

Investment in Lebanon: Framework, Policy, Drivers, Challenges and Recommendations

**Presented to the Chamber of Commerce
and Industry of Beirut
March 29, 2004**

Definition of FDI...

Investment is defined as spending that results in an increase in assets.

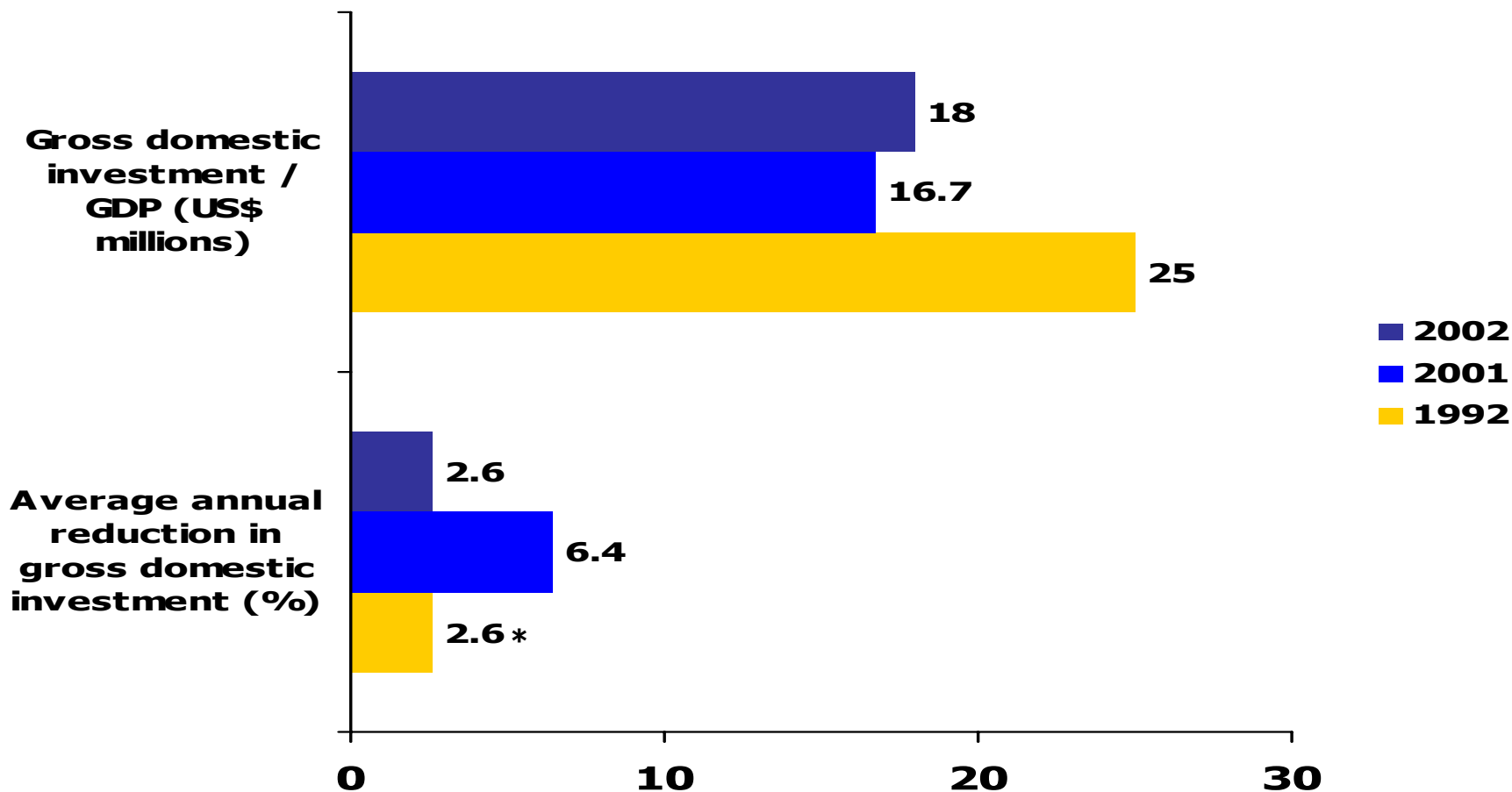
FDI is defined as a cross-border investment in which a resident in one economy (the direct investor) acquires a lasting interest in an enterprise in another economy (the direct investment enterprise).

The lasting interest implies a long-term relationship between the direct investor and the direct investment enterprise and usually gives the direct investor an effective voice, or the potential for an effective voice, in the management of the direct investment enterprise.

By convention, a direct investment is established when the direct investor has acquired 10 percent or more of the ordinary shares or voting power of an enterprise abroad.

I. Trends in DDI and FDI in Lebanon

Despite the lack of reliable national data, domestic investment has been falling over the past ten years

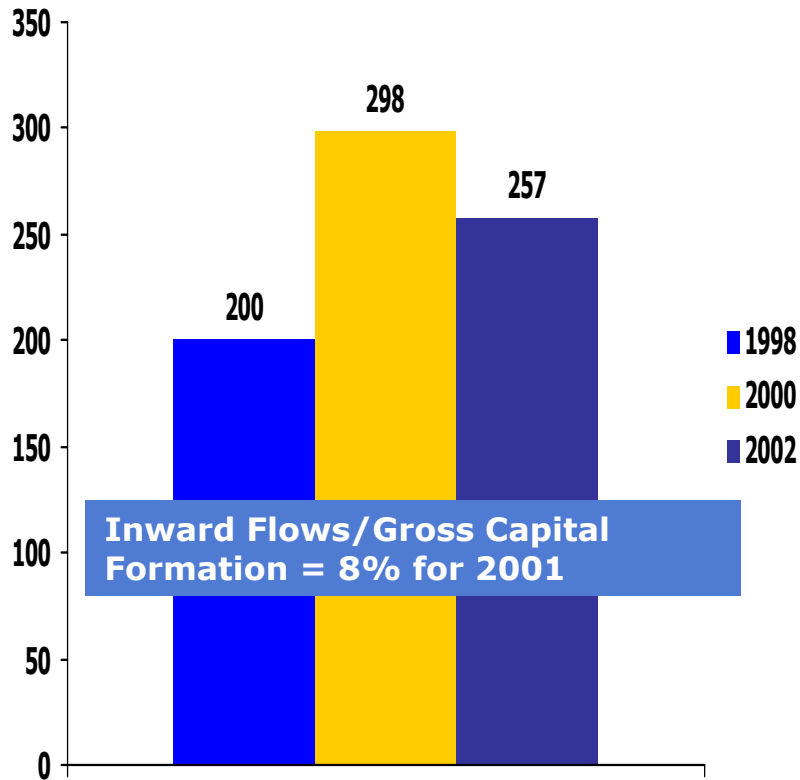


* 1992-2002

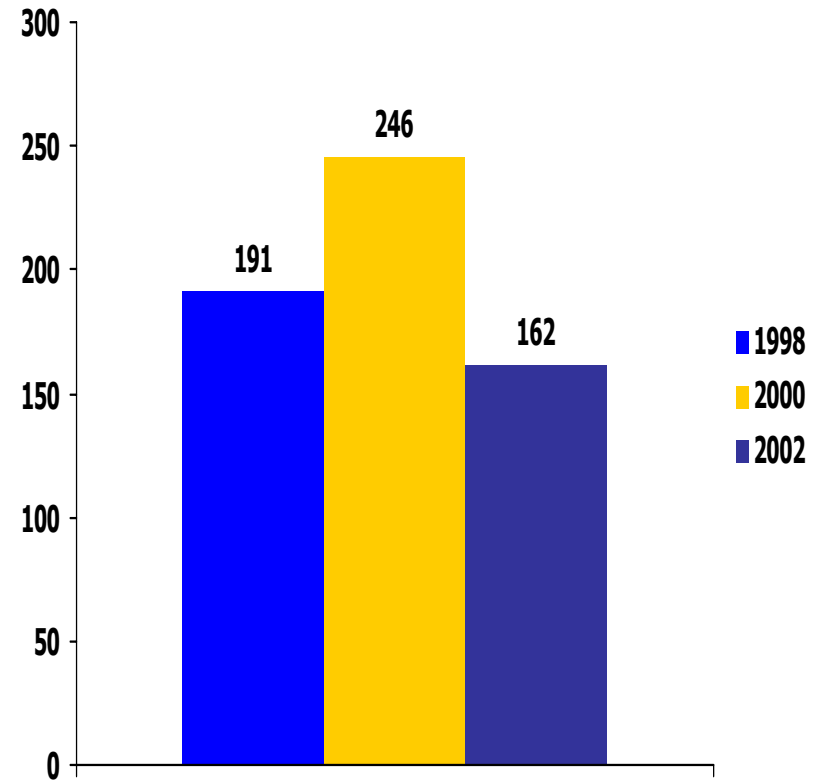
Source: The World Bank

In addition, FDI inflows have been relatively dismal

Lebanon Inward FDI Flows (US\$ millions)



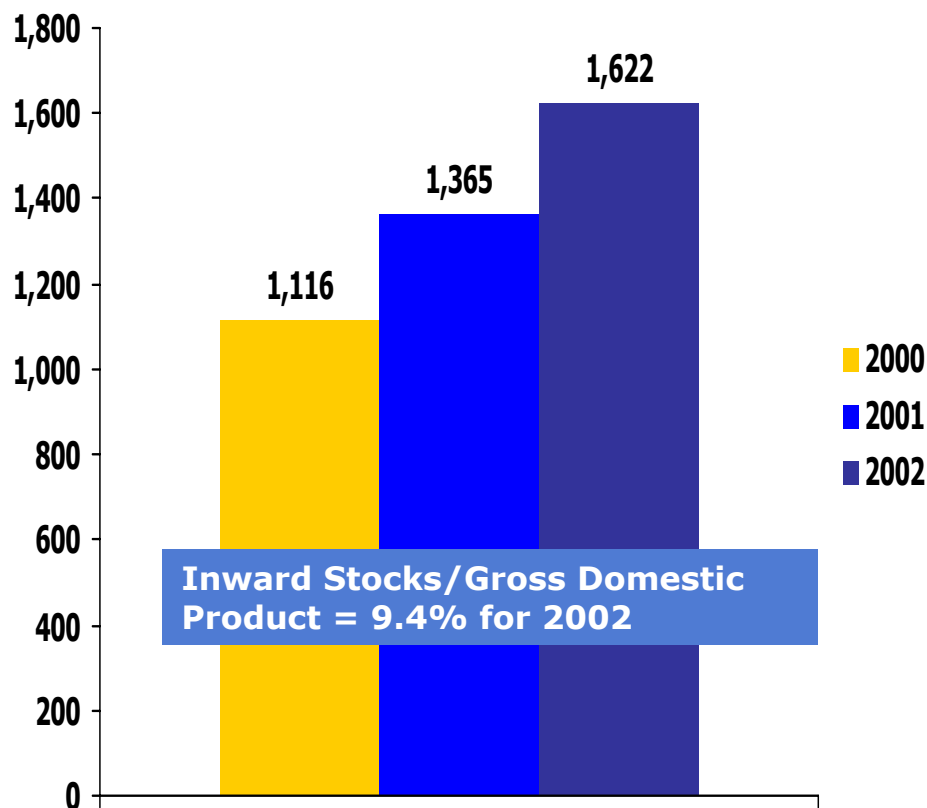
Developing Country Inward FDI Flows (US\$ billions)



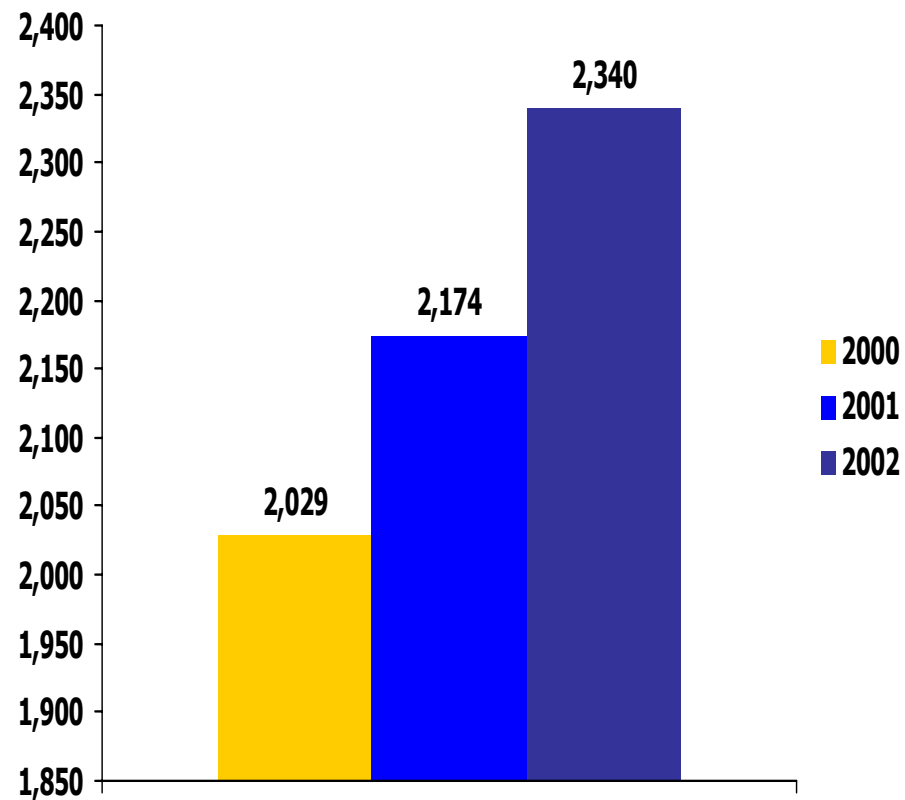
Source: United Nations Conference on Trade and Development (UNCTAD)

Low FDI inflows have lead to small inward FDI stocks over the last few years

Lebanon Inward FDI Stocks (US\$ millions)

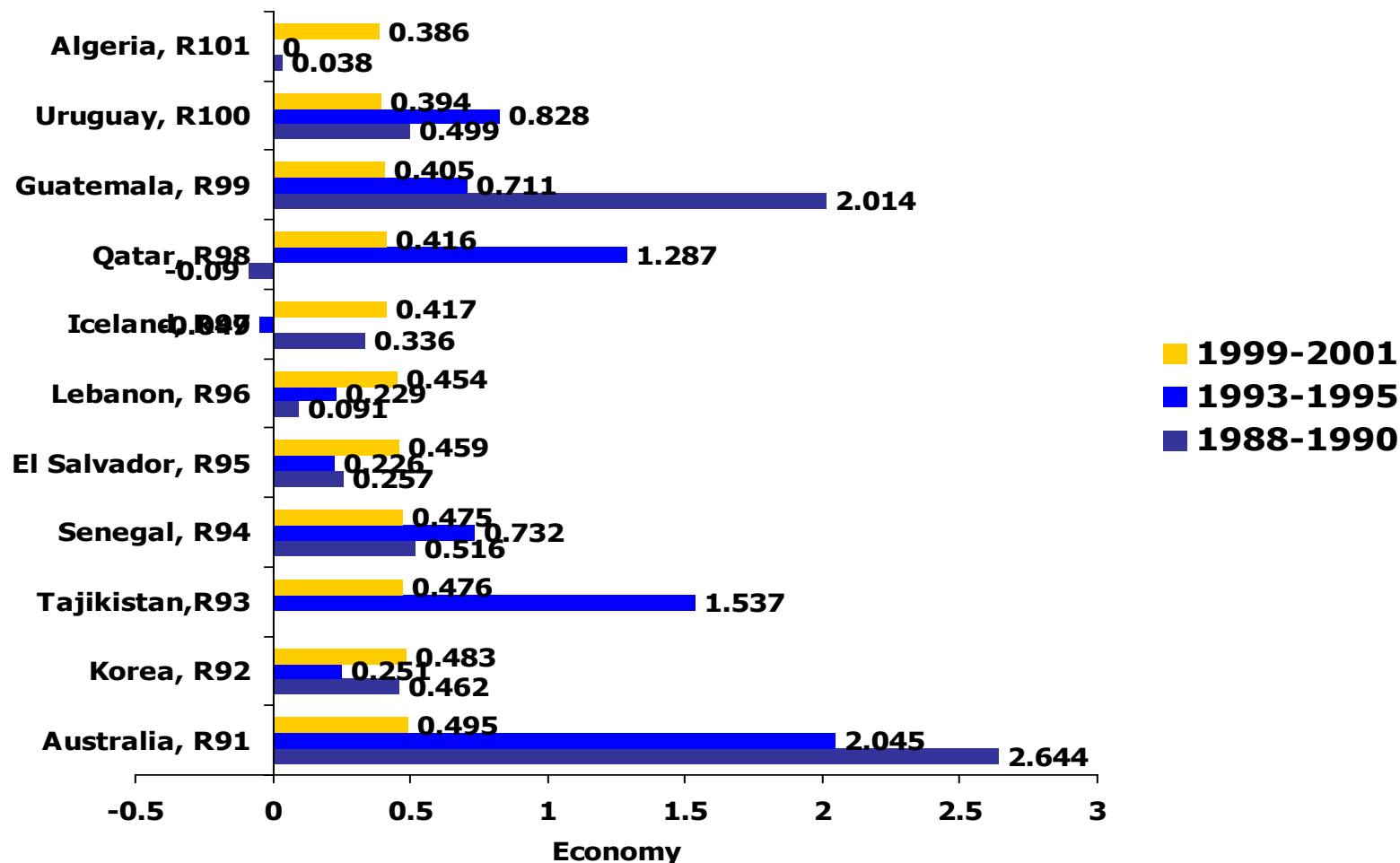


Developing Country Inward FDI Stocks (US\$ billions)



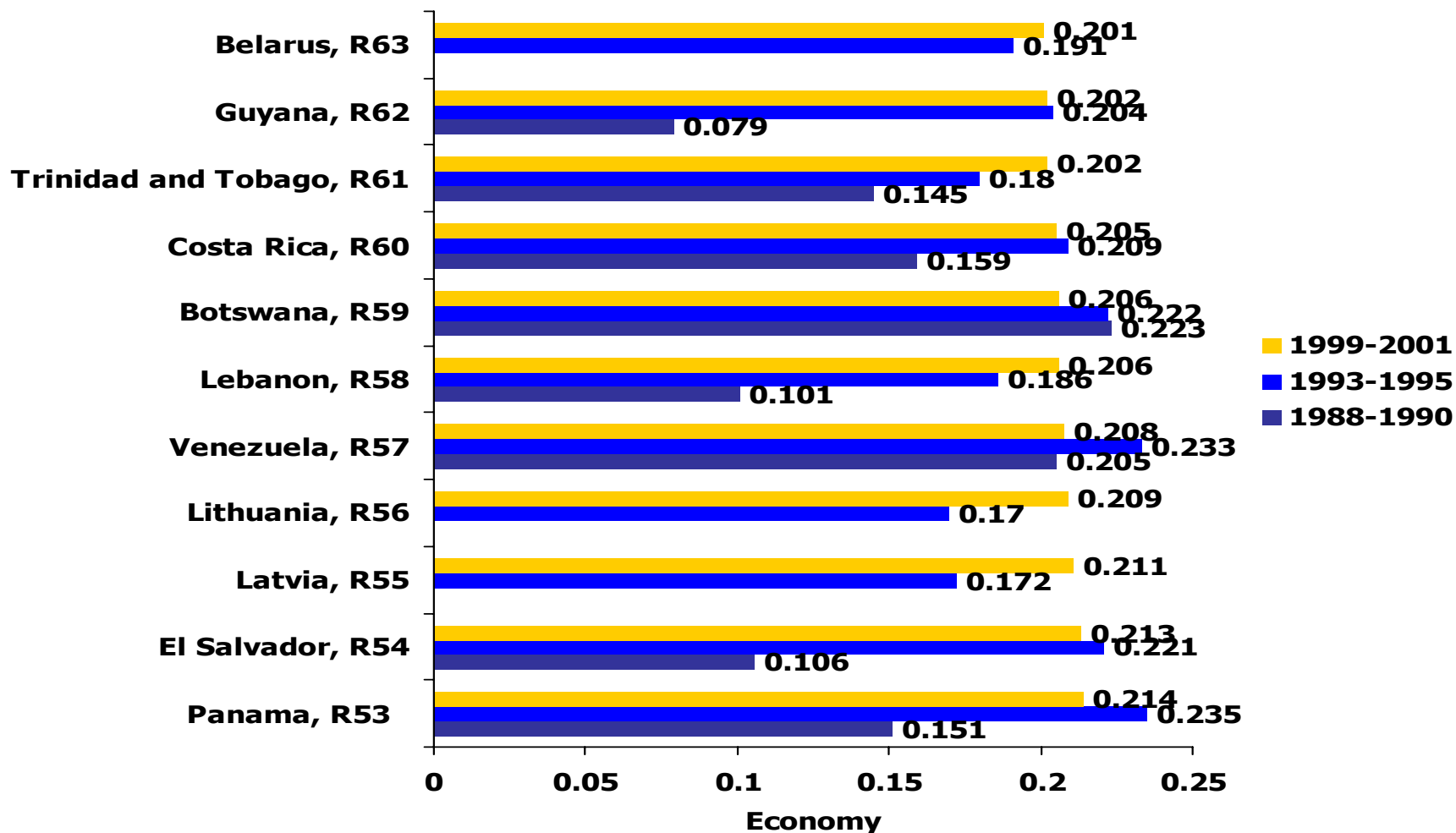
Source: United Nations Conference on Trade and Development (UNCTAD)

