

***Building the Lebanon-EU Partnership:
Reforms for a modern economy and
democratic polity and society***

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The signing of the Lebanon-EU Association Agreement deepens our existing relations rooted in history and common interests, our shared vision of political stability and security, of achieving sustainable growth in democratic societies to reduce income and social disparities, and addressing common challenges in areas such as the environment. For Lebanon emerging from the cauldron of war and in the fulcrum of the destructive Israeli-Arab conflicts, **the EuroMed Association Agreement is a strategic, enabling, framework for: (a) deep, multi-dimensional, integration with the EU, (b) implementing wide-ranging, in-depth, political, institutional, legal, economic, financial, fiscal and tax reforms.** The benefits are not immediate: the EU is already our main trade partner, a major investor and contributor to our post-conflict reconstruction. Existing fiscal problems will be exacerbated by the loss in customs revenue (amounting

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to about 4-5% of GDP), resulting from the future free trade area and will have to be compensated from other sources, including VAT.

For Lebanon, the main benefits and strategic importance of the EuroMed Association Agreement (AA), will come from the legal, regulatory and institutional reforms that will modernize the economy, the polity and society and enable it to strengthen its international competitiveness and face the challenges of globalisation and the pressures on the region arising from the conflicts with Israel and the fallout from the events of 11 September 2001. Effectively implemented the EuroMed Association Agreement promises to open new political, economic, social, and cultural horizons for Lebanon.

We seek to reconstruct our country from the destruction, dislocation wrought by conflicts, civil and un-civil wars, we seek to develop an open society and polity, based on representative, resilient institutions to create a modern democratic Lebanon. The Association Agreement poses a strategic framework, an important toolbox that Lebanon can use to achieve those objectives. Our assessment of the importance of Association Agreement with the EU should be consistent with our overall strategy for rebuilding our country. The EU-Lebanon Association Agreement is no panacea, no magic potion for Lebanon's macroeconomic and structural problems. To achieve the benefits will require strong adjustment, investment, and commitment to deep-seated reforms. To consolidate the gains, Lebanon should also open-up multilaterally and multi-dimensionally to the Arab countries, and to the rest-of-the –world by joining the WTO.

An Agenda for Policy Action and the Role of the EU

How do we build a modern, democratic polity and society, a dynamic economy able to compete internationally in an increasingly globalised world economy? What is the role of the EuroMed AA in this context? We need to maintain strategies and policies that have served us well in the past, but rebuild our institutions and provide new infrastructure and frameworks. Market-based, competition-enhancing solutions are required to meet the multiple challenges facing Lebanon in the new millennium.

The vision and strategy for recovery and sustained growth rests on a number of building blocks.

- **Political reform and the institution of good governance should be a national priority.** Lebanon has a long tradition of democracy and active political life. This has been revived in the period since the end of bloody conflicts in 1990. However, the apparatus and infrastructure of politics, the running of public affairs and the State need to be modernised, in order to achieve norms and standards of good governance. Free, contestable markets for goods and services should be completed and supported by contestable, competitive politics. Our economic régime enables individuals to compete freely in economic life independently of religion, confession, sect or other characteristics. We do not do so in public life, political matters and the running of the State. We must act against discrimination and de-confessionalise our political, administrative and social system, so that the domain of economic competition and freedom coincides with the sphere of political freedom and competition. Political reform will ensure competition and lead to **good governance and greater efficiency in public administration**, which in turn, will improve policymaking. Good governance, in all its varieties, is a necessity, not a luxury. It will also enable and draw a clear path toward economic stabilization, **growth and development in all the regions of Lebanon.**
- **Rehabilitation of public finances.** A two-pronged strategy is required to: (a) reduce the size of the public sector and the public debt through privatisation and the phasing out of a large number of government agencies and entities, (b) permanently reduce the government's budget deficit. The first will require undertaking a wide-ranging restructuring programme, leading to a deep reappraisal of the role and functions of the State. The second will require a sharp, permanent reduction of expenditures through a cutting back of the bureaucracy, a rationalisation and re-orientation of expenditures towards capital spending, an increase in the extent and efficiency of tax collection, and a widening of the taxpayer base. The implementation of broad-based taxes, such as VAT, is a step in the direction of tax reform.

