are difficult enough objectives under normal circumstances. They are more difficult under 'transition' circumstances, as we have learnt from the mixed experience of the Former Soviet Union (FSU) countries. However, the challenges of building institutions and imposing the rule of law are all the more daunting under conditions of reconstruction, of rebuilding the Nation-State after violent conflict: they require re-knitting the social fabric, re-establishing trust between political and social actors, policy-makers and reformers. The related aspect is that implementing 'good governance' is necessarily a multi-faceted, multi-disciplinary, multi-sector undertaking.

Economic security is based on the pillars of good public and corporate governance. A strategy for good governance is necessarily multi-faceted, including constitutional and civil service reform, institution building, legal and judicial sector reform, improvement in the machinery of government, providing access to reliable and accurate information, promoting voice on governance by raising public awareness and strengthening independence in the role of the media. We need to be clear about the issues, vision and objectives. Therein lies the challenge of moving from institutions of economic and political governance that tend to be heavily relationship-based to institutions and strategies that are more effectively rules-based.

This report has developed a series of recommendations covering the political process and electoral reform, public finances and fiscal policy, administration, statistics and information, accounting, judicial reform and corporate governance, and aimed at improving and instituting good national governance. The stakes are high: better corporate and public governance lowers the cost of doing business, improves the investment environment and leads to more effective institutions and higher, sustainable economic growth. However, 'good governance' will not happen *sui generis*: reformers need to create incentives for good governance, develop rewards for integrity and ethical behaviour that are self-reinforcing; incentive-compatible mechanisms have to be established. One way is to publicly recognize firms implementing CG principles: the financial markets and the media have an important role to play in this context by signalling firms, agencies and institutions with 'good governance'.

Good corporate governance requires good political governance, and vice versa. Lebanon's case is internationally relevant: how does one institute good governance for countries that are rebuilding the Nation-State in post-conflict situations?<sup>72</sup> Political and Public Governance

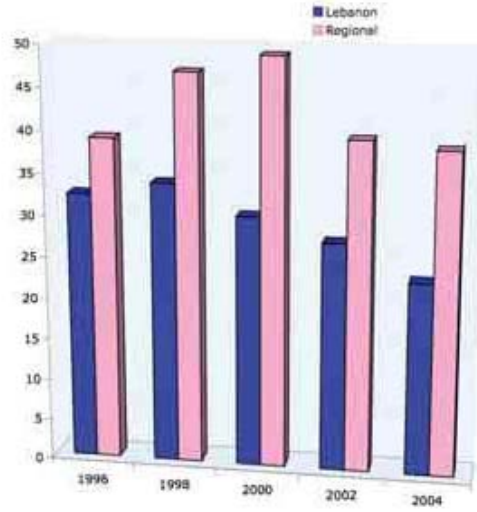
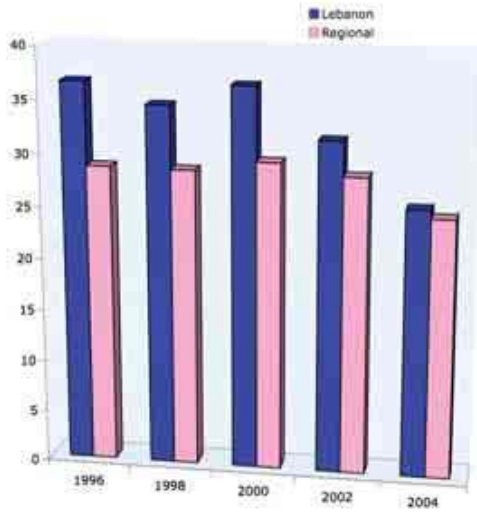
<sup>71</sup> The Code of Business Ethics can be downloaded from <http://www.rdcl.org.lb/CodeofEthicsText.pdf>

The recent Global Corruption Report for 2005 discusses corruption during reconstruction and the additional burdens and costs affecting post-conflict countries. See: <http://www.globalcorruptionreport.org/>