The UNCTAD Inward FDI Performance Index places Lebanon in the 96th



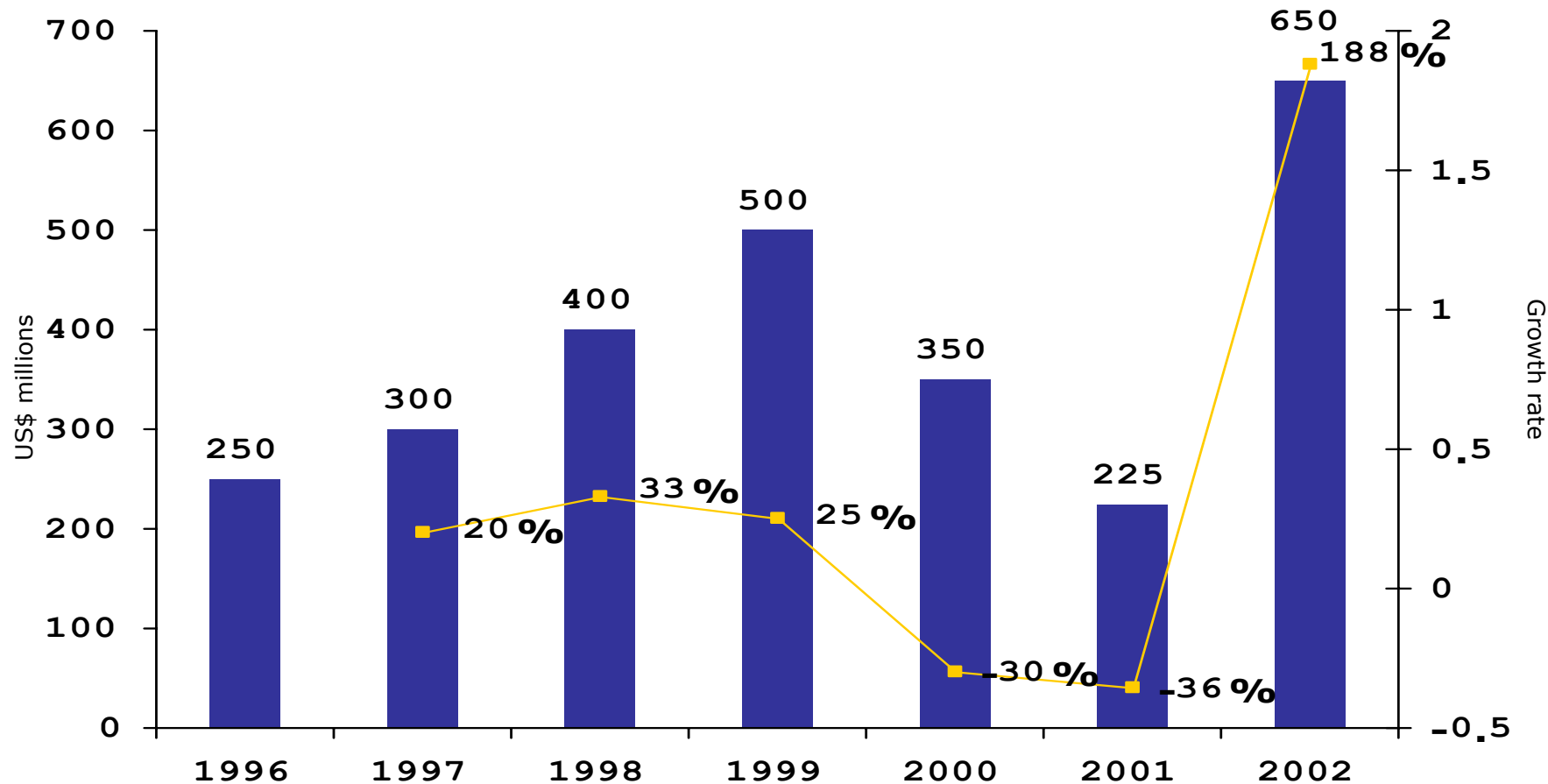
Source: United Nations Conference on Trade and Development (UNCTAD)

...Whereas UNCTAD's Inward FDI Potential Index places it at 58, showing great unrealized potential



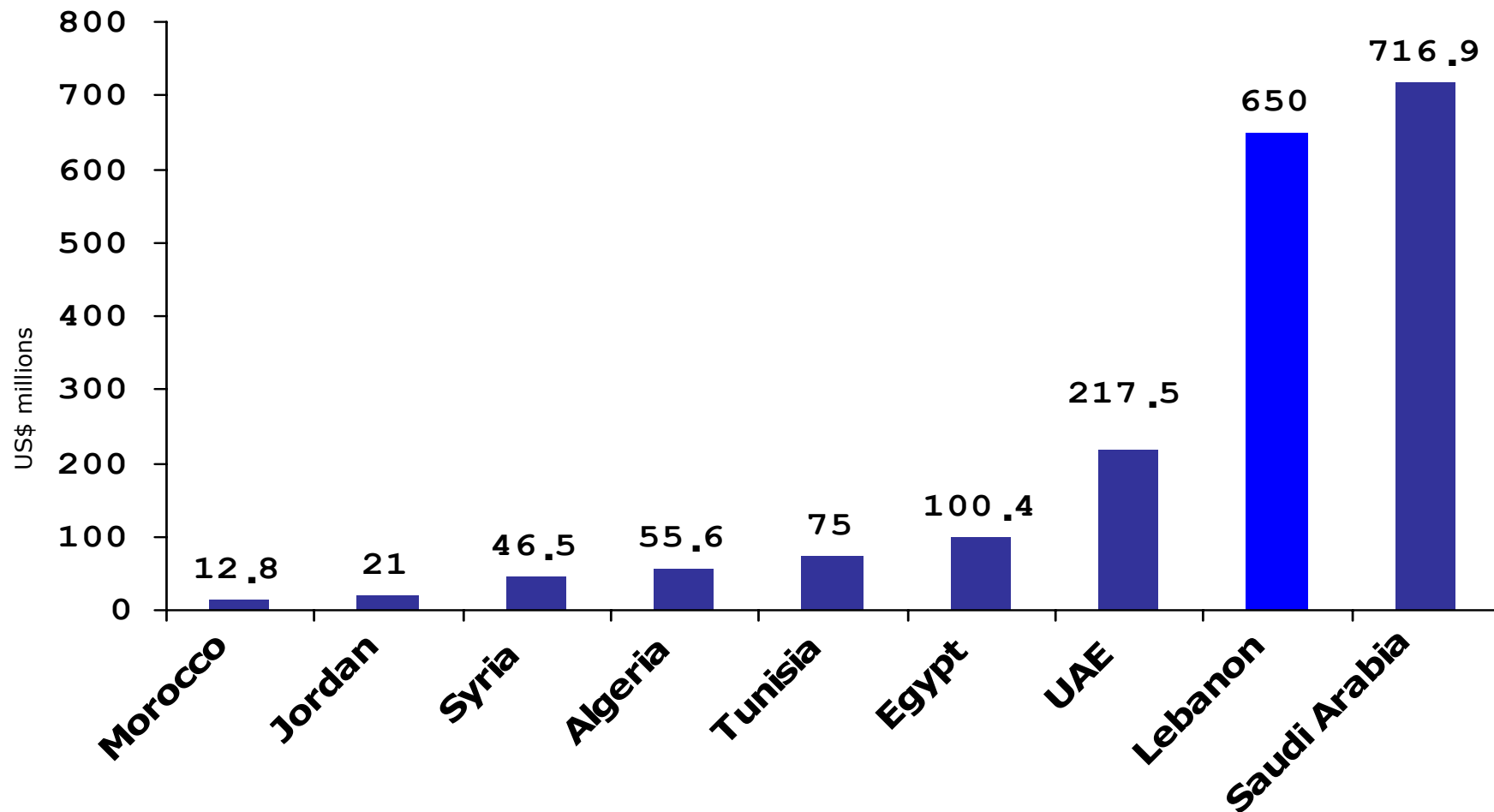
Source: United Nations Conference on Trade and Development (UNCTAD)

On the other hand, accounting for investments in real estate, Arab FDI flows into Lebanon have risen



Source: Inter-Arab Investment Guarantee Corporation

...and are relatively high compared to those inflows to other Arab countries for 2002



Source: Inter-Arab Investment Guarantee Corporation

II. Investment Development Authority of Lebanon (IDAL)

IDAL was established in 1997 as an autonomous body that reports directly to the Prime Minister

Structure

Four directorates: Financial and Administrative, One-Stop-Shop, Information and Marketing, Studies and Statistics

Staffing

24 IDAL employees and 8 UNDP employed

IDAL's One-Stop-Shop is still a long way from being realized

Investment Law 360: "for projects governed by this law, the authority should exclusively supercede all administration authorities and municipalities in issuing administrative fees and licenses, except for those granted by the Cabinet, provided the applicable laws related to zoning and environmental protection are observed"

However



- IDAL does not have the resources for such a service (infrastructure, personnel)**
- Ministries and public administrations not cooperating with IDAL**
- IDAL becomes additional administration to deal with**

IDAL's accomplishments have been affected by the limited resources at its disposal

Package Deal Contracts

- 2 signed in the tourism sector (Metropolitan City Center, Hilton Beirut), total value of US\$ 130 million
- 4 projects in the pipeline (3 tourism: Four Seasons Hotel, Summerland Hotel, Haret El Set Leisure Park, 1 agro-food: Corn Flakes Factory), total value of US\$ 205 million

Investor Matching

- 17 projects listed on IDAL's website
- 0 matchings so far

Regional Cooperation

- Three-year protocol signed between IDAL and the Jordan Investment Board, on exchanging investment legislation, promotional tools and investment opportunities
- Similar agreements underway with Syria, Tunisia and Egypt

Source: IDAL

III. Investment Incentives and Guarantees

The National Investment Guarantee Corporation (NIGC) was established to guarantee against political risks

Risks covered

War, civil disturbance, expropriation, profit repatriation, liquidation, transfers, currency convertibility

Nature and staffing

Non-profit, public entity established in 1977 with financial and administrative autonomy

10 permanent staff (same since establishment)

Council of Ministers appoints Board of Directors (6 members including Chairman, currently only 3)

Relation with other agencies

NIGC does not offer joint coverage with other guarantee agencies

The only link between NIGC and IDAL is the NIGC representative on IDAL's One-Stop-Shop committee

Premiums range from 1-5 per thousand

NIGC functions as an outdated government office, with guarantee applications available in Arabic only

Kafalat is a loan guarantee company established by the Lebanese State to support SME activity

Sectors covered

Industry, agriculture, tourism, handicraft and new technologies

Nature and staffing

Lebanese Joint Stock Company (75% owned by National Institute for the Guarantee of Deposits, 25% by Lebanese banks)

Board of Members constituted of 6 members (including Chairman)

Activity

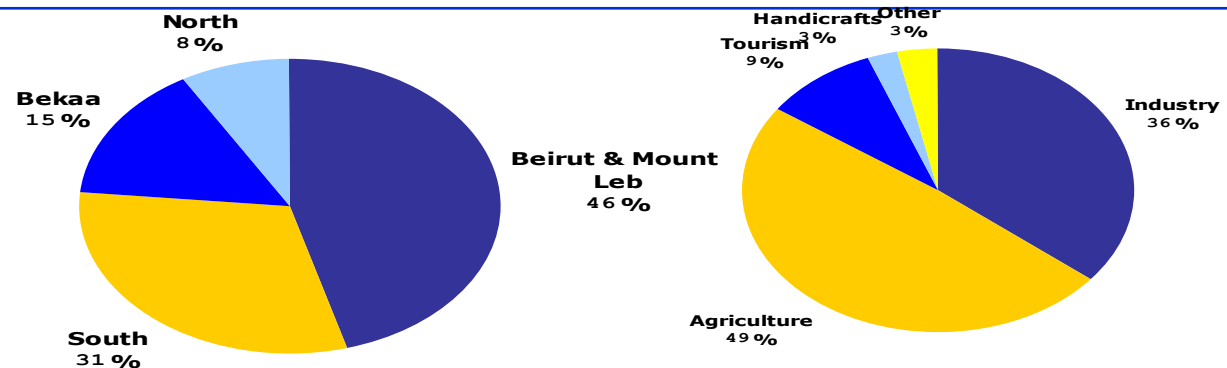
Kafalat grants up to 75% of the loan value with a ceiling of LL 300 million, in addition to interest subsidy

Kafalat lends through commercial banks

Loans repaid over 7 years

So far, Total number of guarantees is 2,768, of a total value of around L.L. 300 billion

Record so far



Other international loan guarantee agencies are either not active or consider the country highly risky

COFACE
(credit,
guarantee,
financial and
political)

Speculative Grade

SACE
(production, credit,
guarantee enforcement,
non-restitution of
bonds/deposits,
destruction/confiscation)

No Cover

MIGA
(political risks)

France's COFACE rates Lebanon C (speculative grade), due to "a very unsteady political and economic environment that could deteriorate an already bad payment record"

Italy's SACE ranks Lebanon 7 (riskiest category), and provides no insurance cover in it (class D)

The World Bank's Multilateral Investment Guarantee Agency, in which Lebanon is member, has not guaranteed any investments in Lebanon to date

CONNEXUS

CONSULTING

Over the last 6 years, the Central Bank has provided 5-7% interest subsidies on medium term loans to domestic investors in the tourism, industry, ICT, agriculture and handicraft sectors

Interest Subsidy

2,800 loan applications to banks for subsidy, and 2,697 beneficiaries

Total value of subsidized loans: US\$ 1.1 billion (Total value of interest subsidies: US\$ 100 million)

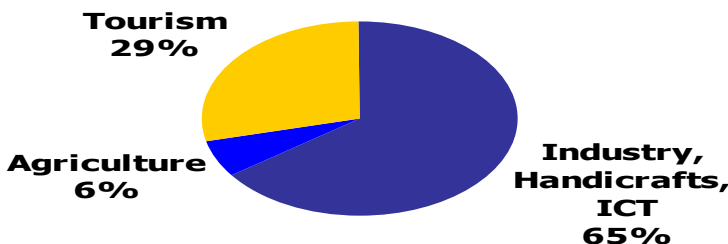
Impact

Lowering the Capital Reserve Requirement

For banks that give out loans through this scheme, legal reserve requirement (15-25% of capital) becomes due on the capital minus loans

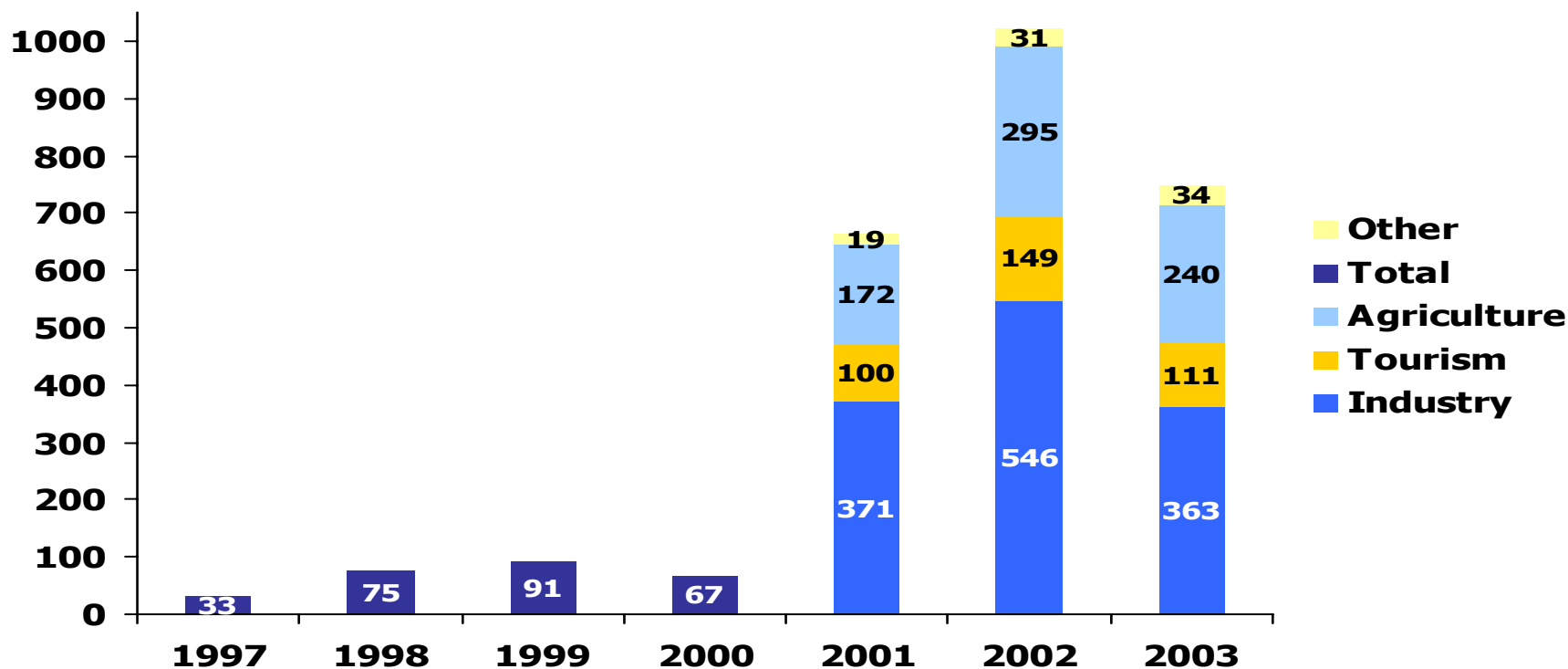
Lowering cost of borrowing for investors

Total Value of Subsidized Loans So Far by Sector



Over the last 6 years, the number of beneficiaries has increased

Number of Beneficiaries from Central Bank Interest Subsidies per Sector (1997-2003)