- **Maintain an open economy** with free trade, unfettered payments and capital movements. The traditional openness of the Lebanese economy needs to be strengthened by entry into the World Trade Organization (WTO), active promotion of the Greater Arab Free Trade Area (GAFTA) and an Arab Common Market (ACM).
- **Liberalize, privatise and deregulate the economy**, and allow markets to operate. This implies creating the framework for the private sector to participate in the provision of infrastructure and its services, and pursue the privatisation of public utilities and services with telecommunications, power, water, transport and communications being the prime candidates. The enabling legal framework for privatisation exists since July 2000. Implementation requires the creation and empowerment of new regulatory structures and independent regulatory authorities to ensure a transparent, effective and accountable privatisation program.
- **Capital Markets Reform**, the set-up of an independent capital markets authority, and privatising the Beirut Stock Exchange, should accompany the privatisation program. Privatisation can be financed with entities to be privatised issuing shares or bonds on the BSE. This would ensure democratic participation through ownership of privatised entities, diminish the potential of monopolies emerging and provide oversight and market supervision of privatised entities. Privatisation and capital market reform will force a fundamental review and transformation of the role of the state and its responsibilities.
- **Invest massively and rapidly in Media, Information and Communication Technologies (MICT)**. This is not just a matter of bridging the “digital divide”. MICT investments are critical so that Lebanon can become the region’s provider and centre of *e-services*. The application of MICT would allow international, cross-border, delivery of digitised goods and services. This offers Lebanon the enormous opportunities and potential offered by the markets of the Lebanese Diaspora, *Lebanon.net*, as well as the Arab world. Lebanon possesses the human capital, the capacities, has access to the enabling technologies, has prepared the legal framework and is competitively well positioned to become the *e-services* centre of the Middle East. *E-services*, including banking, payments, capital

markets and financial services, call-centres, medical, educational, consulting services should become a national focus and priority.

Lebanon and the EuroMed Association Agreement

It is in this context of political reform and modernization, of good governance and institutional reform, that Lebanon can achieve a harmonization of laws, regulations and standards with the EU in a structured and systematic manner, and develop its political dialogue. The methodological approach used for the adoption of the “*acquis communautaire*” in the Central and Eastern European Countries (CEECs) –as the successful examples of Hungary, Czech, Poland and other countries illustrate-could be used in Lebanon as a reference for legislation approximation and strengthening of administrative and institutional structures through the transfer of expertise.

Similarly, Lebanon can also benefit from the EU’s experience for the modernization of competition and consumer protection legislation and policies and anti-trust frameworks, for reforming government procurement policies, and the establishment of regulatory authorities responsible for supervising privatised entities, ensuring fair-trading and services delivery. The AA will signal to investors, domestic and foreign, a commitment to deep and widespread economic and financial reforms, that will cut red tape, de-regulate and liberalize trade (domestic and foreign) and economic activity. This “*policy signalling effect*” of initiating the AA will complement the deeper reforms required for our entry into the WTO. *The dynamic benefits will result from the credibility imposed on our policy-makers locked into the process of reforms and liberalization required by the Association Agreement.*

Investment, Adjustment Costs & Productivity Growth

As a small country Lebanon *can* generate substantial economic growth payoffs from increased integration with the EU, benefiting from a large and expanding market. Indeed, the dynamic gains from the Association are likely to be more important than the static gains. The AA will be favourable if it generates higher investment rates that will raise total factor productivity growth, attracts resources into productive, export-oriented activities, integrates Lebanon into Europe’s supply-chain and leads to the creation of Lebanon-EU joint ventures involving a transfer of technology and “know-ware”.

Economic adjustment to the AA will require increased domestic investment (public and private) by about 2% of GDP per year over the next ten years to upgrade, achieve the *mise à niveau* of agriculture and industry towards *new, competitive, high value-added activities*. They require the setting and harmonization of norms and standards for Lebanese products enabling them to enter the EU's markets. This requires building up the institutional capacity of Libnor, the standards setting agency in Lebanon. What can the EU do to help the transition and Lebanon's adjustment?