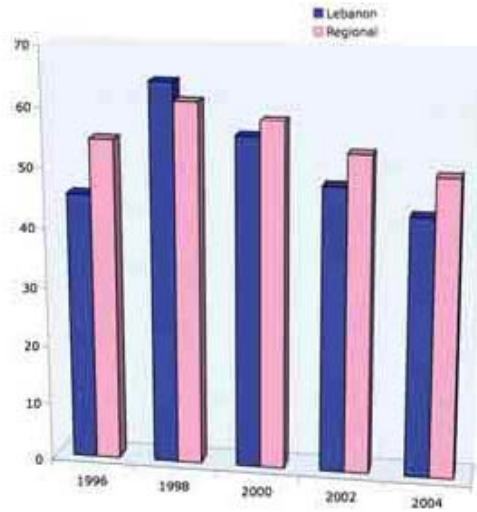
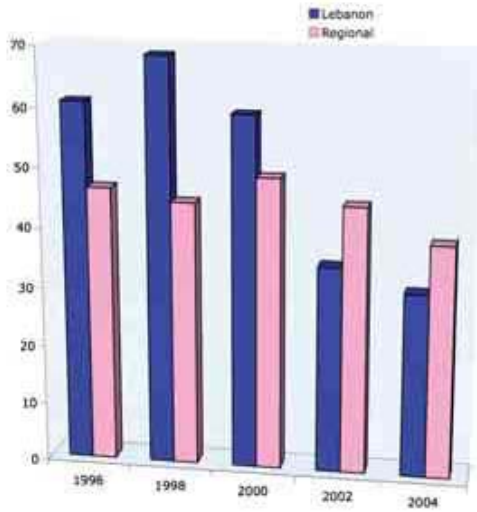
and Corporate Governance must move in tandem to improve the economic environment. As Juvenal asked: "Quis Custodiet Ipsos Custodes?" Who watches the Watchmen?

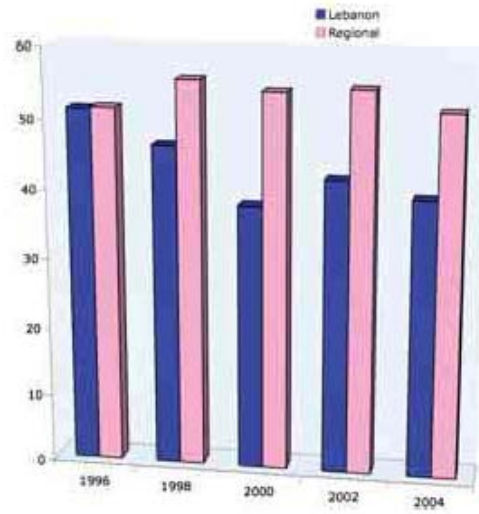
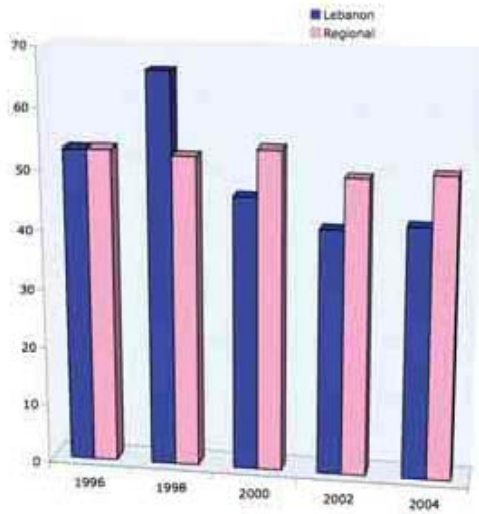
ANNEXES

Appendix 5.1.: World Bank 6 Governance Dimensions Voice & Accountability Political Stability



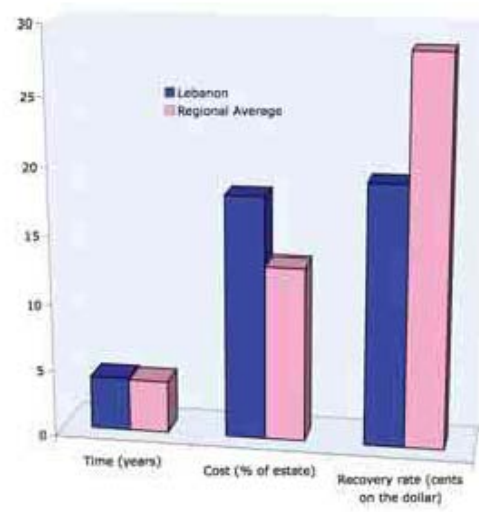
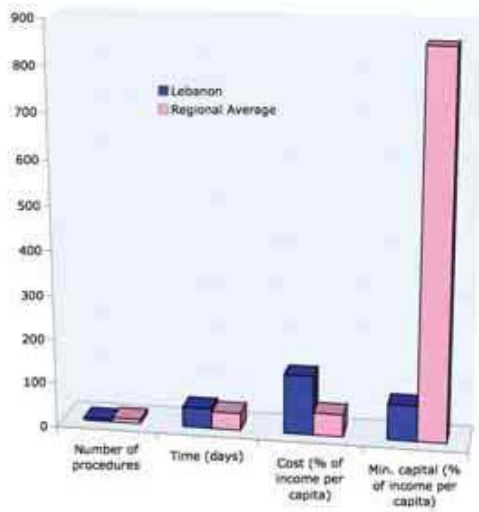
Regulatory Quality Rule of Law Government Effectiveness Control of Corruption