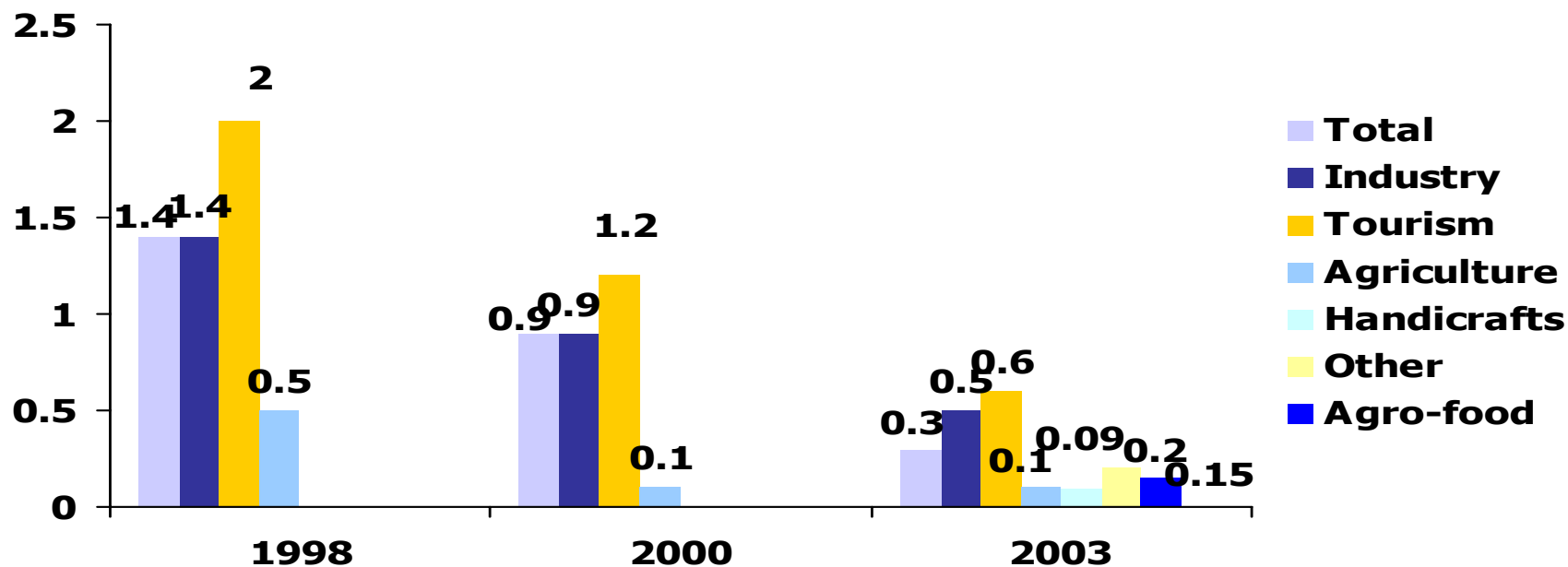


Data includes Kafalat and EIB credits

Source: Central Bank

...Whereas the average value per loan has decreased

Average Value per Loan Benefiting from Central Bank Subsidy per Sector (1998-2003)



Data includes Kafalat and EIB credits

Source: Central Bank

IV. Investment Climate

IV. Investment Climate:

- A. Legal and Regulatory Framework**
- B. Fiscal situation**
- C. Macroeconomic Environment**
- D. Business Climate**

IV. Investment Climate:

A. Legal and Regulatory Framework

Property ownership in Lebanon is not restrictive for foreigners

Restrictions on foreign acquisition of property eased in 2001:

- **Foreigners can acquire up to 3% of total area of Lebanon regardless of geographical location**
- **Foreigners can acquire up to 10% of the total Beirut area (3% for other cazas)**
- **Foreigners can acquire up to 3,000 m² of land without decree by Council of Ministers**

Real estate registration fees for Lebanese and foreign investors lowered in 2001:

- **Registration fees reduced by 1% for Lebanese investors and 11% for foreign investors to become 5% for both**

The Commercial Code poses some restrictions for foreign investors interested in joint stock and holding companies

Joint Stock Companies

- **Majority of board members must be Lebanese citizens**
- **Each board member hold limited number of shares**
- **Chairman can be foreign resident, but should obtain work permit**
- **Free transferability of shares, with limitations**
- **No explicit limits on amount of capital held by foreigners (except in real estate, insurance, media and banks)**
- **Serious deficiencies in corporate governance**

Holding Companies

- **At least two Lebanese citizens must sit on the board of directors**
- **Chairman can be foreign resident, does not need work permit**

Investors are subject to a Personal Income Tax, a 10% VAT, and a Corporate Tax

Joint stock and LLCs

- **15% tax on corporate profit**
- **7.5% tax on real estate profit**
- **10% tax on income derived from movable capital assets generated in Lebanon (distributed dividends, additional shares, directors' fees)**

Holding companies

- **No tax on profits and profit distribution**
- **10% tax on interest on loans of maturity < 3 years**
- **10% tax on capital gains from share sales or ownership in Lebanese companies (for < 2 years)**
- **10% on renting patents and reserve rights**

Offshore companies

- **No tax on profits, profit distribution and 30% of foreign employees' basic salary, no stamp duties on overseas business contracts signed in Lebanon**
- **US\$ 660 fixed annual tax**
- **10% tax on profits from sale of fixed assets in Lebanon**
- **2-20% tax on salaries of Lebanon-based employees**

On the other hand, indirect taxes are burdensome

3 per thousand stamp duty on each contract may amount to 1.5% of total project value:

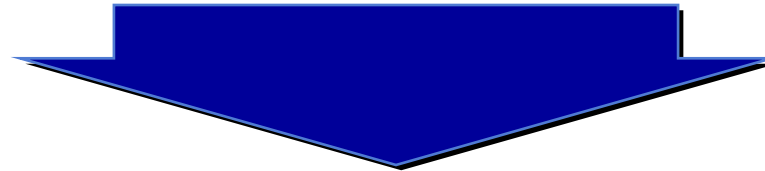
Assume a project of a value of US\$ 100,000,000

The duty on the contract for approving the project would be US\$ 300,000

If US\$ 80,000,000 of project value were subcontracted, another duty would be US\$ 240,000

If another US\$ 70,000,000 were subcontracted, add US\$ 210,000 of duties

Till this point, a total of US\$ 750,000 has been paid in indirect taxes (0.75%)



Unjustifiably high transaction costs

The Lebanese Government offers a variety of tax incentives and holidays

Regional

- Investment Law 360 divides Lebanon into three geographical zones: A, B and C, each subject to a different set of exemptions
- Zone A companies granted work permits by IDAL subject to conditions, and Zone A joint stock companies exempt from income tax for 2 years subject to conditions
- Zone B companies enjoy Zone A exemptions, plus a 50% reduction on income taxes and taxes on dividends for 10 years subject to conditions
- Zone C companies enjoy Zone A exemptions, plus full exemption of income taxes and taxes on dividends for 10 years subject to conditions

Sectoral

- Farms (subject to conditions), shipping and transport companies exempted from income tax
- Real estate development companies granted income tax exemptions up to 50% subject to conditions
- Machinery, equipment, spare parts and building material imported to set up new industrial firms subject only to 2% customs duty
- Imported hotel equipment exempt from certain duties (subject to conditions)
- Imported buses for tourism agencies exempt from customs

Other

- Offshore companies exempt from income tax
- Dividends distributed by offshore companies exempt from capital gains tax
- Companies established in free trade zones exempt from customs duties
- Companies established in free trade zones not subject to corporate taxes for 10 years
- Foreign employees employed in companies established in free trade zones exempt from personal income tax
- Companies using operating profits to finance capital investment allowed income tax exemption up to 50% (subject to conditions)
- Holding companies exempt from income tax and capital gains tax
- SOLIDERE exempt from tax on profits for 10 years
- SOLIDERE dividends and capital gains exempt from tax for 10 years

The effectiveness of tax exemptions in attracting investment is still questioned in the literature

Overall, the legal and regulatory framework for doing business poses a few challenges

How much of a burden do the following regulations impose?

Business licensing	
Customs/Foreign trade regulations	
Labor regulations	
Foreign currency/exchange regulations	
Environmental regulations	
Safety and fire regulations	
Tax regulations	
Foreign labor regulations	
Availability of information on laws and regulations affecting business*	
Real estate regulations	

● most favorable → ○ least favorable

* IDAL Investment Support and Information Center – In Progress

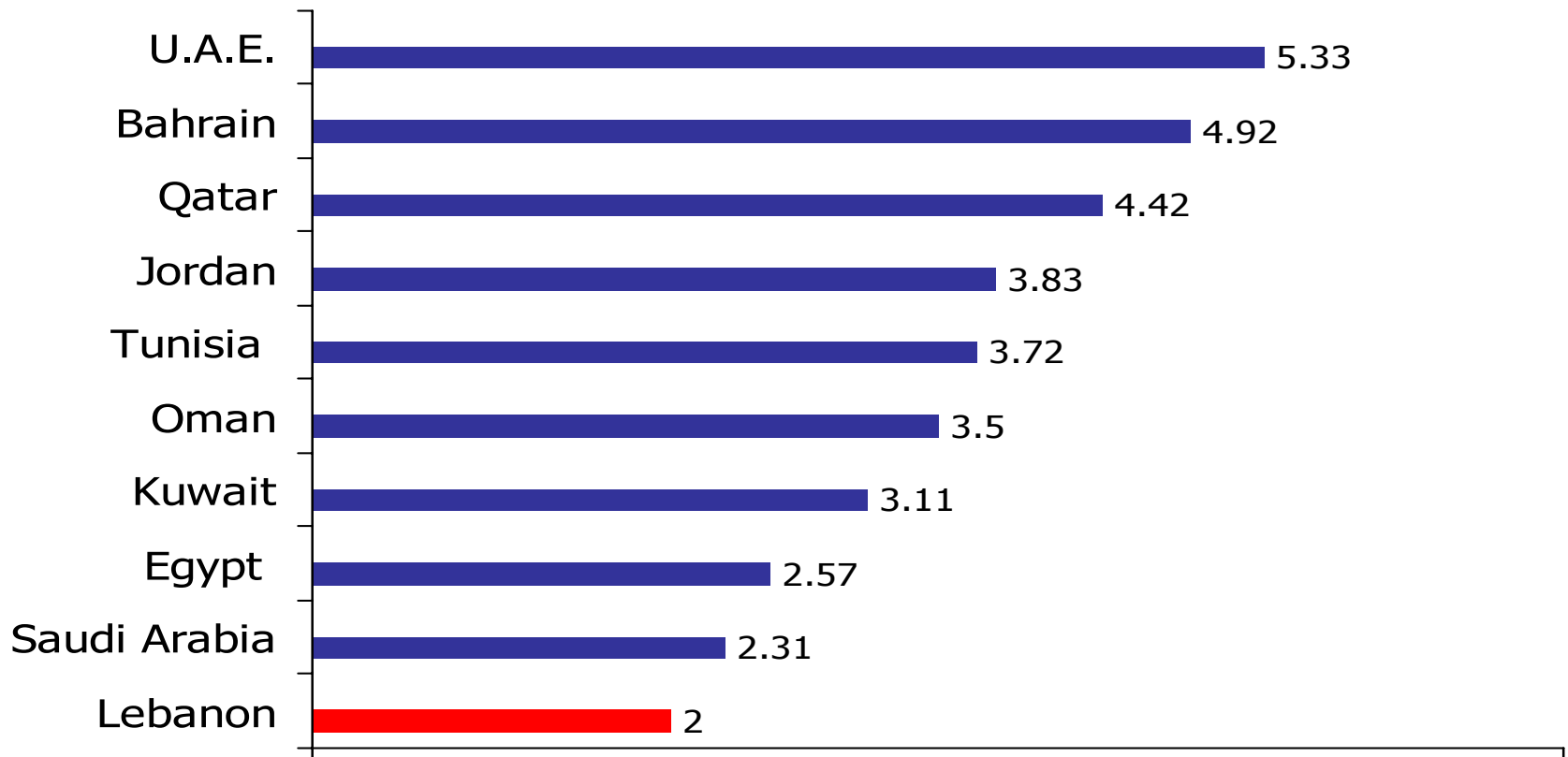
Source: Connexus analysis, using World Bank criteria

CONNEXUS

CONSULTING

Administrative regulations have been judged as burdensome, most burdensome from a selection of Arab countries

*Administration regulations in your country are:
Scale 1= burdensome, 7= not burdensome*

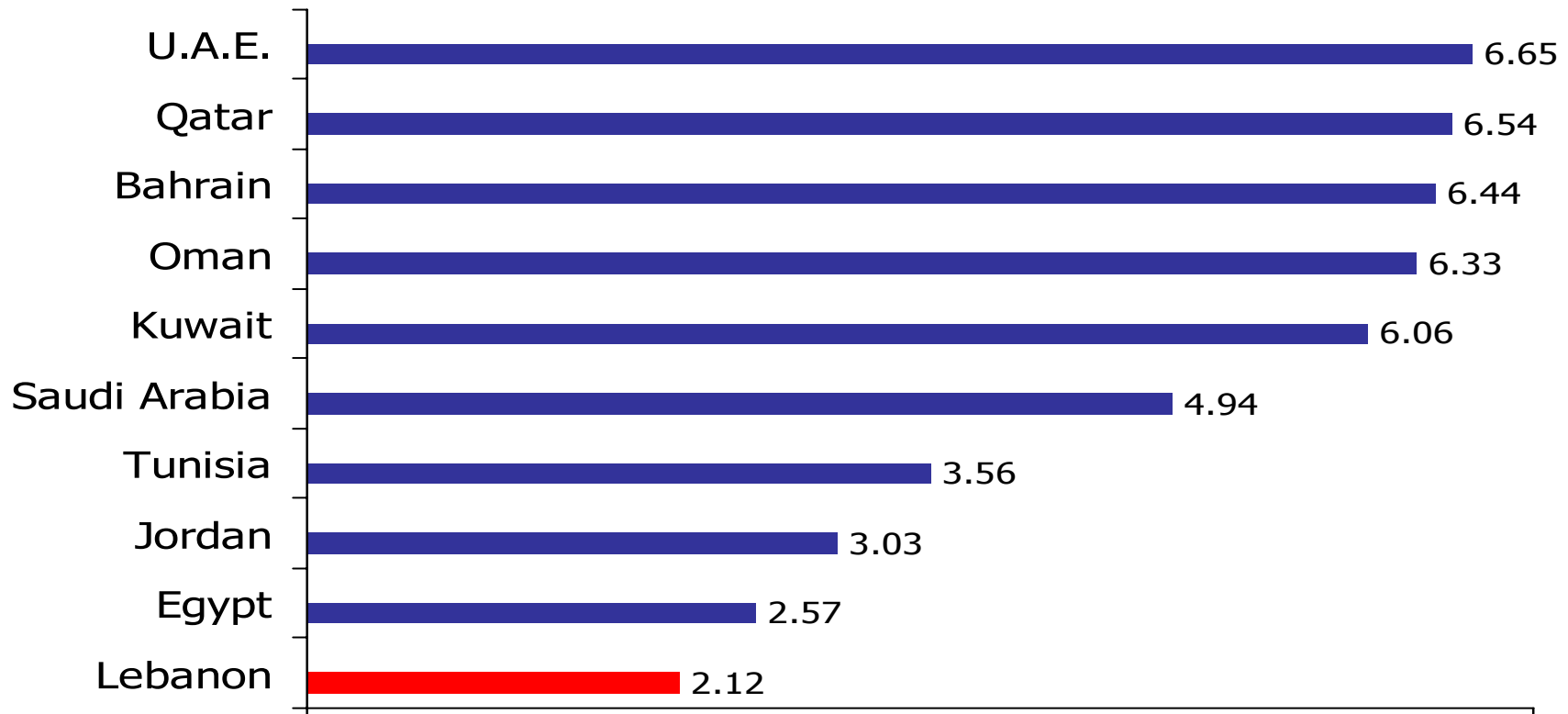


Source: Arab World Competitiveness Report

Enforcement has been judged as weak, as tax evasion has been perceived by businessmen as common in Lebanon

Tax evasion is:

Scale 1= common in your country, 7 = minimal in your country



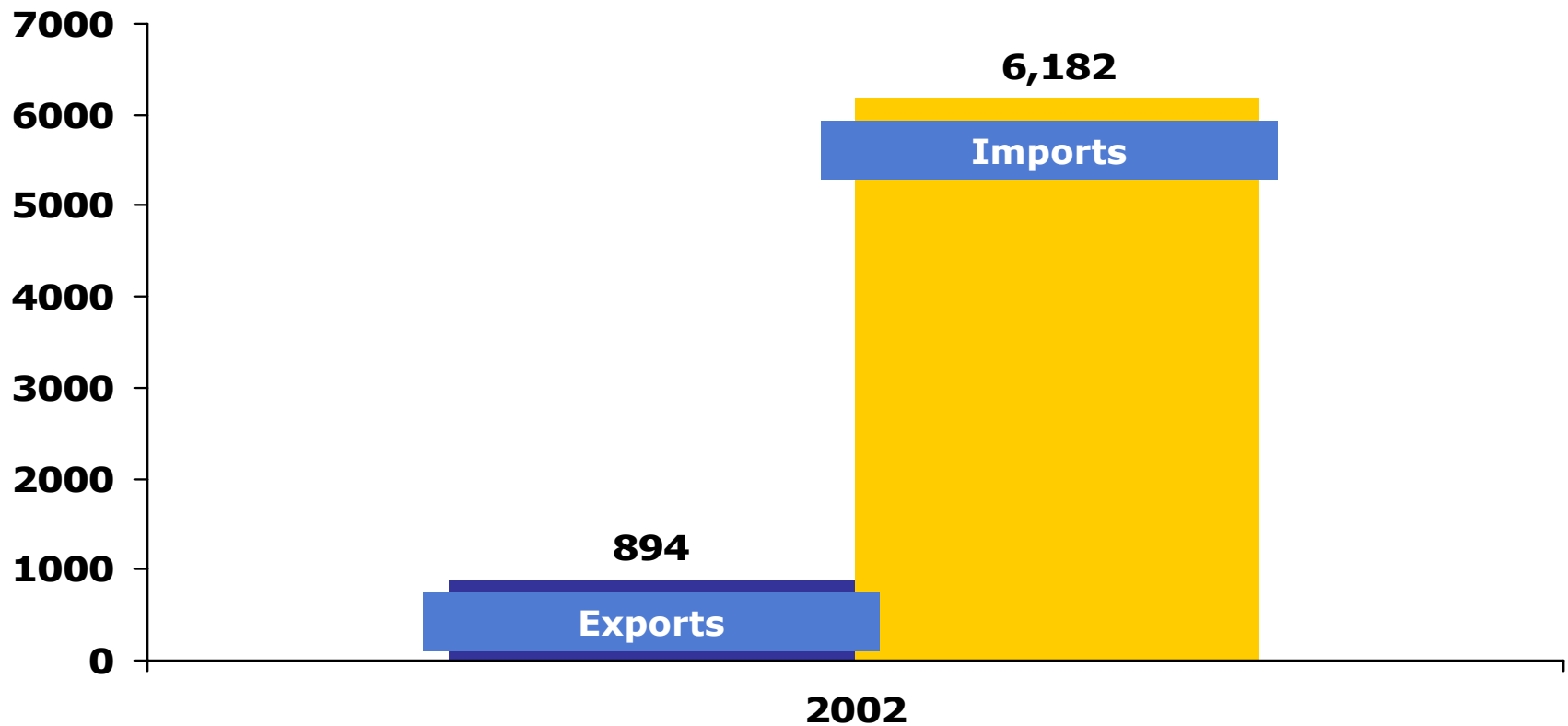
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Source: Arab World Competitiveness Report