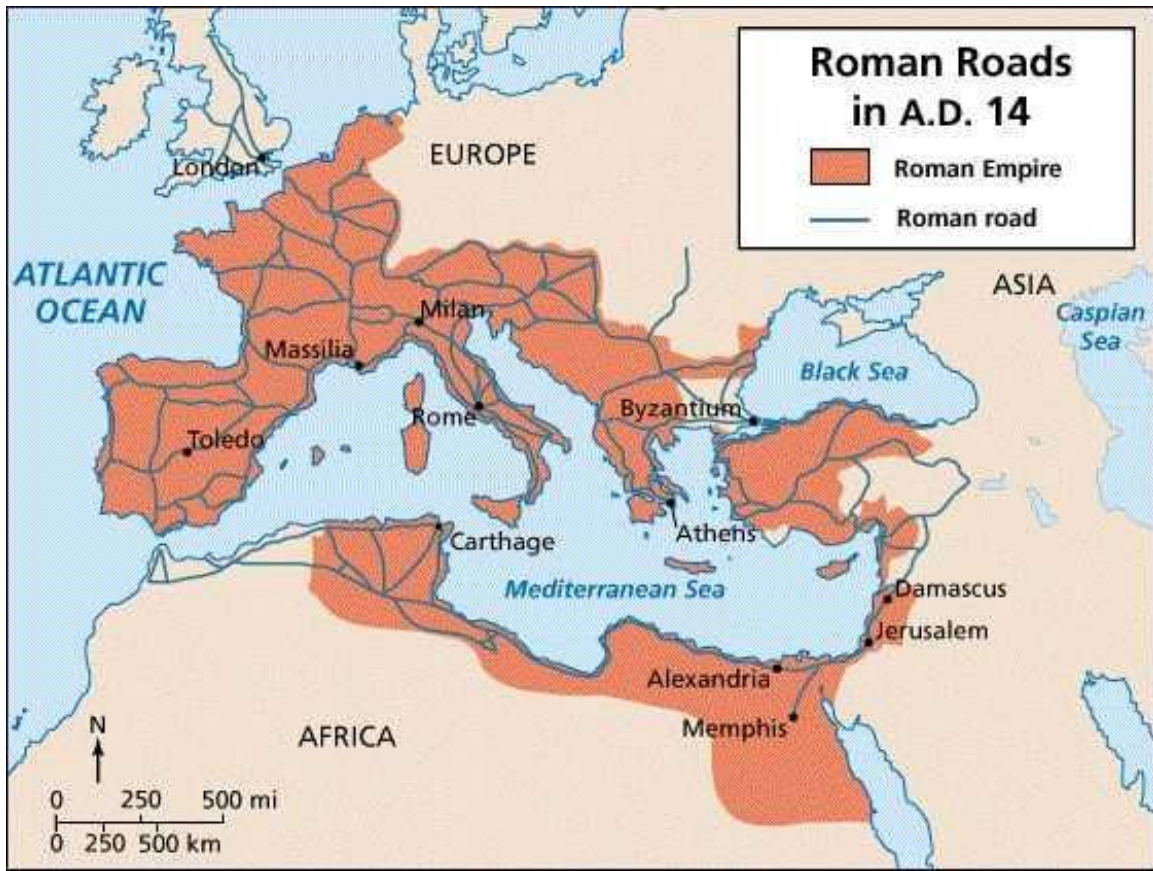
1. The EU should provide a generous, comprehensive financial and economic cooperation package enabling Lebanon to: (a) complete the reconstruction of its infrastructure and (b) implement reforms and for the private sector to lower their costs of adjusting to increased competition resulting from the AA. The disbursement and implementation of the MEDA program should be accelerated to ease the process of adjustment. The Industrial Modernisation Programme should be strengthened and an Agro-industrial Modernisation Programme initiated.
2. The EU has to widen access to its markets, by removing non-tariff barriers to trade, for Lebanon –in particular in agro-industry and services-and implement a pro-active action plan to promote investment by EU businesses in Lebanon. Lebanon's privatisation program provides extensive investment opportunities in the area of public utilities –telecommunications, power, water, and ports and transport- in which the EU has substantial experience.
3. ***Our AA should be expanded to include science, R&D cooperation and assistance*** to enable the transfer of technology and Lebanon's transition into the "digital economy". Lebanon with the EU's assistance should become ***e-Lebanon*** using its human capital and investment in Media and ICT, integrating the network of the Lebanese Diaspora, ***Lebanon. net***, to provide *e-services* to the region.
4. Success of the EU-Lebanon AA **requires increased integration of Lebanon with the Arab world, implementation of the Greater Arab Free Trade Area and the Arab Common Market, fostering intra-regional economic links, liberalizing services, to avoid trade and investment diversion and potential hub-spoke effects.** The EU can provide assistance in developing the Greater Arab Free Trade Area, to be followed by closer integration in the form of the Arab

Common Market. There is a wealth of knowledge and experience that the EU has gained in achieving a common market and a common currency, that it can and should share with Lebanon and the Arab countries in order for them to achieve greater economic integration. Indeed, we should benefit from the EU's knowledge and experience in this area: the do's and don'ts!