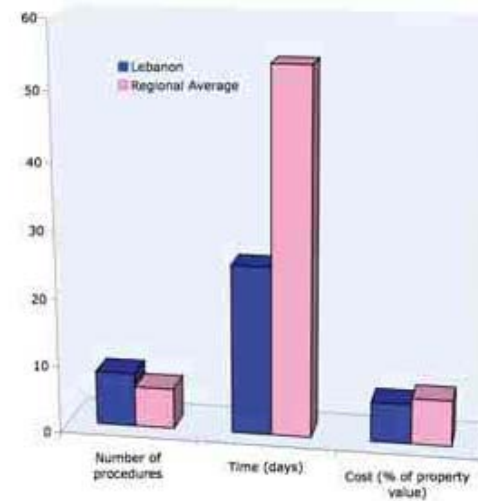
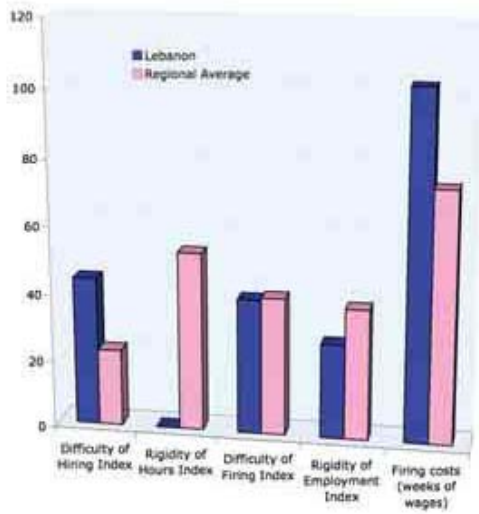
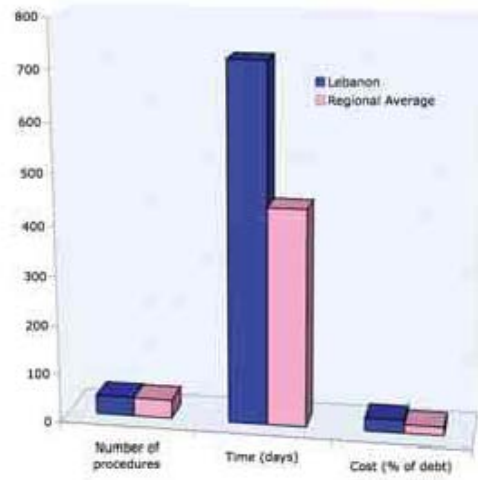
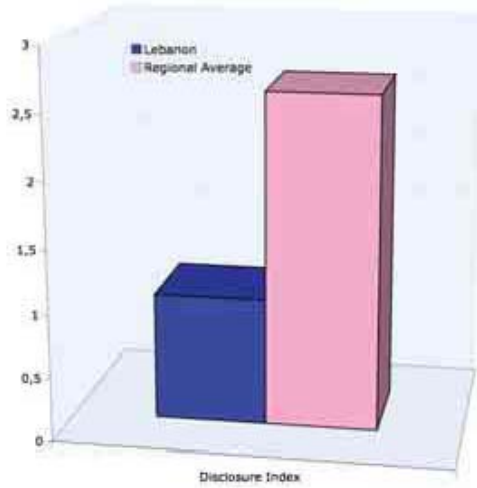
Source: World Bank

Appendix 5.2.: Cost of Doing Business – 2005 Starting a Business Closing a Business

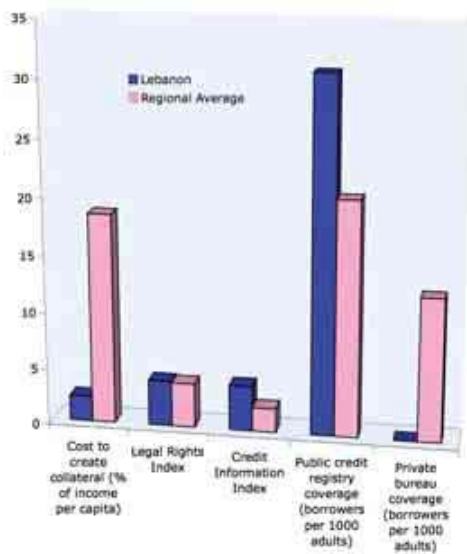


Protecting Investors Enforcing Contracts Hiring and Firing Workers Registering Property