IV. Investment Climate:

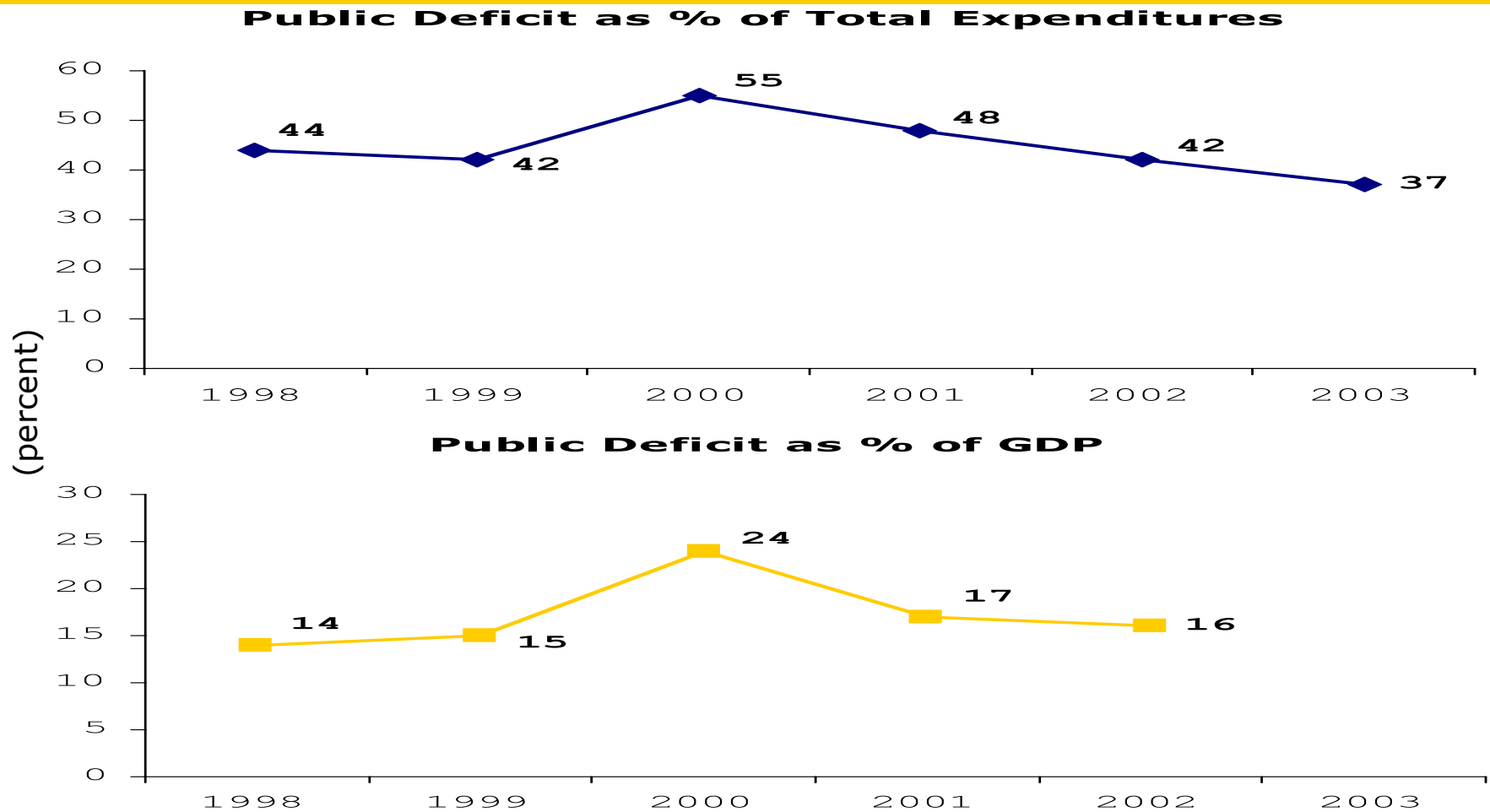
B. Fiscal situation

Lebanon suffers from a huge current account deficit caused by the trade deficit

Total Exports and Imports for 2002 (US\$ millions)



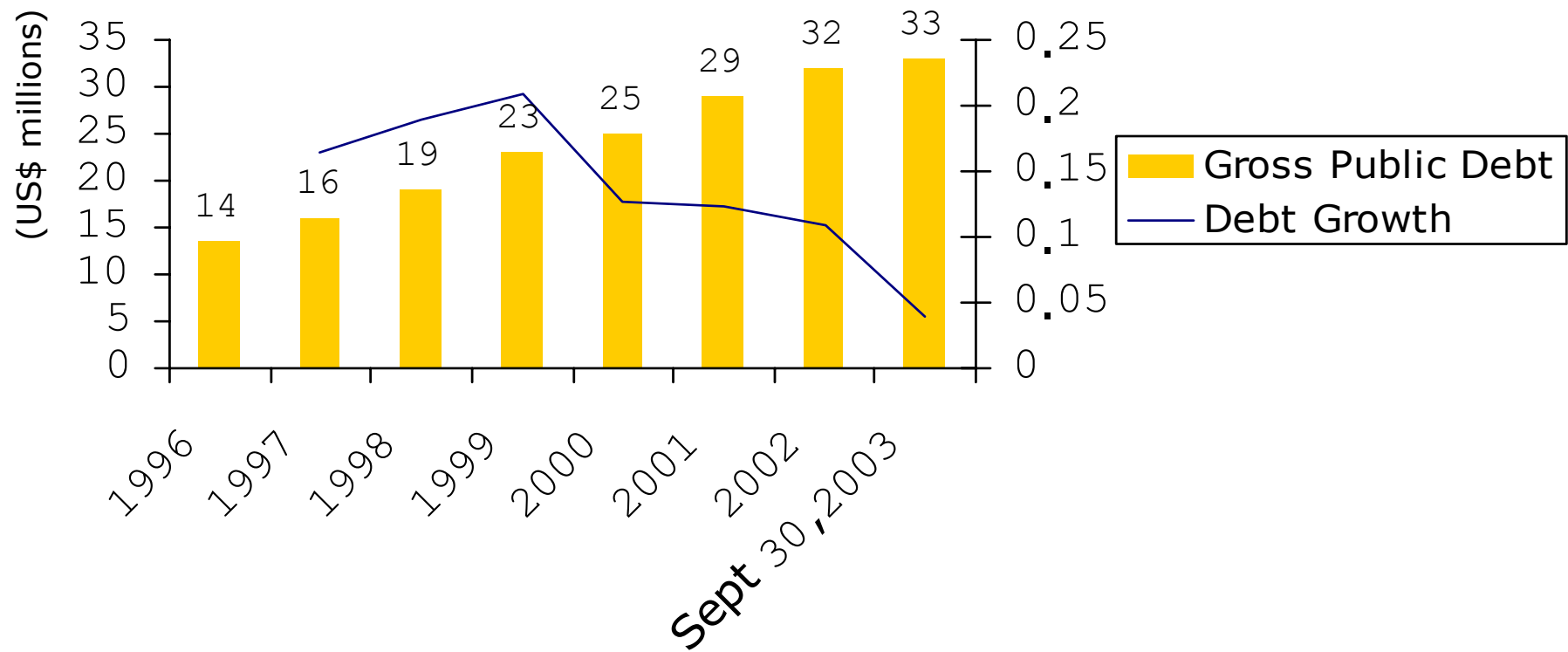
Lebanon's fiscal mismanagement in the post-war era has resulted in unusually high structural deficits



Source: Ministry of Finance, Audi Bank, IMF

Fiscal mismanagement has resulted in an increasing public debt, even if in recent years it grew at a slower rate

**Gross Public Debt and Debt Growth
(1996 -2003)**



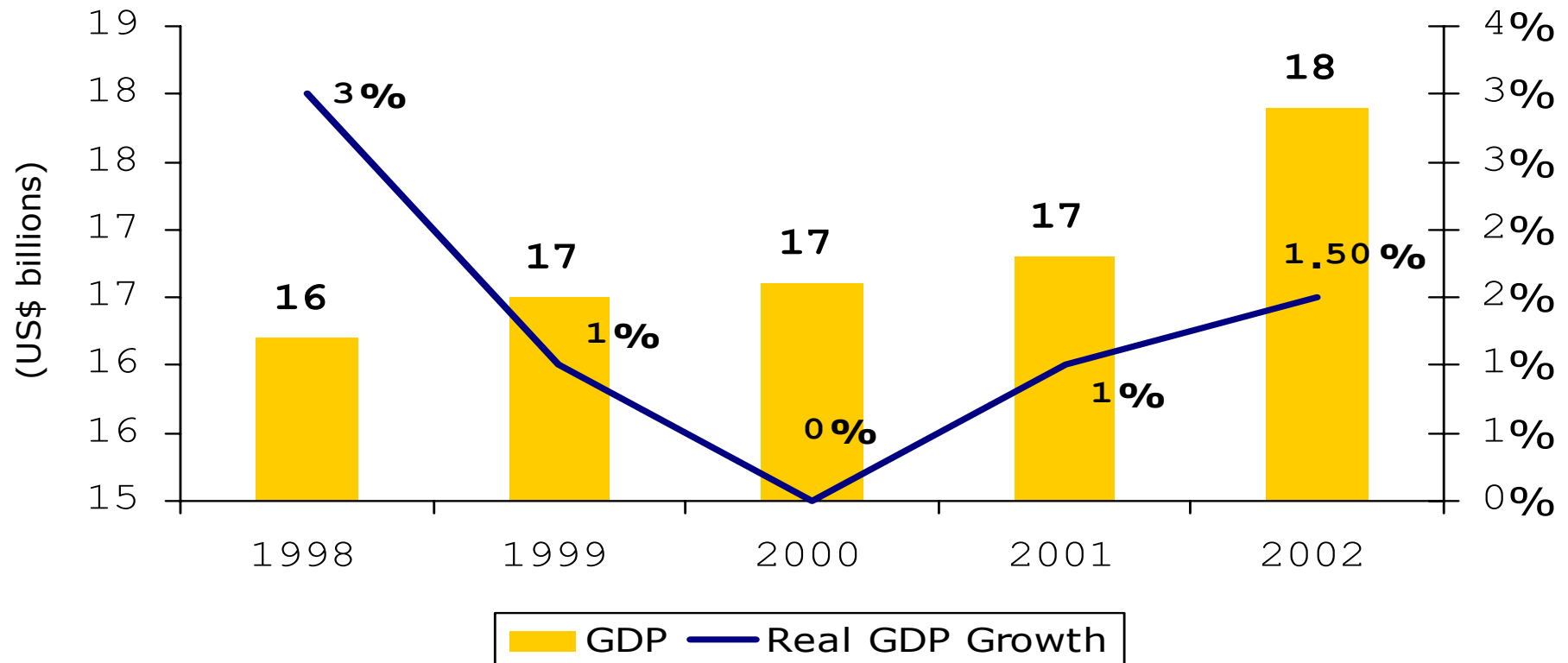
Source: Ministry of Finance

IV. Investment Climate:

C. Macroeconomic Environment

Fiscal mismanagement, the crowding out of the private sector and domestic and regional instability have contributed to a dismal macro-economic performance

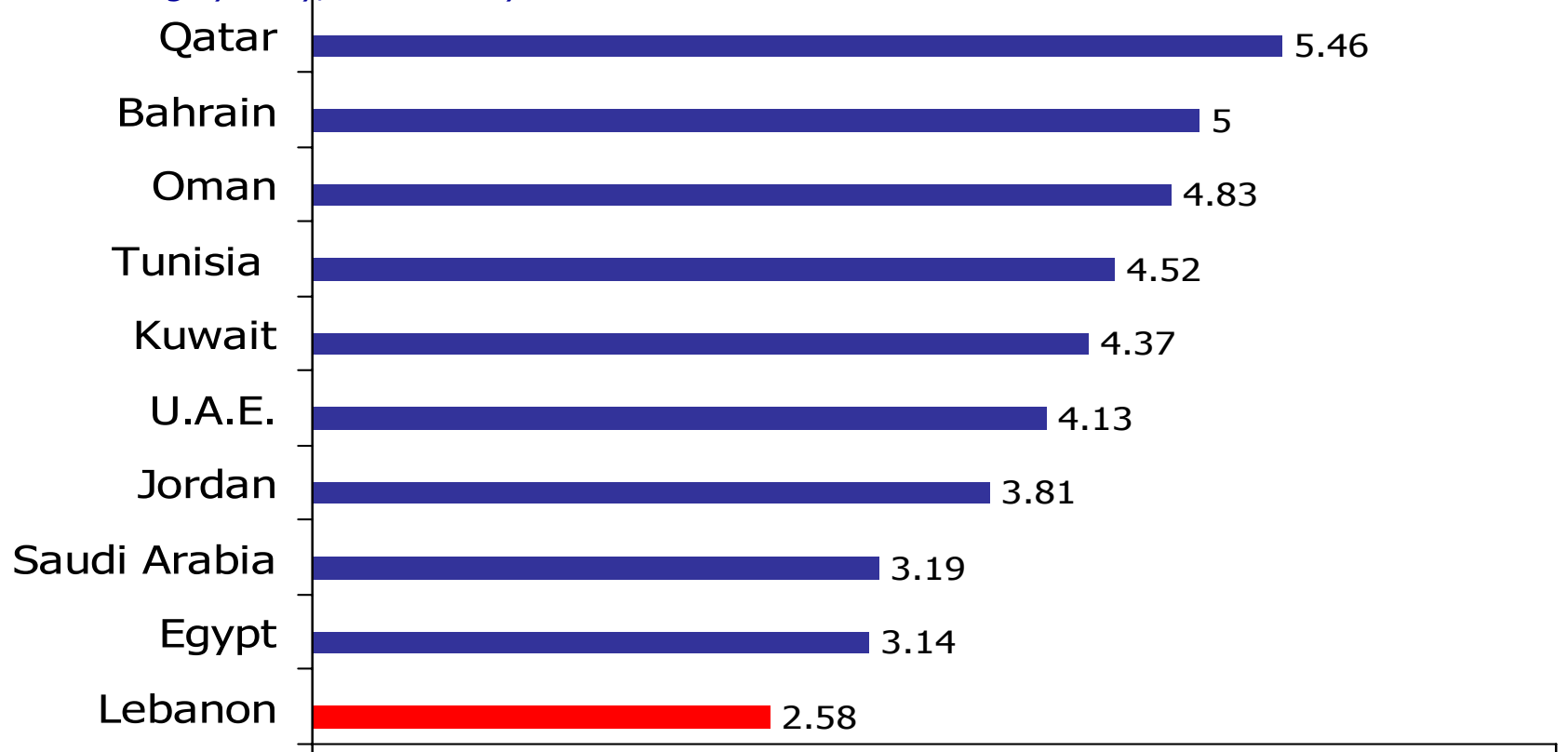
Nominal GDP and Real GDP Growth (1998 -2002)



Source: IMF, Audi Bank

Lebanese businessmen have thus perceived a likelihood of Lebanon falling into recession

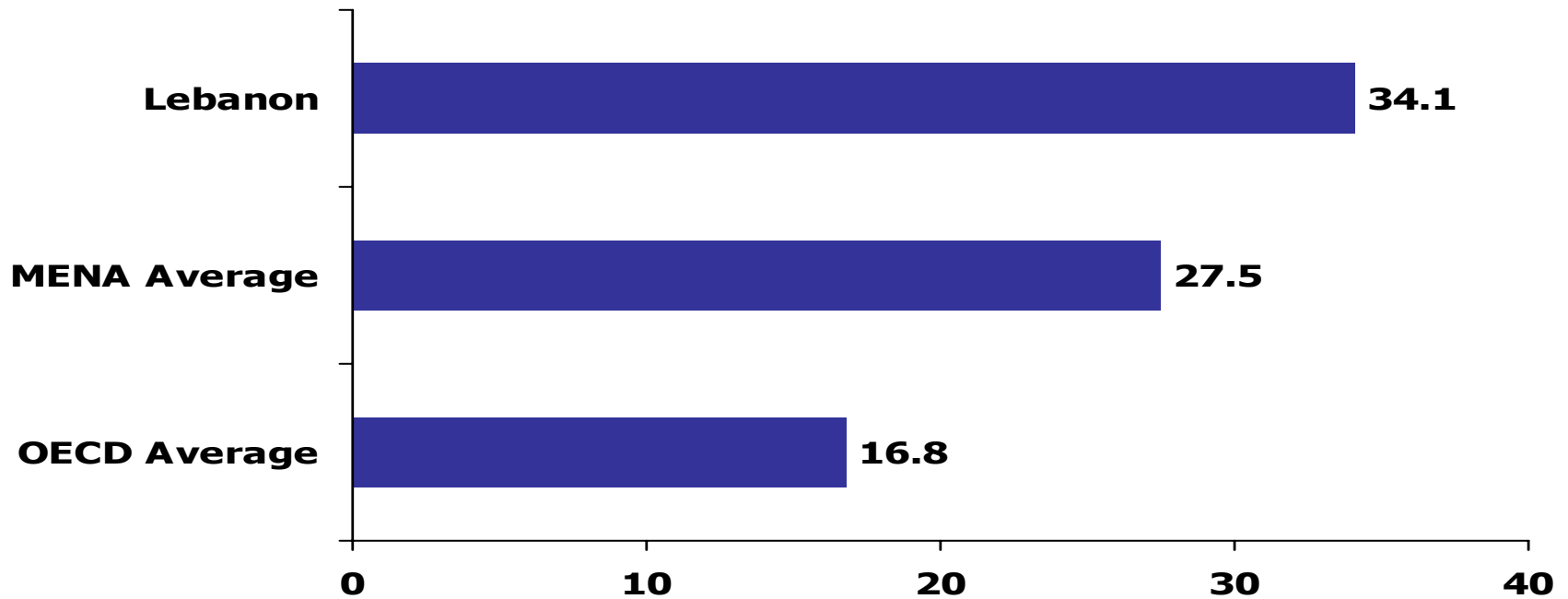
*The likelihood of your country's economy being in a recession next year is:
Scale 1=highly likely, 7=not likely*



Source: Arab World Competitiveness Report

The share of the informal economy in gross national income is high

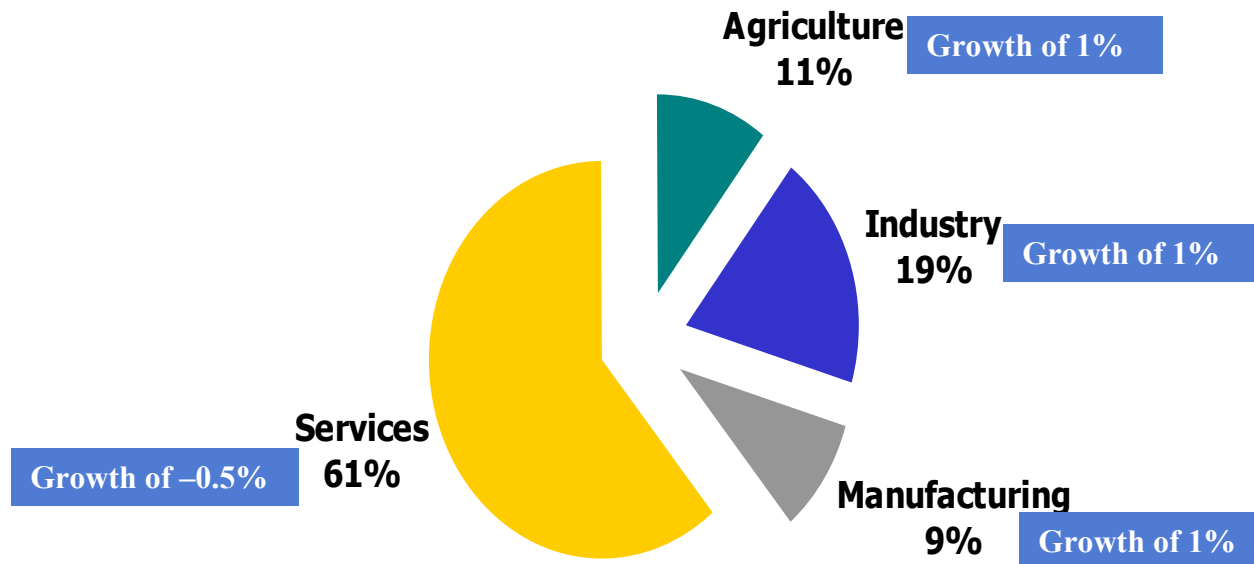
Share of Informal Economy in Gross National Income for 2002 (%)