A New Barcelona Process?

The EU's action plan for the region has to be re-visited. Nearly all the countries have now signed on to the EuroMed strategy. What can the EU do? I advocate a three-pronged strategy: (i) reform the process of aid and cooperation; (ii) Deepen the EU's involvement in conflict prevention and peace building; (iii) Develop a new strategy of investment promotion and financial integration of the Mediterranean partners. The EU has initiated reform of the aid process through the set-up of EuropeAid, which promises to increase aid effectiveness. I focus in this forum on the third aspect, with specific economic and financial policy proposals:

1. **The EU has to actively develop the region's infrastructure** (the Mediterranean road and maritime transport network is less developed today than it was in Roman times!) and **its info-structure**, the telecommunications and MIC networks, the modern day equivalent of Roman roads and networks.



2. *Set-up the proposed Euro-Mediterranean Investment Bank (EMIB) in Beirut to signal its commitment to Lebanon and the region. EMIB would work with the EIB and other international organizations to increase the financing of regional infrastructure projects: infrastructure and info-structure are major elements in fostering physical and communication links, reducing transactions costs, lowering transport and communication costs, bridging the digital divide and generating economic growth. This will reduce private sector costs and foster intra-Arab trade and investment, bringing the region into the digital age.*
3. **Regional projects should include the institutional development of regional organizations** responsible for the management of regional integration initiatives or programs, such as the Arab League, and increased support to countries adopting an aggressive regional integration trade agenda. Building-up the capacity of regional organisations should be considered a **regional public good** to the same extent as regional environmental issues.

4. Promote foreign direct investment in Lebanon and the Mediterranean region by setting-up a **EuroMed Investment Guarantee Agency (EMIGA)** to provide guarantees for European private sector investment projects in the Mediterranean countries.
5. **Promote the development of local capital markets in Lebanon** and the Mediterranean countries through technical assistance for the set-up of local stock exchanges and capital market authorities and the necessary legal infrastructure of laws and regulations. A starting point is to **link up the Beirut Stock Exchange with the major European Bourses.**
6. **Promote access by Lebanon and the other EuroMed countries to the expanding European Capital Markets** by facilitating the listing of shares and investment funds, and by providing a principal and/or interest guarantee program for sovereign bond issues. This would reduce perceived portfolio investment risk, and would help expand the European capital markets, expand the economic size of the Euro currency area, provide increased portfolio diversification for European and international investors and attract increased financial flows to Lebanon and the Mediterranean countries. Yet another win-win strategy for the partners!
7. **Provide preferential access to finance in the European Capital Markets** by allowing the tax deductibility of interest income arising on bonds issued by the Mediterranean countries, i.e. interest received on such bonds would not be subject to income tax. This form of indirect aid would be similar to the aid given by the US to so-called “Israel Development Bonds”. Such bonds are treated like local, US municipal bonds and interest income from the bonds is exempt from US income taxes, which allows Israel to issue the bonds at lower yields, an interest-cost- saving worth more than 2% per annum!
8. **Promote the use of the Euro by Lebanon and the Mediterranean countries by integrating them into the European payment system, including the expansion of TARGET to include the EuroMed partners.**

Working together to transform our Mare Nostrum into a Mare Pacifica

A new reinvigorated Barcelona Process is required post-September 11. Multi-lingual, multi-religious and multi-cultural Lebanon is uniquely placed to be the EU's true Barcelona partner. Lebanon should become the EU's portal to the Arab world and Western Asia, while the Arab world should use Lebanon's privileged position as a portal to the EU.

The EU should possess and develop, the political willpower to seize the historical, geo-strategic opportunity in the Mediterranean and the Middle East created by the end of the cold war and as a consequence of the terrible events of September 11 2001 and their aftermath. The EU has to build on its economic and financial power and its privileged historical and economic links with the countries of the Mediterranean. Together we need to have the courage and the will, in these difficult and testing times, to create a zone of peace, stability and prosperity. We have to start with some visible, confidence building measures. A good starting point is *EU assistance in the reconstruction of the liberated territories of South Lebanon and the Western Beqaa.* **Working together, our partnership can and should transform our *Mare Nostrum* into a *Mare Pacifica*.**