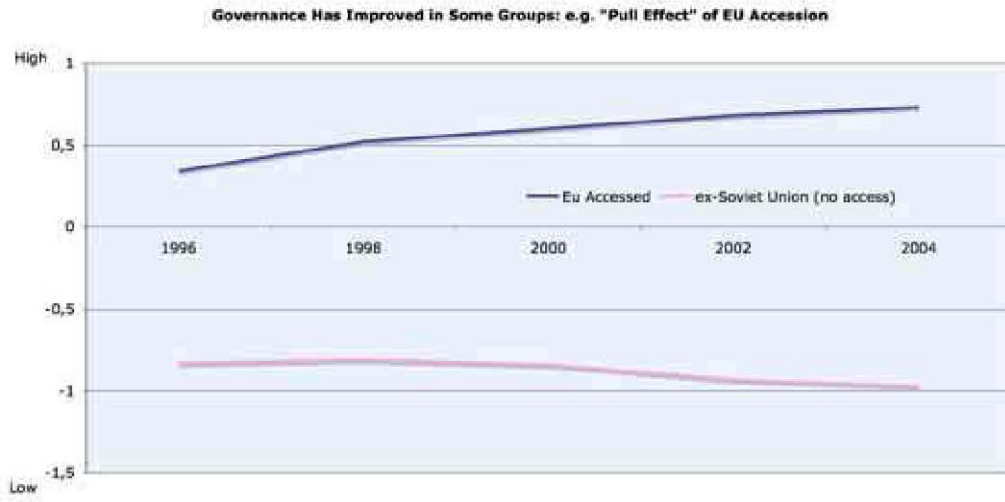




### Getting Credit



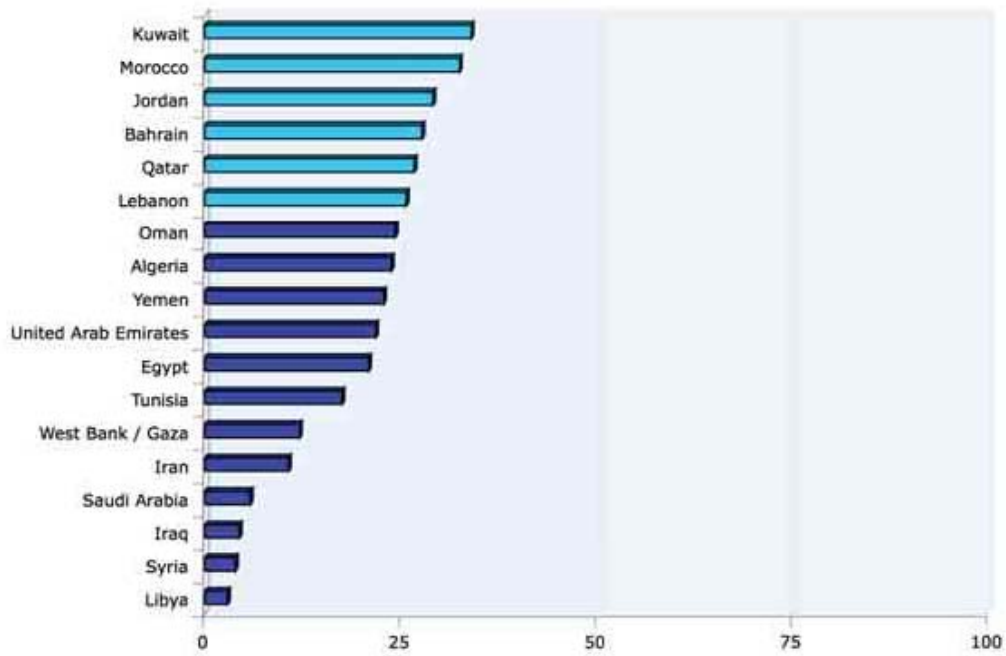
Source: World Bank  
Appendix 5.3.: Pull Effect of EU Accession Agreements