Source: World Bank

The share of agriculture and manufacturing in GDP remain low

Composition of Lebanese Gross Domestic Product in 2002




Source: World Bank

IV. Investment Climate:

D. Business Climate

The prevailing political environment in Lebanon is not favorable for investment

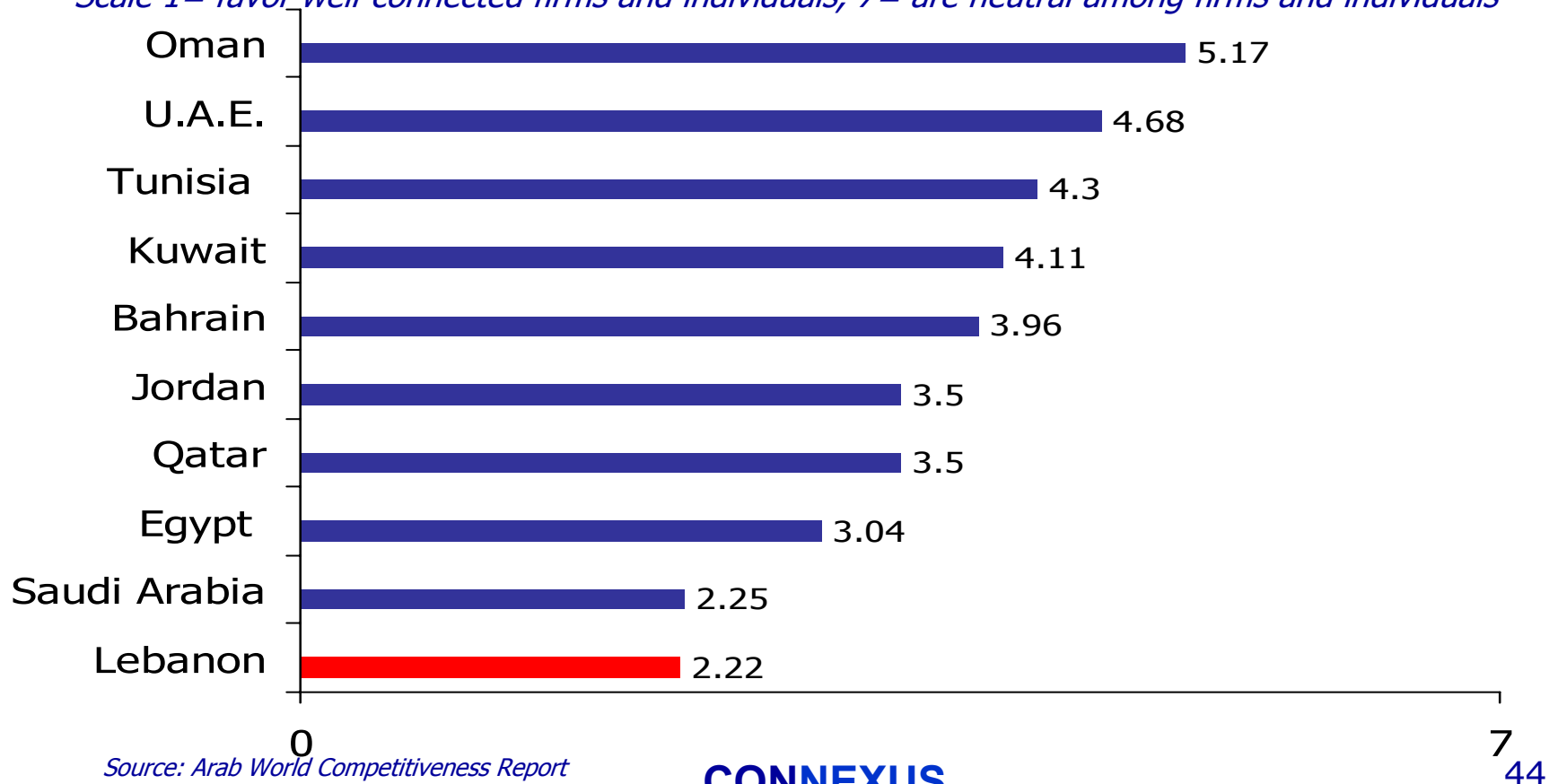
Political stability	
Policy stability	
Government stability	
Security	
Political corruption	
Independence of judiciary	
Public governance	

● most favorable → ○ least favorable

Source: Connexus analysis

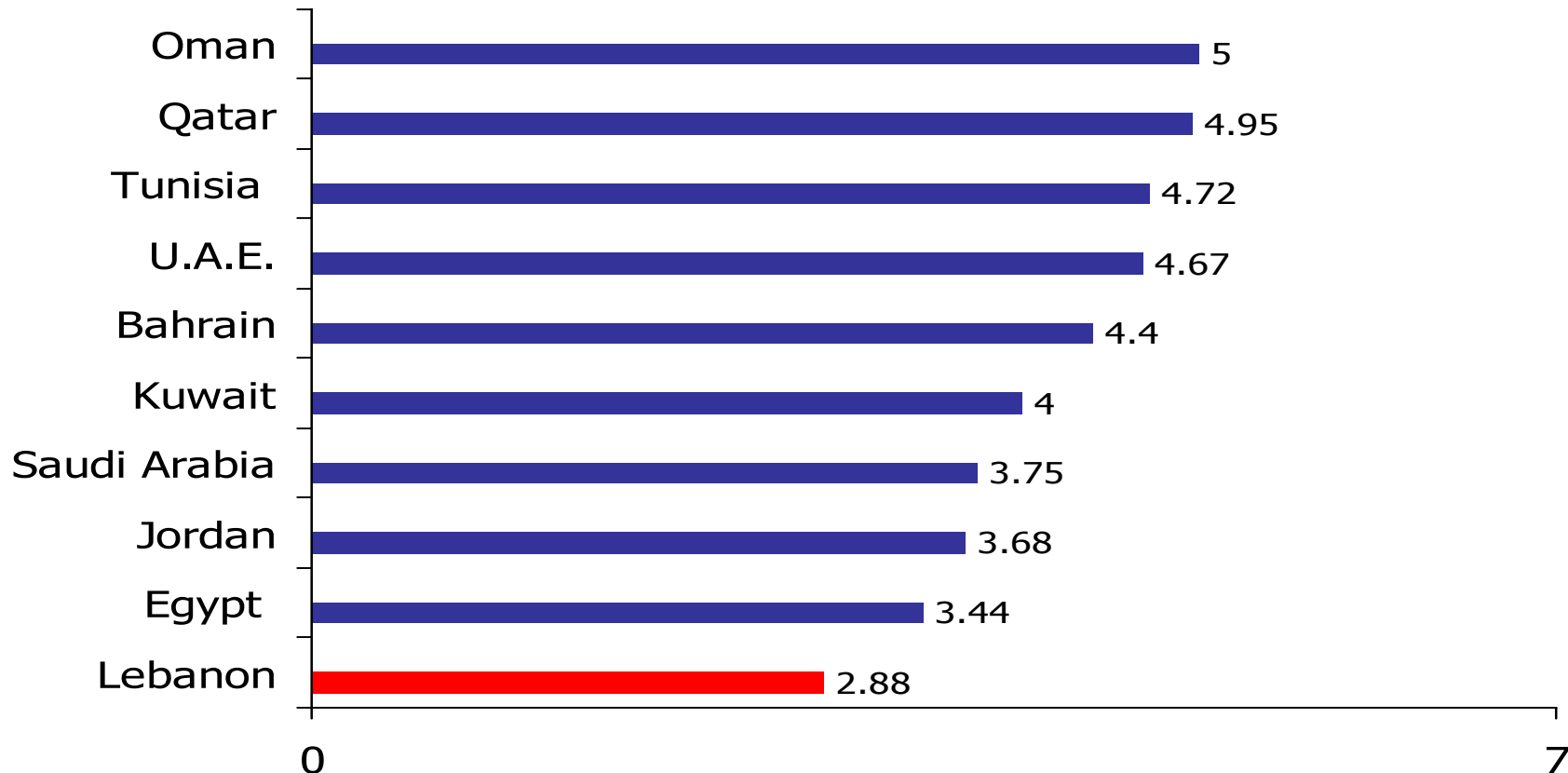
Public officials' behavior has created a negative perception of favoritism

*When deciding upon policies and contracts, government officials:
Scale 1= favor well-connected firms and individuals, 7= are neutral among firms and individuals*



Government subsidies have been perceived as distortive









*Government subsidies to business in your country:
Scale 1= keep uncompetitive industries alive artificially, 7= improve productivity of industries*





Source: Arab World Competitiveness Report

In addition, public services are generally inefficient and of low quality

Quality and Efficiency of Public Services

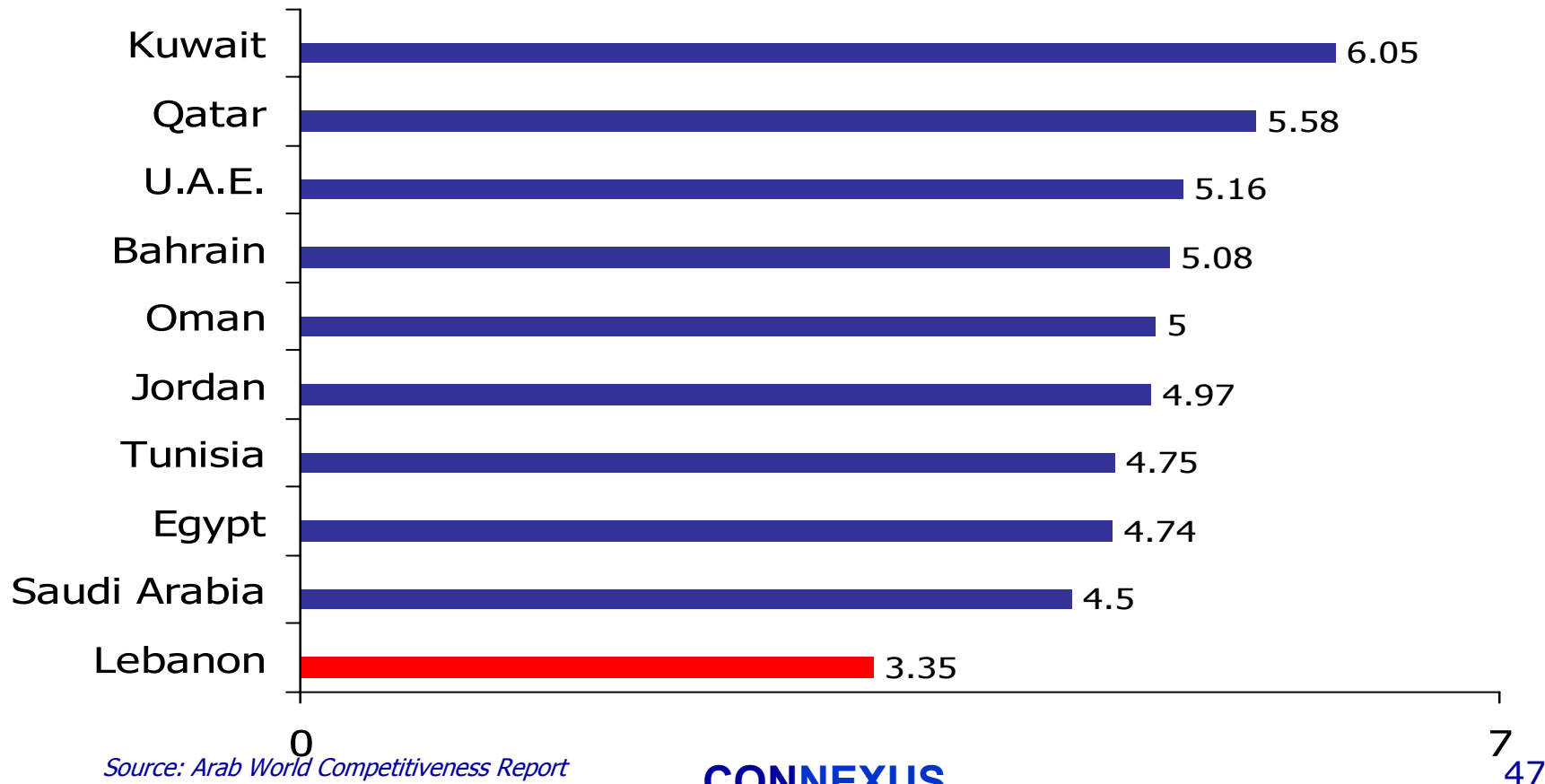
Customs	
Judiciary/courts	
Public works	
Public healthcare	
Education	
Military/armed forces	
Police	
Central bank	

 good quality →  low quality

Source: Connexus analysis, World Bank criteria

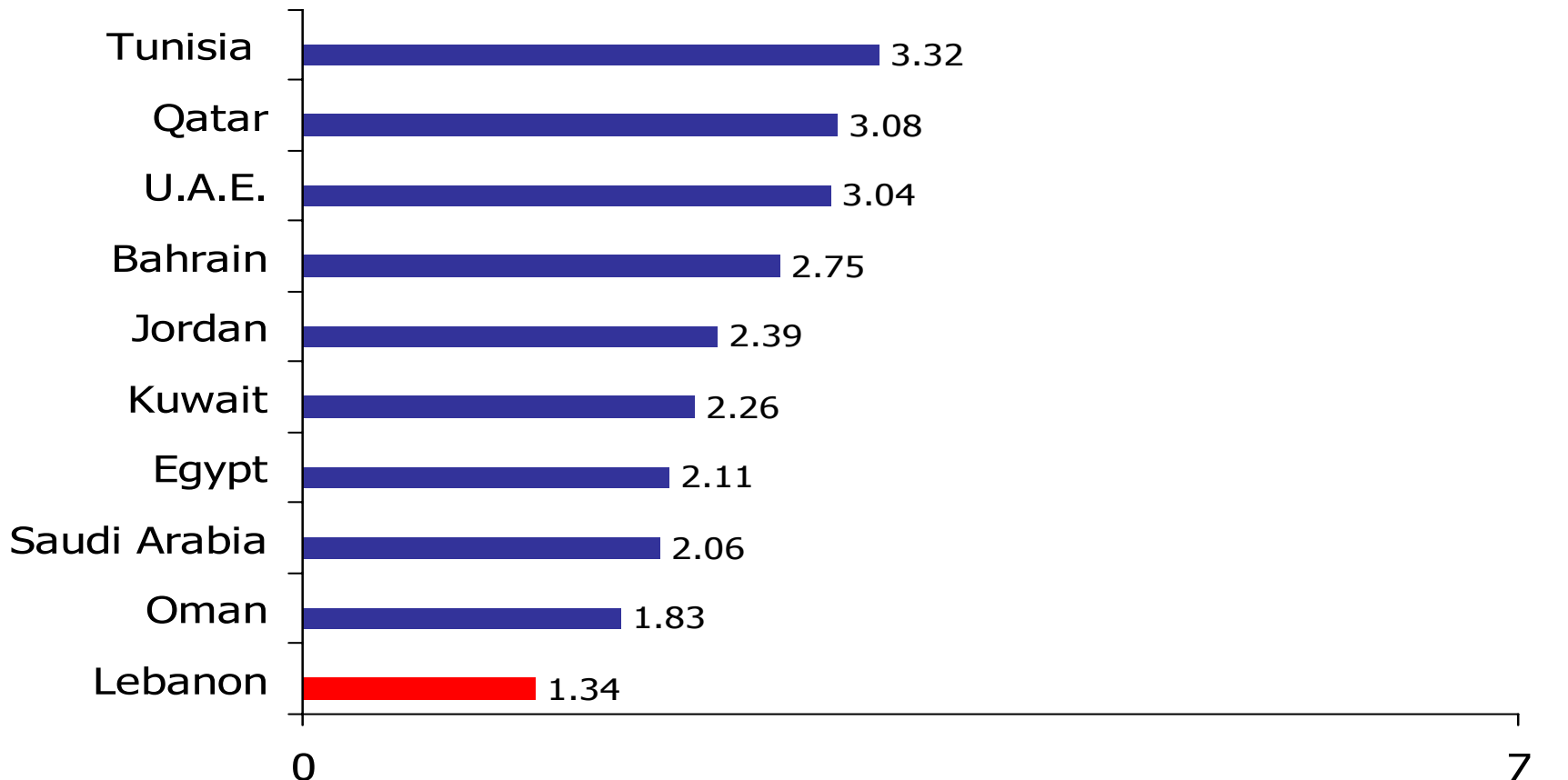
The judiciary is judged to be subject to political interference

The judiciary in your country is independent and not subject to interference by the government and/or parties to the dispute, Scale: 1=not true, 7=true



Public sector officials are perceived to be much less competent than their private sector counterparts

*The competence of personnel in the public sector is:
Scale 1= lower than the private sector, 7 = higher than the private sector*



Source: Arab World Competitiveness Report

Other important economic drivers for doing business are also not encouraging for Lebanon

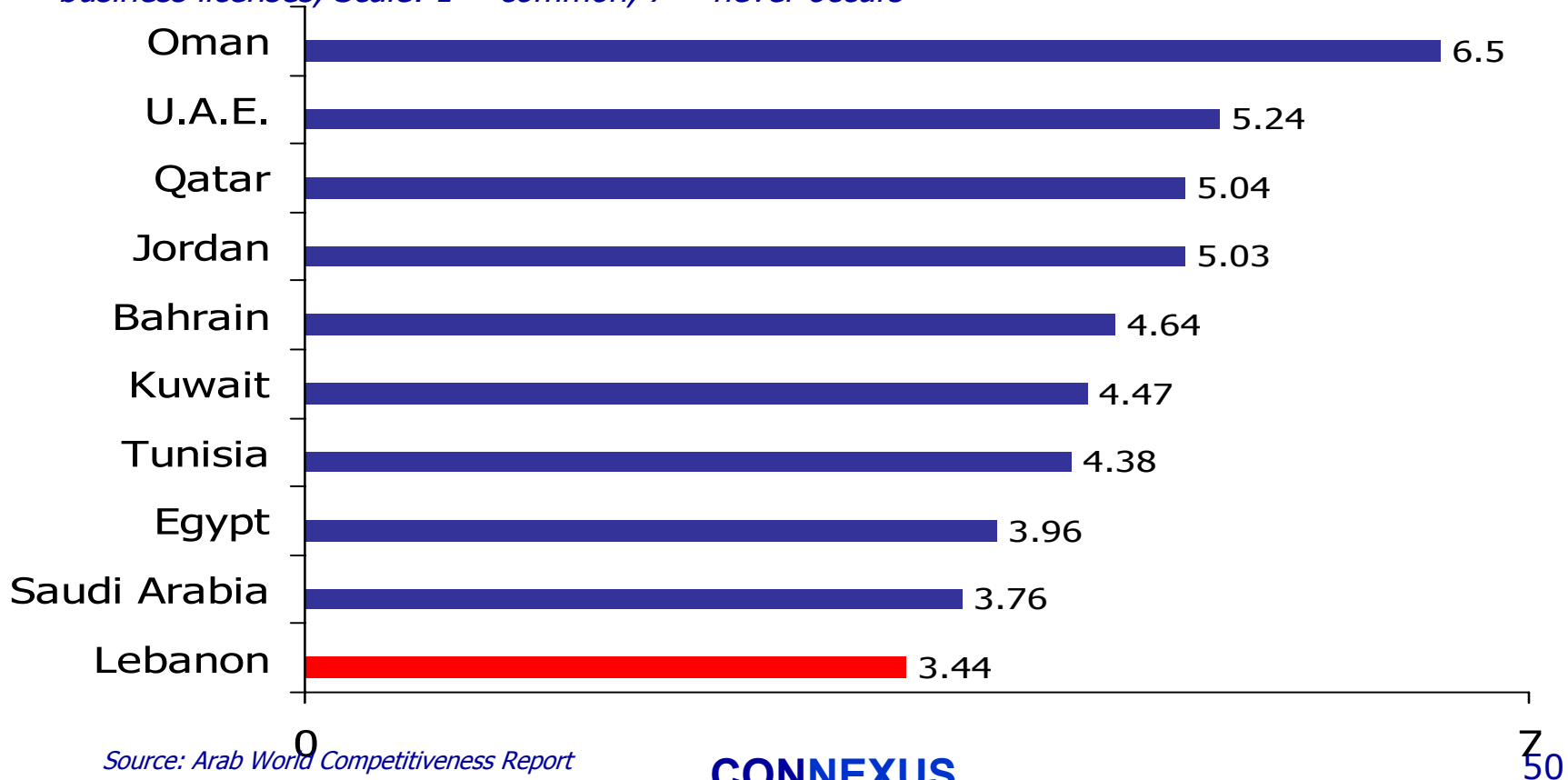
Tax rates	
Bureaucracy	
Access to financing	
Work ethic	
Educated workforce	
Crime and theft	
Corruption and bribery	
Anticompetitive practices	