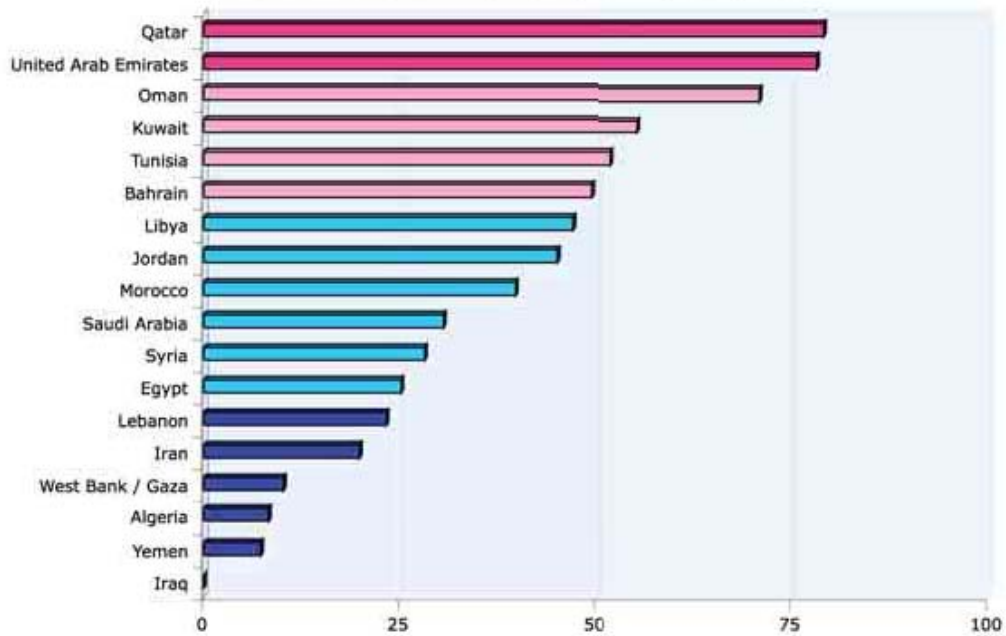
Source for data: <http://www.worldbank.org/wbi/governance/govdata> EU EE Accessed Countries: Czech Republic, Estonia, Hungary, Latvia, Lithuania, Slovak Republic, and Slovenia.

Appendix 5.4.: Governance Indicators -World Bank

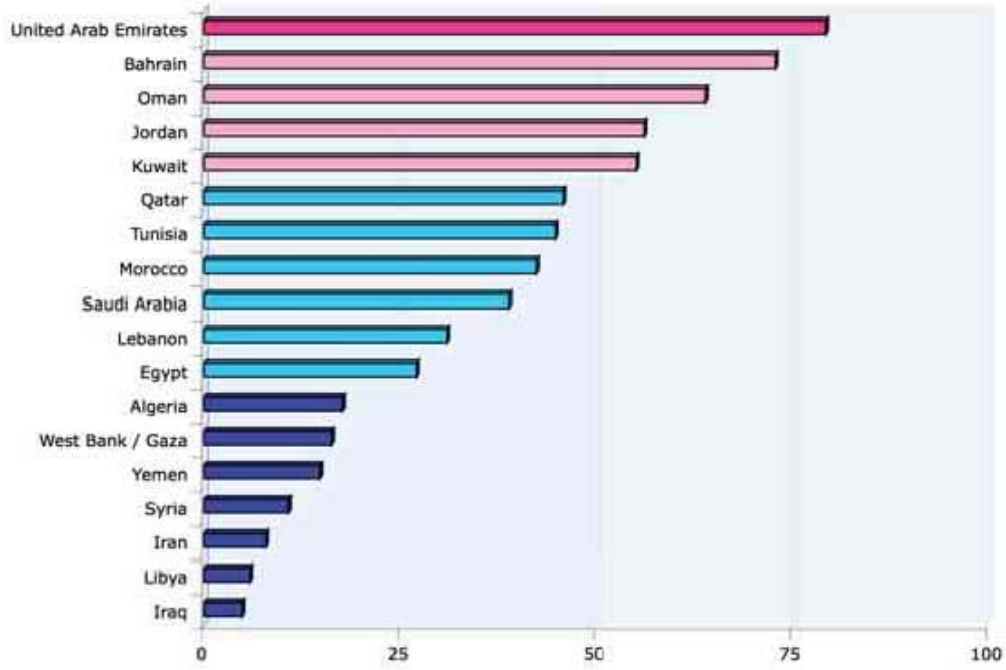
Voice and Accountability (Middle East and North Africa Region, 2004)