● most favorable → ○ least favorable

Source: Connexus analysis

Businessmen have mentioned a high incidence of corruption in connection with the award of public contracts and business licenses

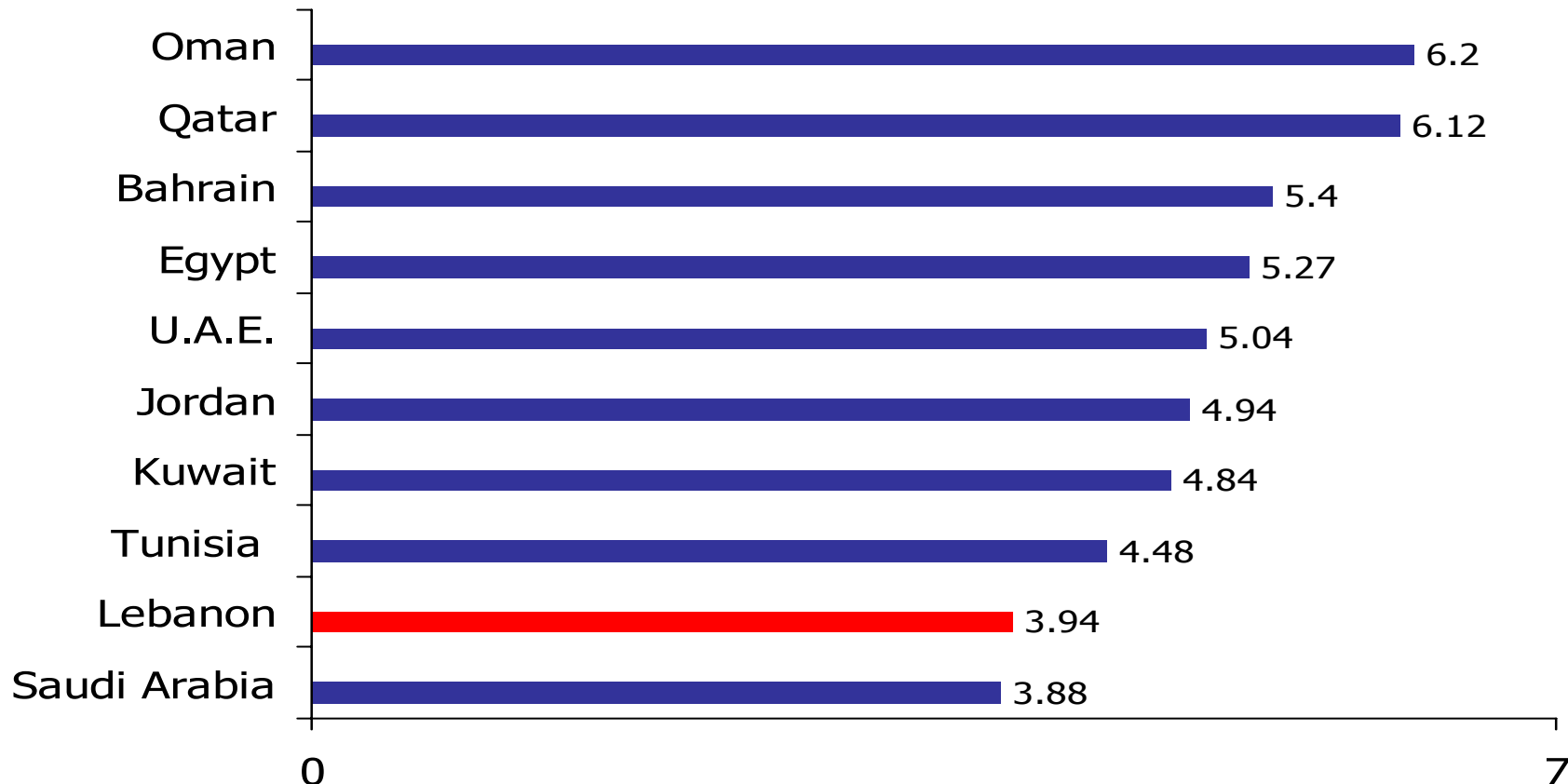
In your industry, how often would you estimate that firms make irregular extra payments or bribes connected with the awarding of public contracts (investment projects) and/or the initial acquisition of business licenses, Scale: 1 = common, 7 = never occurs



Source: Arab World Competitiveness Report

In addition, corruption is perceived to significantly increase the cost of operation

Do unfair (e.g. influence on government policies) or corrupt activities of other firms impose costs on your firm? Scale 1= impose large costs, 7= impose no costs/not relevant



Source: Arab World Competitiveness Report

The failure to complete a single privatization transaction has further contributed to Lebanon's dismal performance in terms of attracting investments

Law Regulating Privatization Operations enacted in 2000

Lack of consensus and political bickering have caused unnecessary delays

Not a single privatization transaction completed

Privatization has spurred on domestic and foreign investment in other countries:

- 1) *Direct impact*** Privatization attracts domestic and foreign investors who buy into the privatization projects
- 2) *Indirect impact*** Privatization is accompanied by liberalization measures, and improves the business climate (for eg, capital markets)
- 3) *Induced impact*** Privatization as part of a series of economic reforms that can enhance investment profitability
- 4) *Catalytic impact*** Privatization transactions generate interest in a country among investors

Heritage Foundation's Index of Economic Freedom for 2003 categorizes Lebanon as Mostly Unfree

Trade Policy: Very high level of protectionism

- **30 types of import controls administered by various ministries**

Monetary Policy: Very low level of inflation

- **Weighted average annual rate of inflation for 1992-2001: 0.23%**

Government Intervention in the Economy: Moderate

- **Government consumed 18.9% of GDP in 2000**
- **14.19% of Lebanon's revenues in 1999 from SOEs and Government-owned assets**

Fiscal Burden of Government: Low tax rates, Very high level of government expenditure

- **Top income tax rate at 20%, top corporate tax rate at 15%**
- **In 2000, Government expenditures were 34.1% of GDP**

Capital Flows and Foreign Investment: Moderate barriers

- **Bureaucratic red tape, corruption**
- **Central Bank approval required to purchase treasury securities, money market instruments and derivatives**
- **Some credit operations prohibited**

Banking and Finance: Low level of restrictions

- **Many private sector borrowers crowded out of the market, more than 60% of bank credits go to the Government**

The Index ranks Lebanon at 94 out of 151 countries, and at 11 out of the 17 MENA countries

Wages and Prices: Low level of intervention

- **Controls on prices of bread, petroleum derivatives, pharmaceuticals and infrastructure services**
- **Monthly minimum wage not effectively enforced**

Property Rights: Low level of protection

- **Contract enforcement weak**
- **Unpredictable judiciary system, judiciary influenced by Government**

Regulation: High level

- **Lack of transparency**
- **Political interference in contract awards**
- **Start-ups face complex administrative procedures to obtain approvals and permits, difficulty accessing information**

Black Market: Very high level of activity

- **Extensive trade in pirated intellectual property and unauthorized copies**
- **Extensive black market trade, especially with Syria**

Lebanon's Composite Risk Rating as calculated by The PRS Group ranks it at 123 out of 140 countries

Rating measures political risks

Government unity, popular support
Legislative strength
Foreign pressures
Unemployment, poverty
Consumer confidence
Corruption, bureaucracy
Contract viability
Profit repatriation
Payment delays
War, terrorism, cross-border conflict
Democracy, accountability
Civil disorder, tensions
Military in politics

Rating measures financial risks

Total foreign debt/GDP
Debt service/exports
Current account/exports
Months of import cover (liquidity)
Exchange rate stability

Rating measures economic risks

GDP per capita
Real annual GDP growth
Annual inflation rate
Budget balance/GDP
Current account/GDP

Lebanon presents high political, financial and economic risks

Lebanon's sovereign risk rating is unfavorable

RATING SCALE	
AAA	Investment Grade
AA+	
AA	
AA-	
A+	
A	
A-	
BBB+	
BBB	
BBB-	
BB+	Speculative Grade
BB	
BB-	
B+	
B	
B-	
CCC/CC/C	
SD/D	

According to universal standards, the rating of financial institutions in Lebanon could achieve the country's sovereign risk rating at best



Lebanon's Sovereign Rating	
Moody's Rating	S&P Rating
B2 (B)	B-

The business climate has been assessed at three different stages of the business cycle: Entry, Operation and Exit

A. Entry

Starting a business in Lebanon is time-consuming and costly

Indicator	Lebanon	Regional Average	OECD Average
Number of procedures	6	11	7
Duration (days)	46	50	30
Cost (% of Gross National Income per capita)	129.9	54.5	10.2
Minimum capital (% of Gross National Income per capita)	83.1	1,104.3	61.2

Regional average refers to the average for the Middle East and North Africa region that includes: Algeria, Bahrain, Djibouti, Egypt, Iran, Iraq, Israel, Jordan, Kuwait, Lebanon, Morocco, Oman, Qatar, Saudi Arabia, Syria, Tunisia, United Arab Emirates, Yemen, West Bank & Gaza

The text of the Commercial Code is used as a source for costs. If there are conflicting sources and laws are not clear, the most authoritative source is used. In the absence of express legal fee schedules, a governmental officer's estimate is taken as an official source. If several sources have different estimates, the median reported value is used. In the absence of government officer's estimates, estimates of incorporation lawyers are used instead. If these differ, the median reported value is computed. In all cases, the cost estimate excludes bribes.

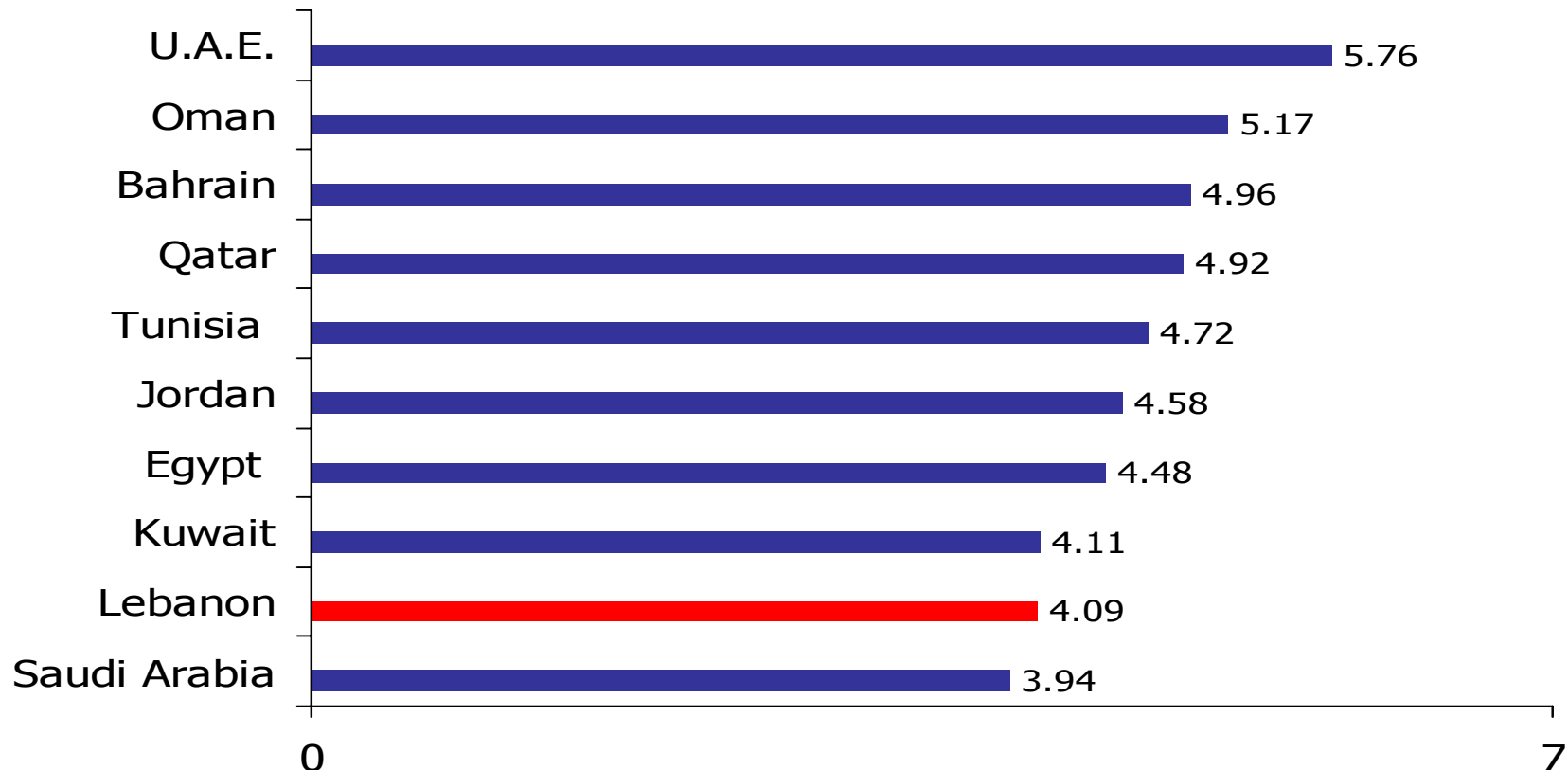
The minimum capital requirement reflects the amount that the entrepreneur needs to deposit in a bank account in order to obtain a business registration number. This amount is typically specified in the Commercial Code.

Several permits are required during the initial stages for investors to enter and establish a business

- ✓ **Residency permits (for foreign investors/labor)**
- ✓ **Work permits (for foreign investors/labor)**
- ✓ **Company registration**
- ✓ **Land registration**
- ✓ **Construction permit (major administrative cost during startup)**
- ✓ **Other (in case demolition is required, etc.)**

Starting a business in Lebanon was judged as the second most difficult and time-consuming from a selection of Arab countries

*Starting a new business in your country is generally:
Scale 1= extremely difficult and time consuming, 7= easy*

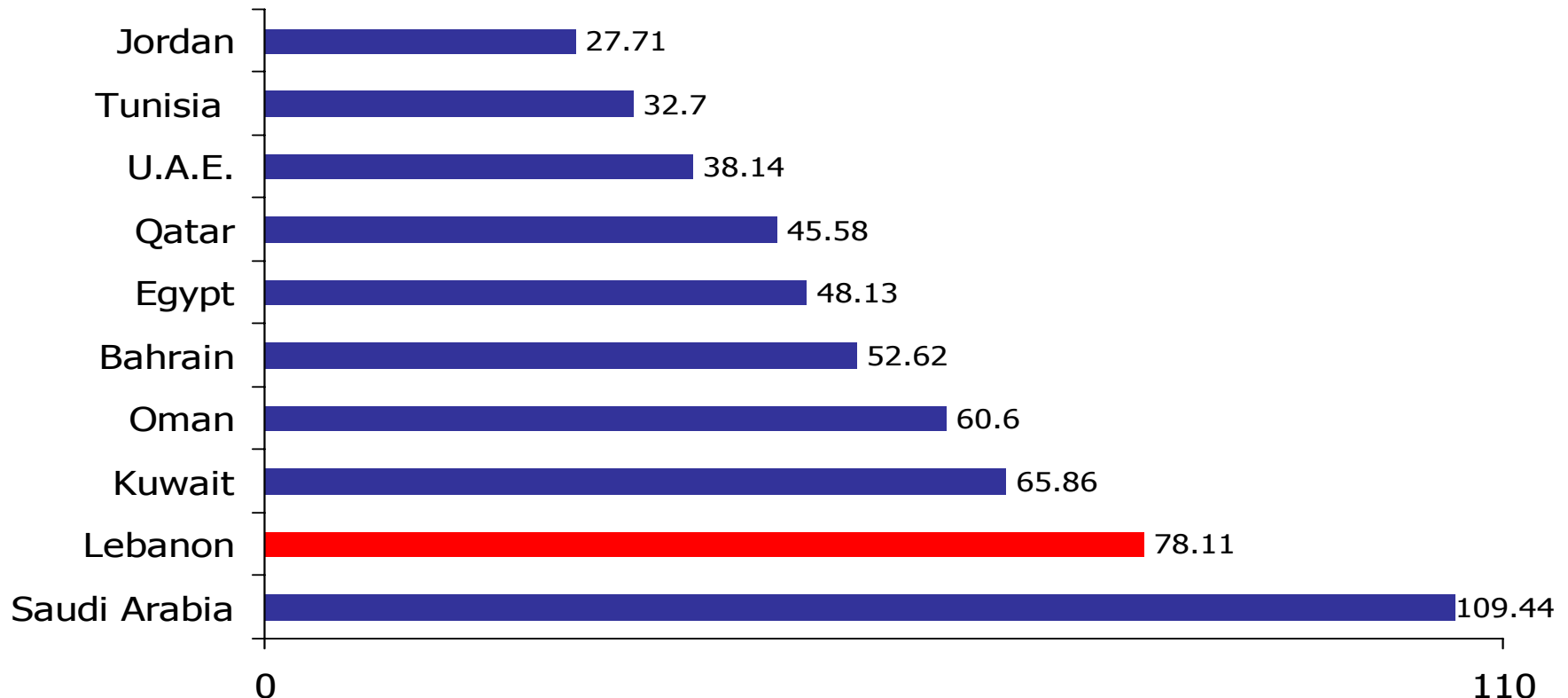


Source: Arab World Competitiveness Report

Lebanon was also rated second in the number of days to start a firm, indicating that the process can consume more than two months on average

Considering license and permit requirements, what is the typical number of days required to start a new firm in your country?

Scale open question: number of days required



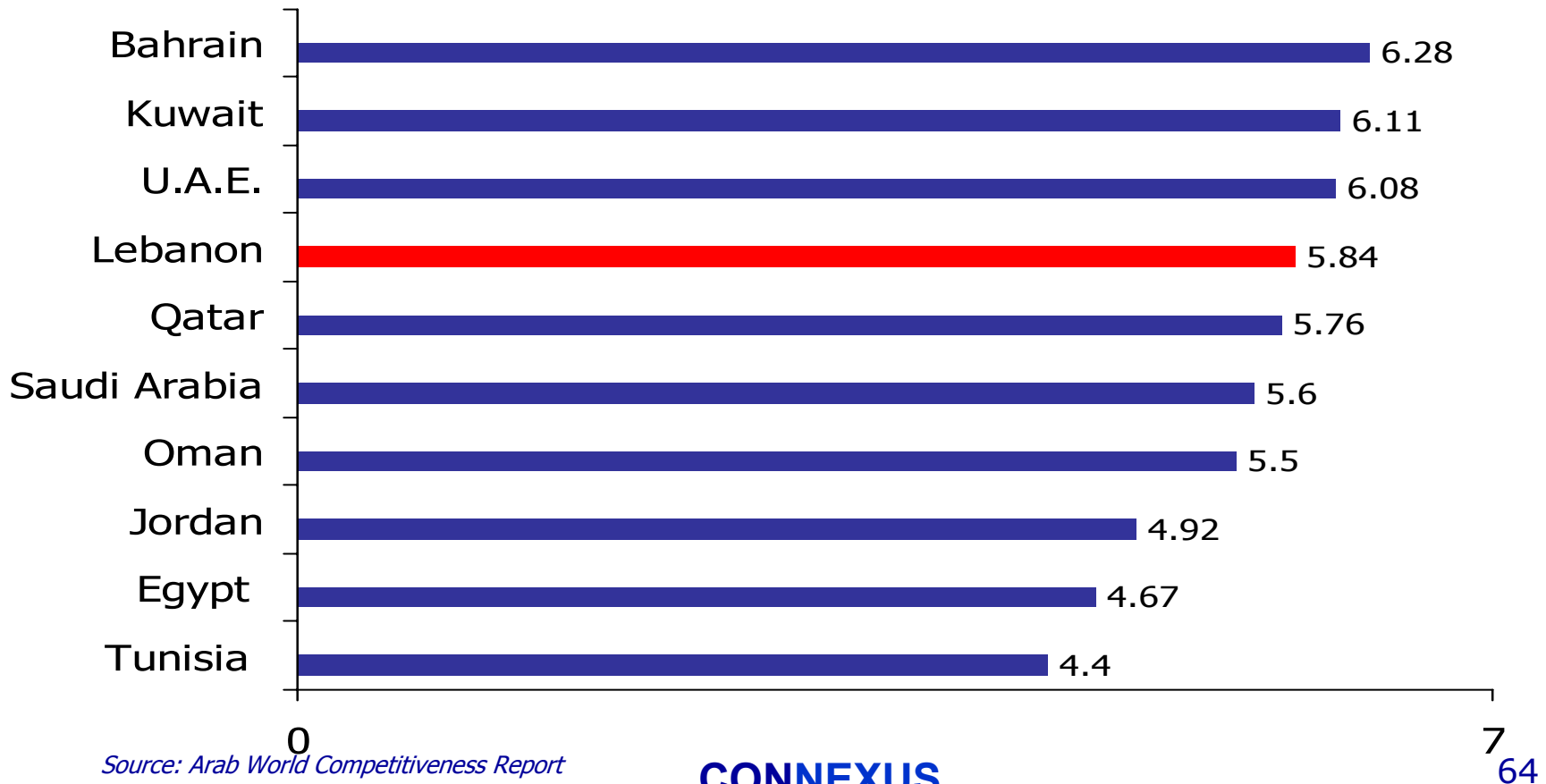
Source: Arab World Competitiveness Report

B. Operation

Banks operating in Lebanon are trusted as financial institutions and have been rated as healthy

Banks in your country are:

Scale 1=insolvent and may require bailout, 7= generally healthy with sound balance sheets



Source: Arab World Competitiveness Report

However, Lebanon does not have a public credit bureau or registry, and creditor rights are very strong

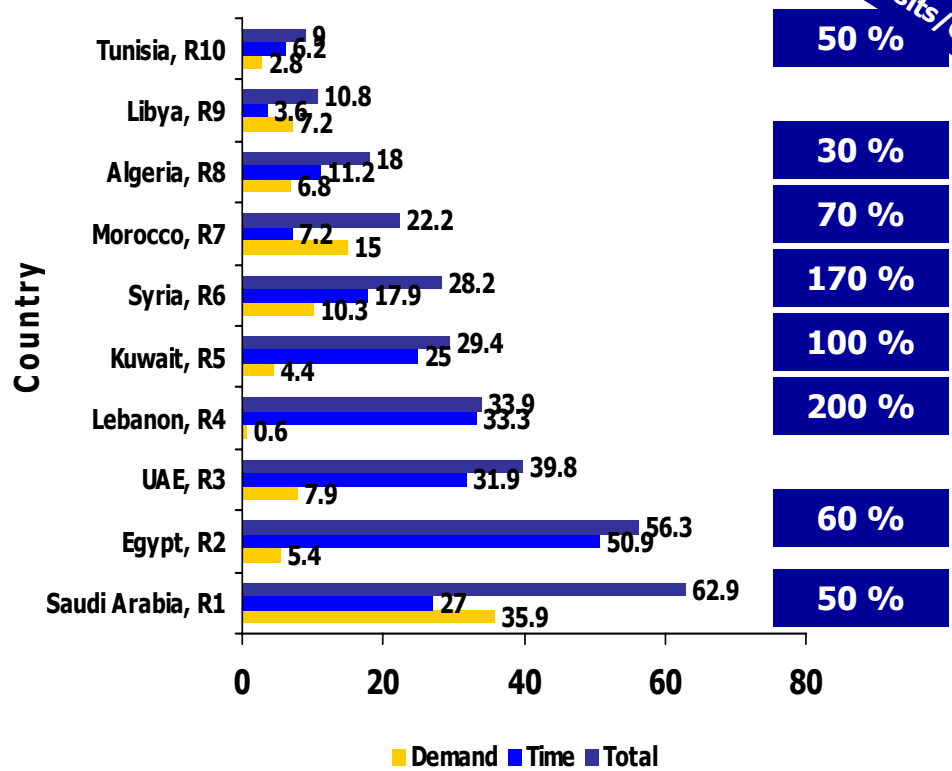
Indicator	Lebanon	Regional Average	OECD Average
Does public credit registry operate?	No		
Does private credit bureau operate?	No		
Creditor rights index	4	1	1

*Creditor rights index is calculated by assigning 1 for every yes response to each of the four types of creditor rights and then summing up
4 represents strong creditor rights*

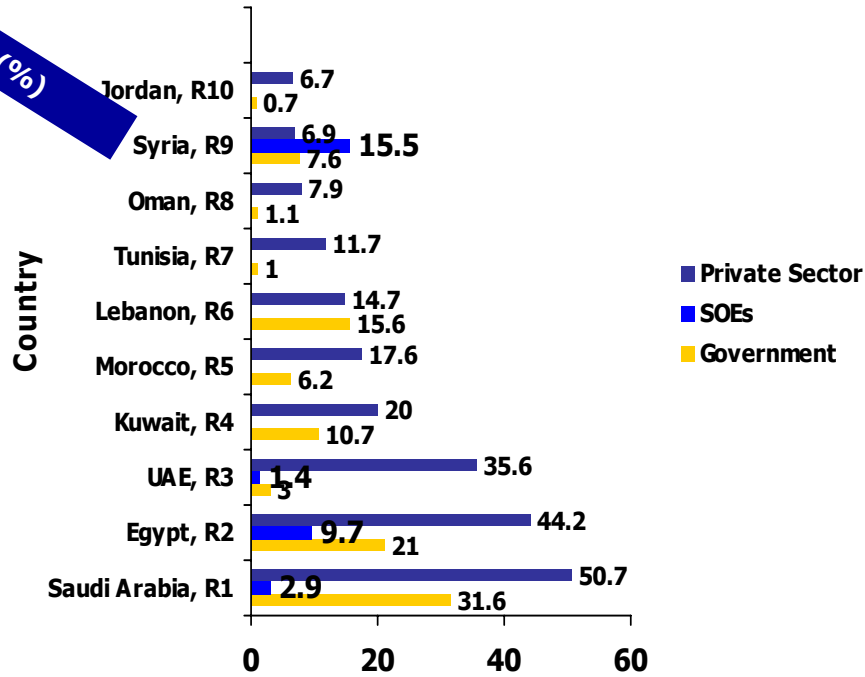
Bank deposits are highest relative to GDP across a selection of countries, whereas bank loans are equally divided between the public and private sectors, indicating an oversized public sector

Total bank deposits/GDP (%)

Bank Deposits, February 2002 (US\$ billions)



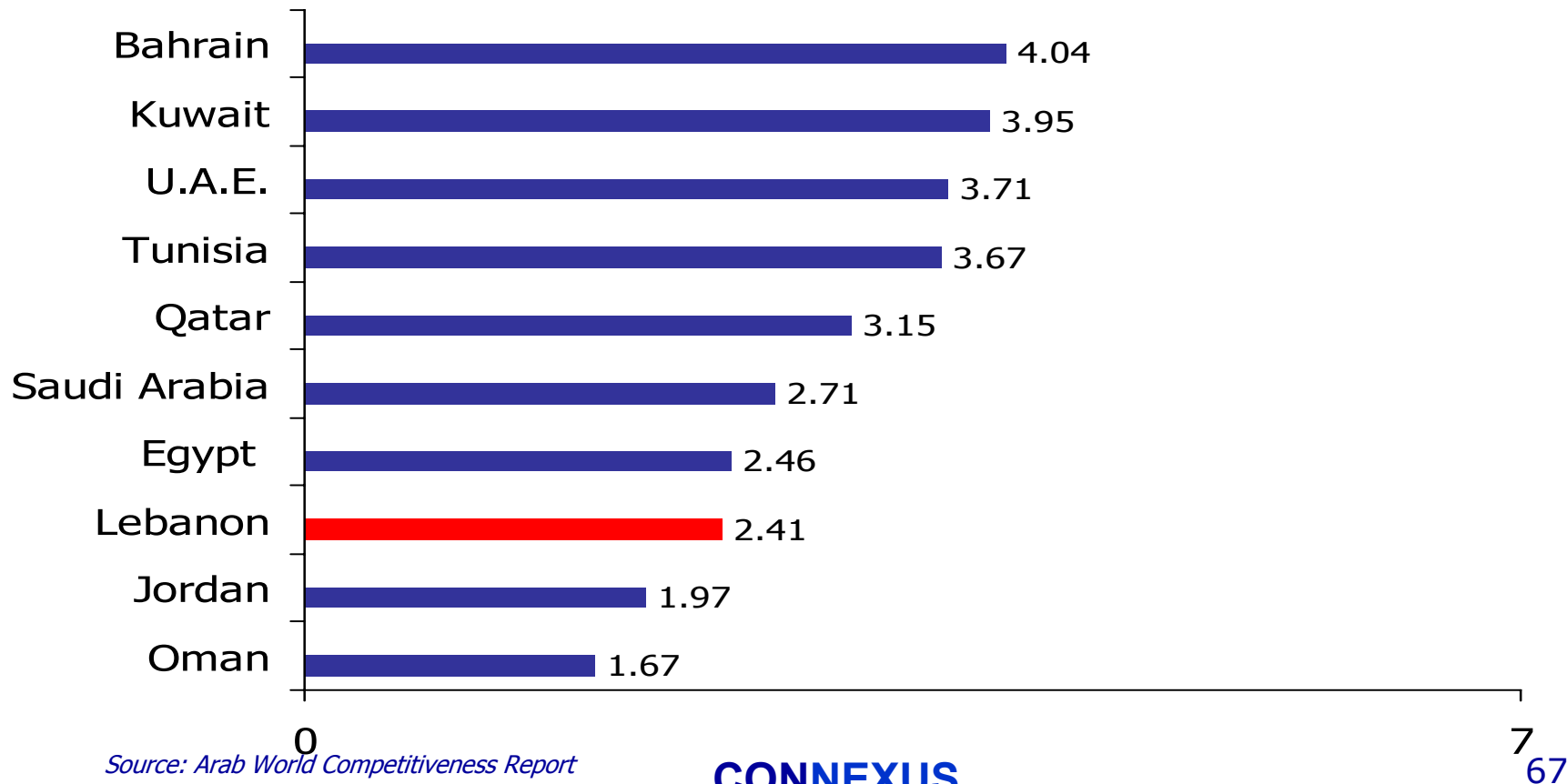
Bank Loans, February 2002 (US\$ billions)



Source: IMF, International Financial Statistics

Obtaining loans was rated as relatively difficult, signaling difficulty in accessing capital for investment

*How easy is to obtain a loan in your country with only a good business plan and no collateral?
Scale 1= impossible, 7= easy*



Source: Arab World Competitiveness Report

On the other hand, infrastructure access in Lebanon is adequate for business

Indicator	Value for 2002
Access to improved water source (% of population)	100
Access to electricity (% of population)	90
Aircraft departures	10,300*
Fixed lines (per 100 people)	16.3
Mobile lines (per 100 people)	20.3
Personal Computers (per 100 people)	5.62*
Internet users (per 100 people)	11.7

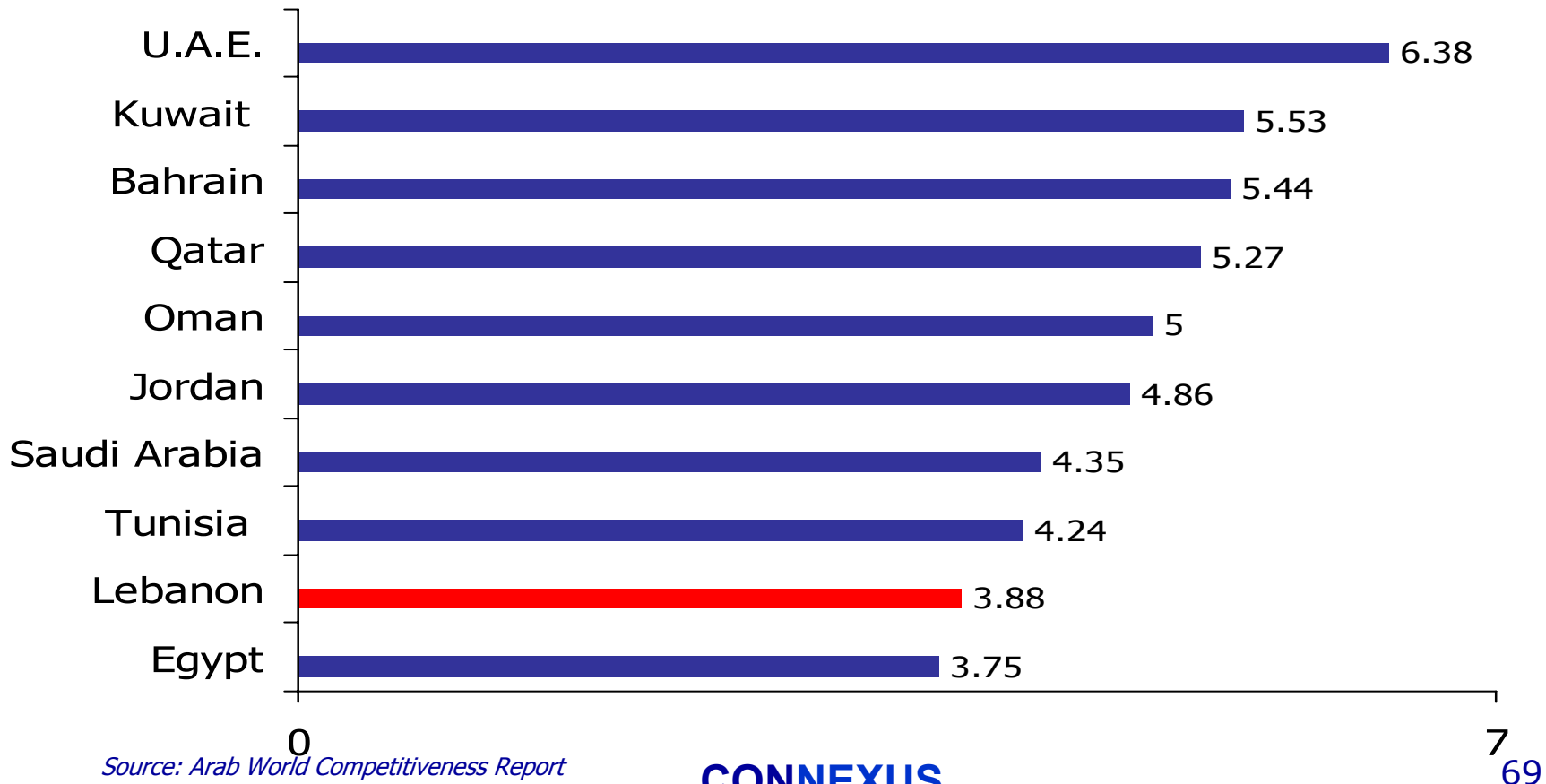
* Value for 2001

Source: World Bank, ITU, Connexus

However, Lebanon was rated second in a selection of Arab countries in terms of overall infrastructure quality

General infrastructure in your country is:

Scale 1= poorly developed and inefficient, 7= among the best in the world



Source: Arab World Competitiveness Report

At the same time, infrastructure costs are high, with power costs criticized as high and burdensome for businesses

End user	Consumption (KWh/month)	Price (US\$/KWh)
Low voltage power	Residential	Up to 100
		100-300
		300-400
		400-500
		>500
Small industry/agriculture	Flat	0.076

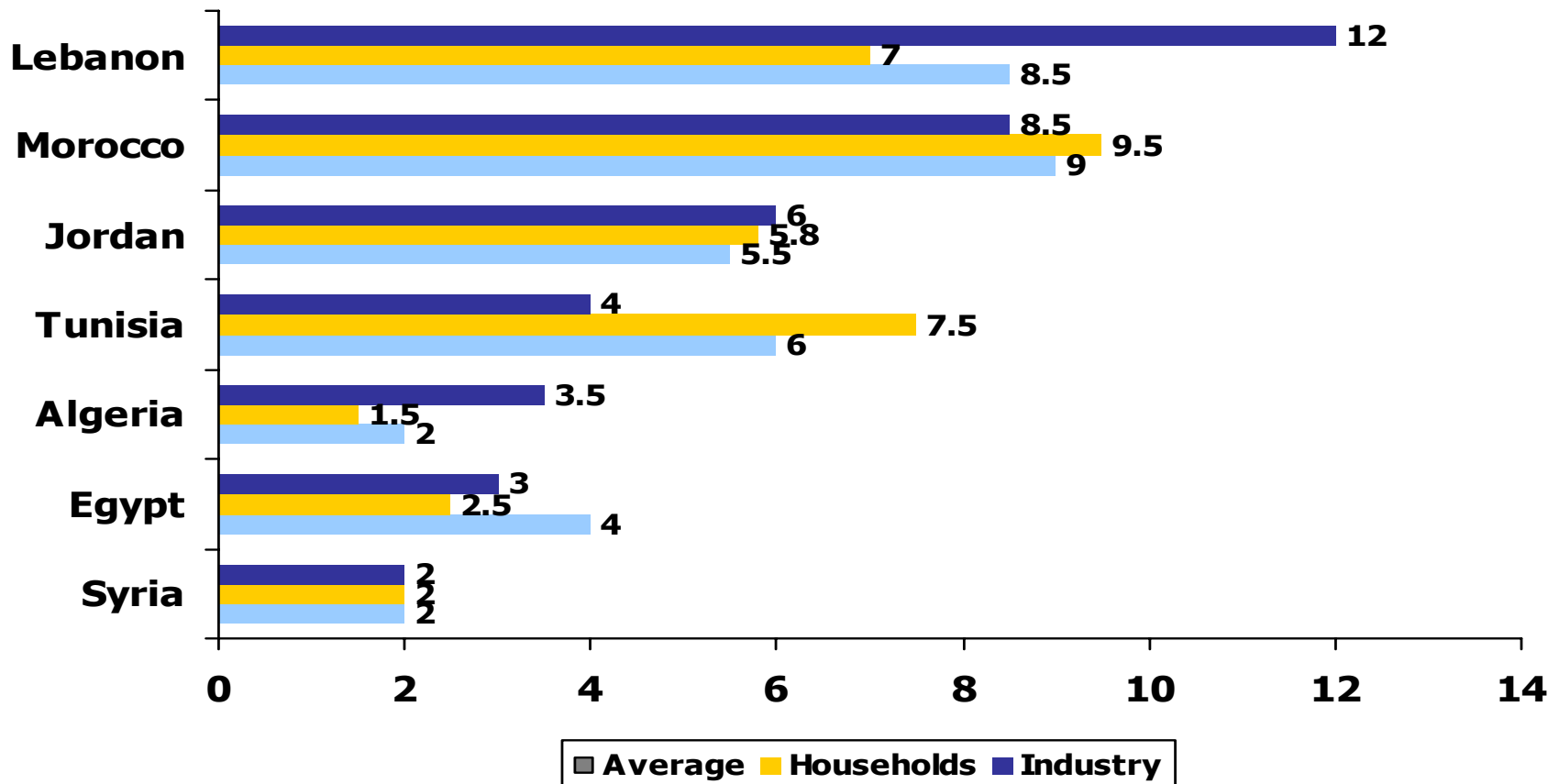
Time	Price (US\$/KWh)
Daytime	0.074
Daytime - peak	0.212
Night	0.053