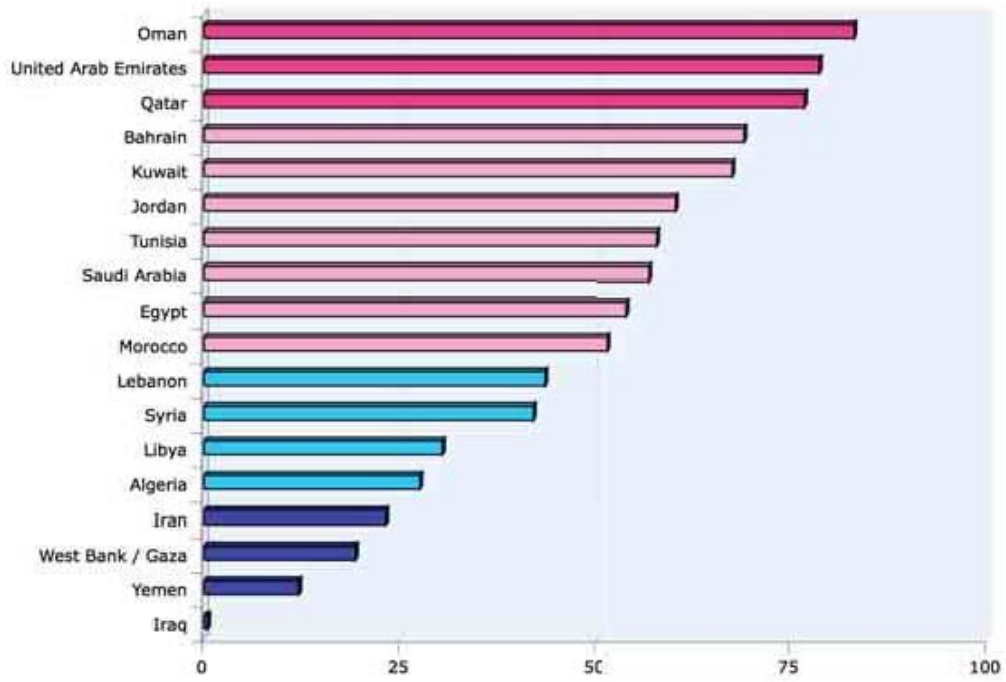
Political Stability (Middle East and North Africa Region, 2004)



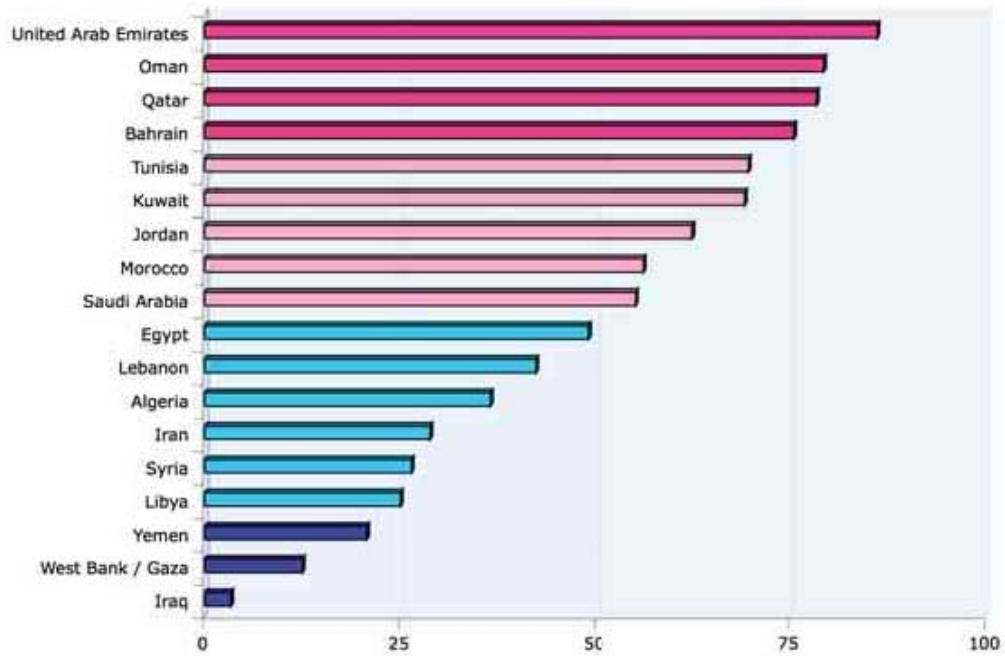
**Regulatory Quality (Middle East and North Africa Region, 2004)**



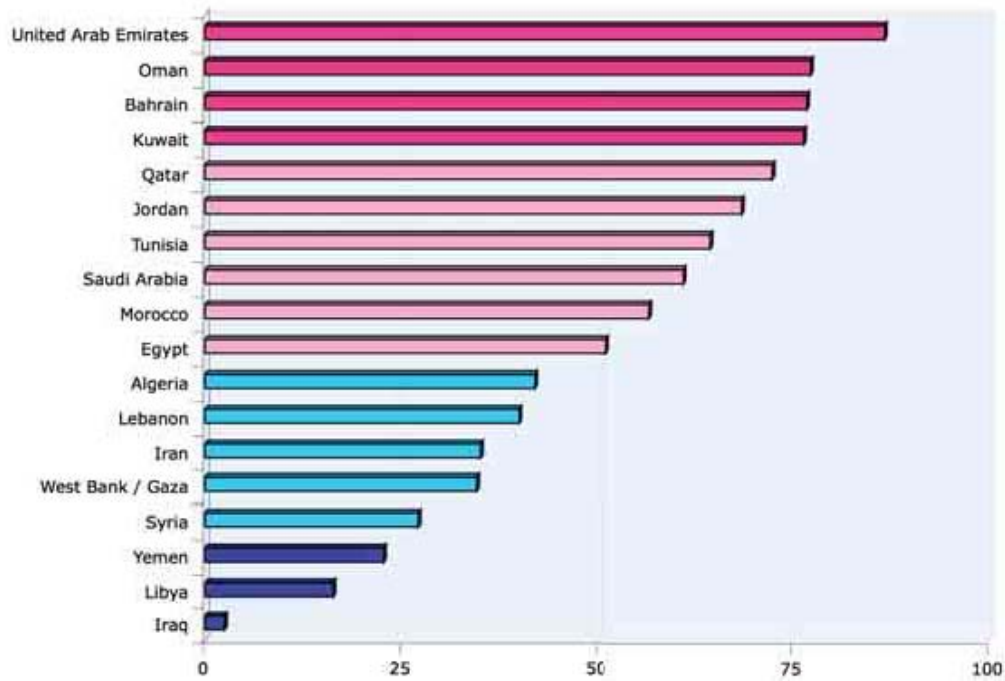
**Rule of Law (Middle East and North Africa Region, 2004)**



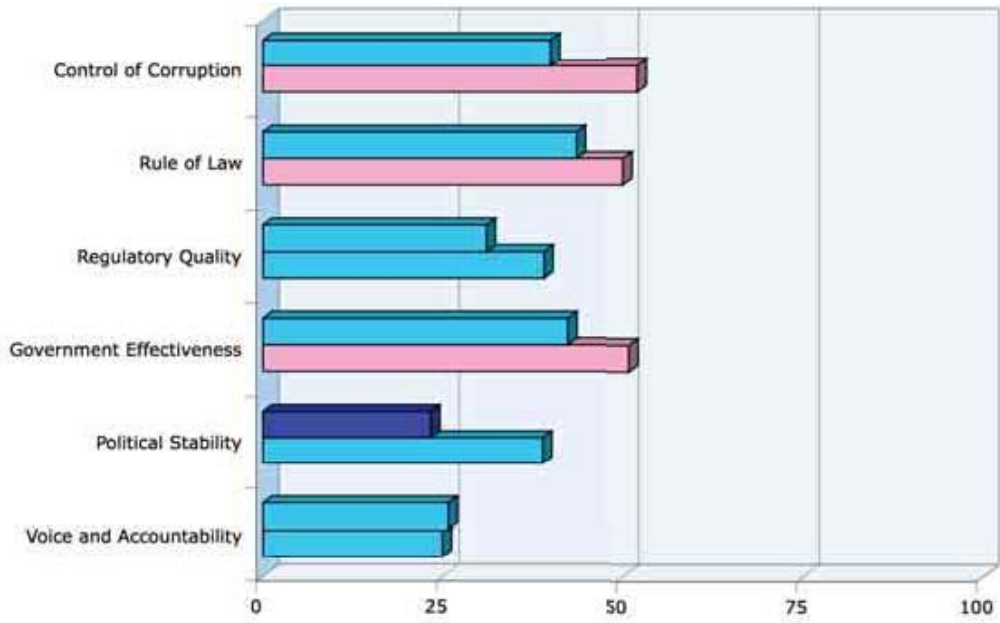
**Government Effectiveness (Middle East and North Africa Region, 2004)**



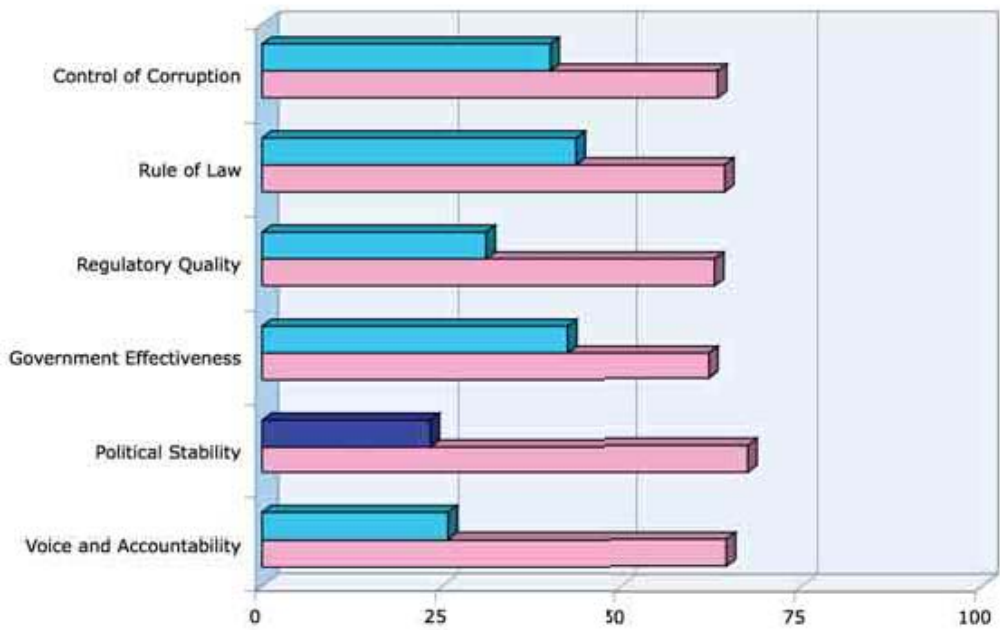
**Control of Corruption (Middle East and North Africa Region, 2004)**

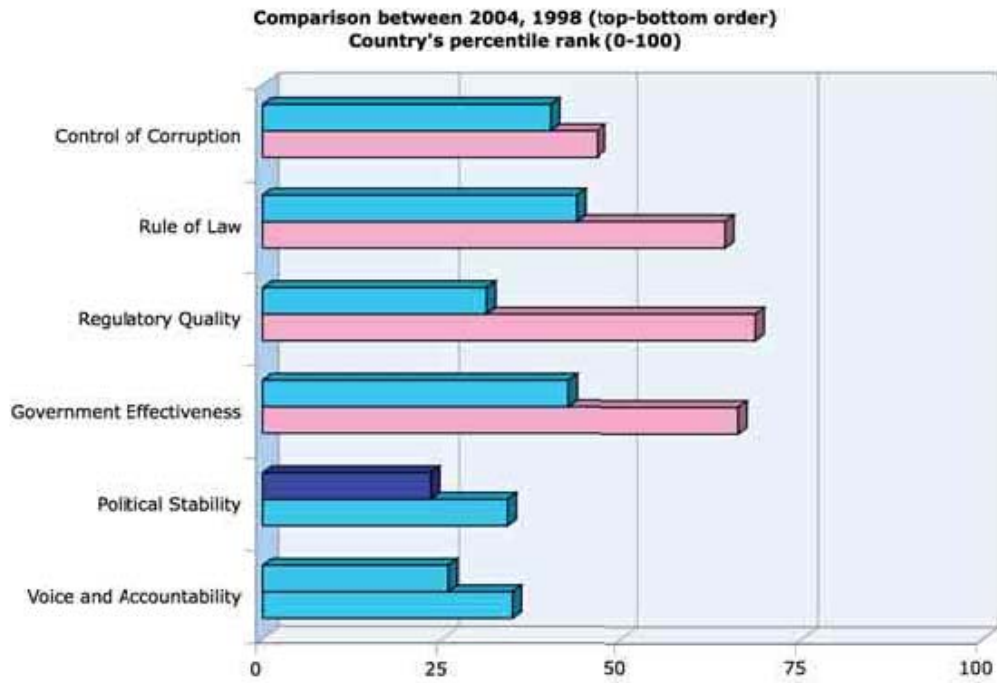


**Comparison with regional average (Middle East and North Africa, lower bar)**  
**Country's percentile rank (0-100)**



**Comparison with income category average (Upper Middle Income, lower bar)**  
**Country's percentile rank (0-100)**





Source: D. Kaufmann, A. Kraay, and M. Mastruzzi 2005: Governance Indicators for 1996-2004  
<http://www.worldbank.org/wbi/governance/pubs/qomatters4.html>

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