Type of fuel	Price (US\$/lit)
Gas oil	0.68
Diesel	0.26
Gasoline - regular	0.66
Gasoline - super	0.69

Source: InfoPro

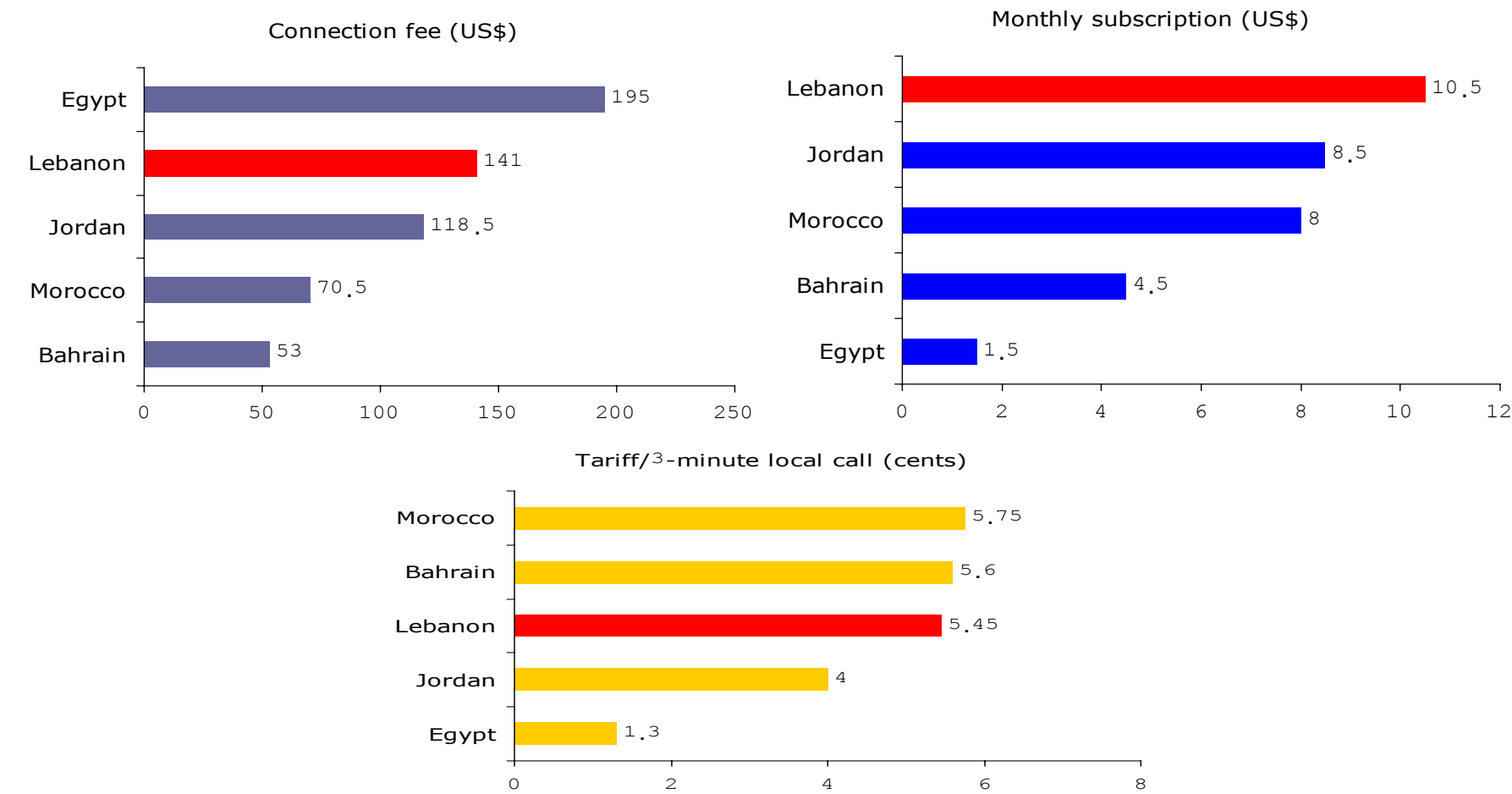
Electricity prices for industrial use are highest in Lebanon compared to a selection of countries in the region

Electricity Prices in a Selection of Countries (US\$/kWh)



Source: The World Bank

Fixed telephony tariffs in Lebanon are also high compared to tariff levels in other middle income countries in the region...



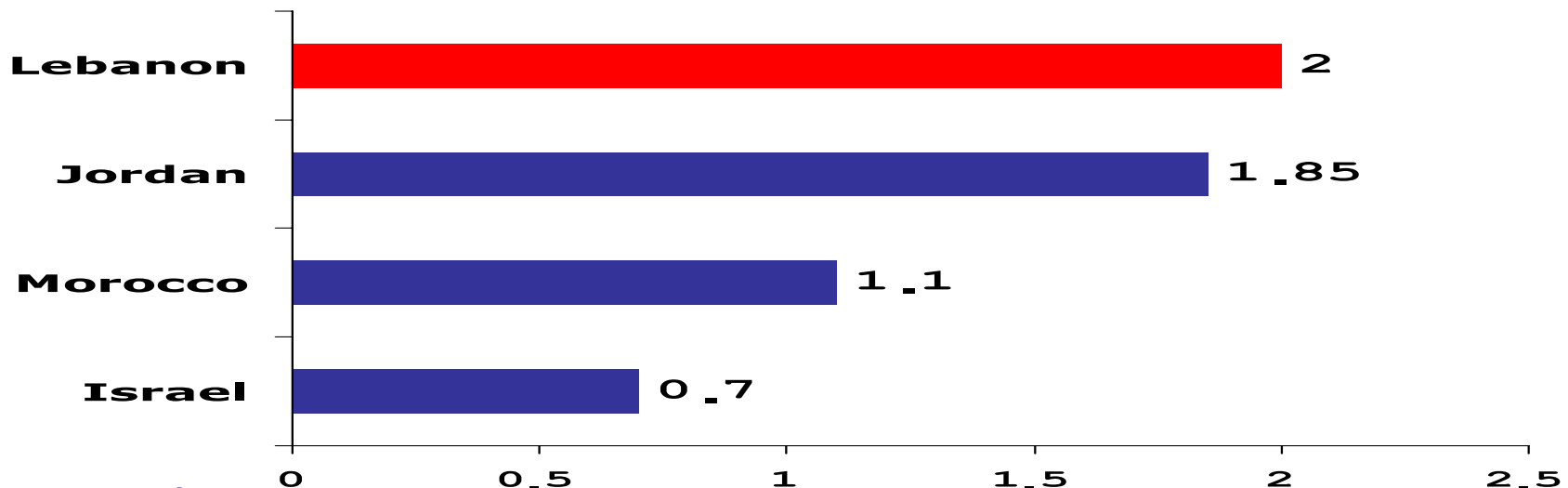
Source: Tariffica, 2002 and OGERO (for Lebanon); Average of Peak and Off-peak charges, residential and business charges

Despite the recently introduced 35% drop in per-minute tariffs for international telephony, connection and per-minute tariffs remain relatively high

Connection tariffs for international lines	Residential	Corporate
Deposit	300,000 L.L. (US\$ 200)	500,000 L.L. (US\$ 333.3)
International Direct Dialing (IDD) access (per month tariff)	5,000 L.L. (US\$ 3.3)*	5,000 L.L. (US\$ 3.3)*

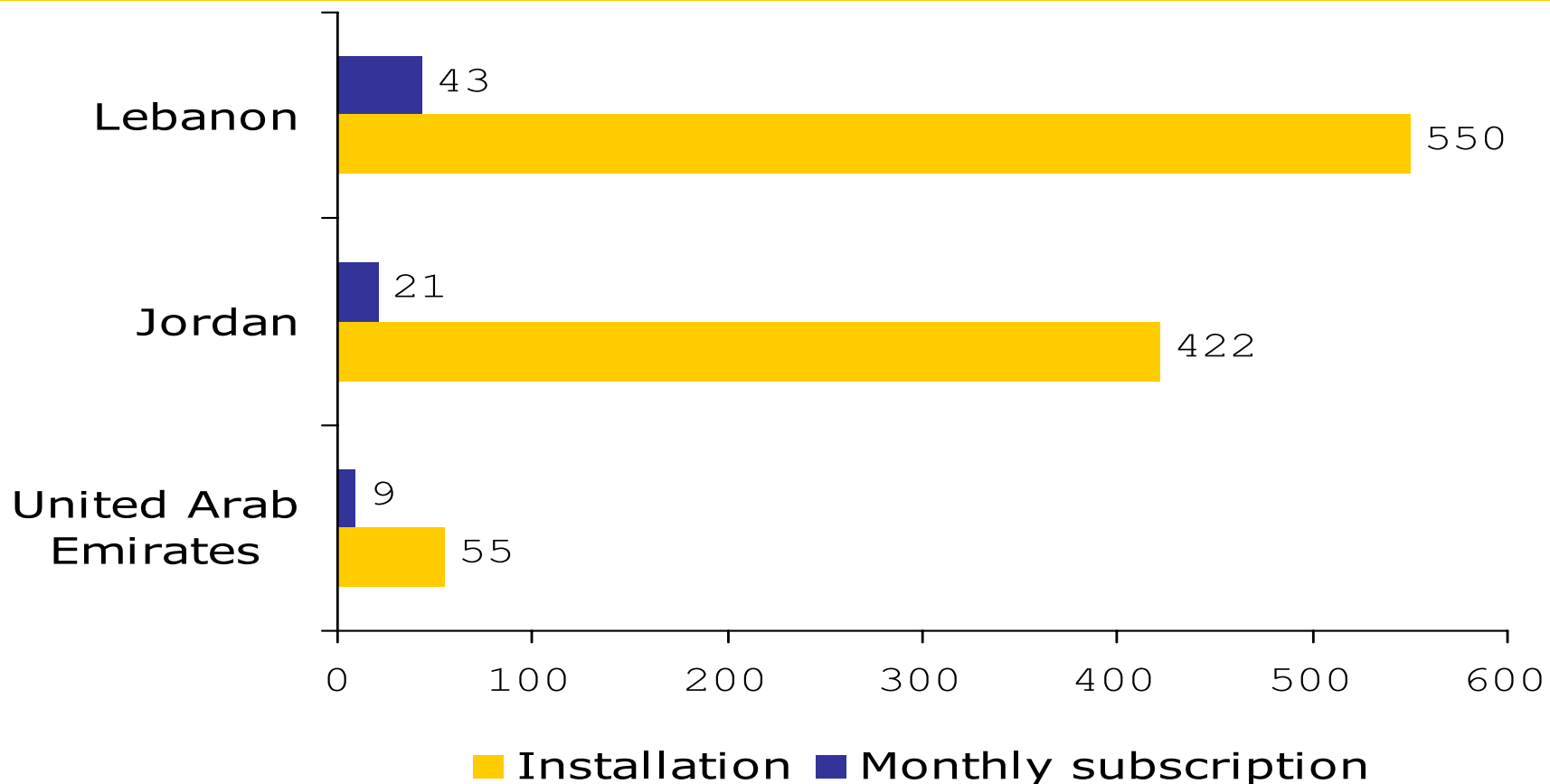
* Down from 10,000 L.L.

Tariff in US\$/ 3 minute call to NYC, average of peak and off-peak rates



Source: Tarifica, ITU, Operators

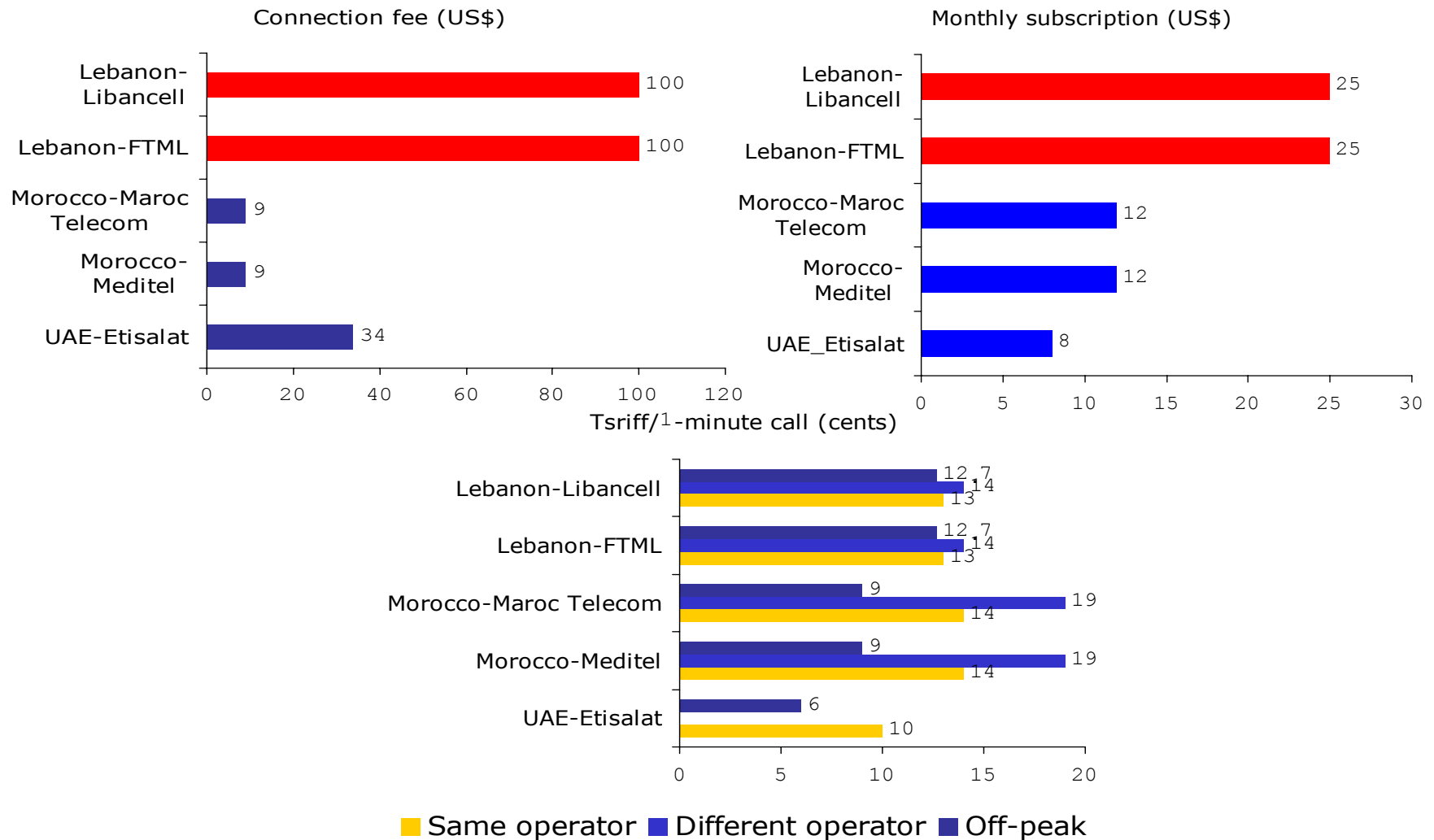
ISDN tariffs for businesses are also high compared to other countries in the region



Source: Telecommunications Operators

For Lebanon, the ISDN BRI Monthly subscription rate used is the average of residential and business rates

In addition, mobile tariffs are much higher than other regional comparators



Source: Operators

Etisalat is the only GSM operator in UAE

Therefore, the infrastructure in Lebanon leaves a lot to be desired

Telecommunications

- Expensive
- Data and broadband services inadequate (No DSL...)

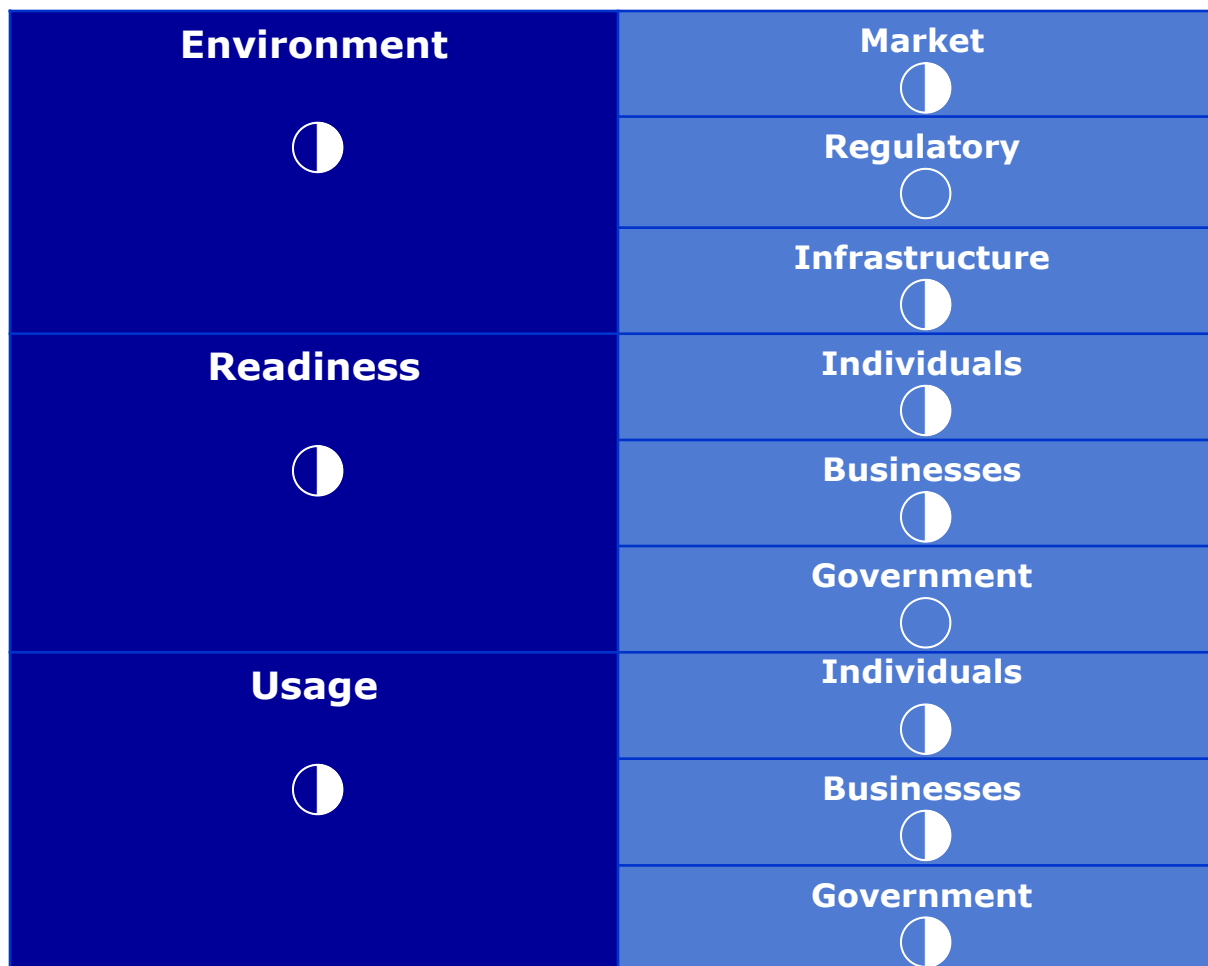
Power



- Expensive
- Shortages make services unreliable

Transportation

- Poor quality of roads
- Public transportation unreliable

Lebanon is only half-way there when it comes to its Information and Communication Technology sector



 Ready →  Not ready

Source: Arab World Competitiveness Report

Lebanon ranks 62nd globally and 6th regionally in technology infrastructure

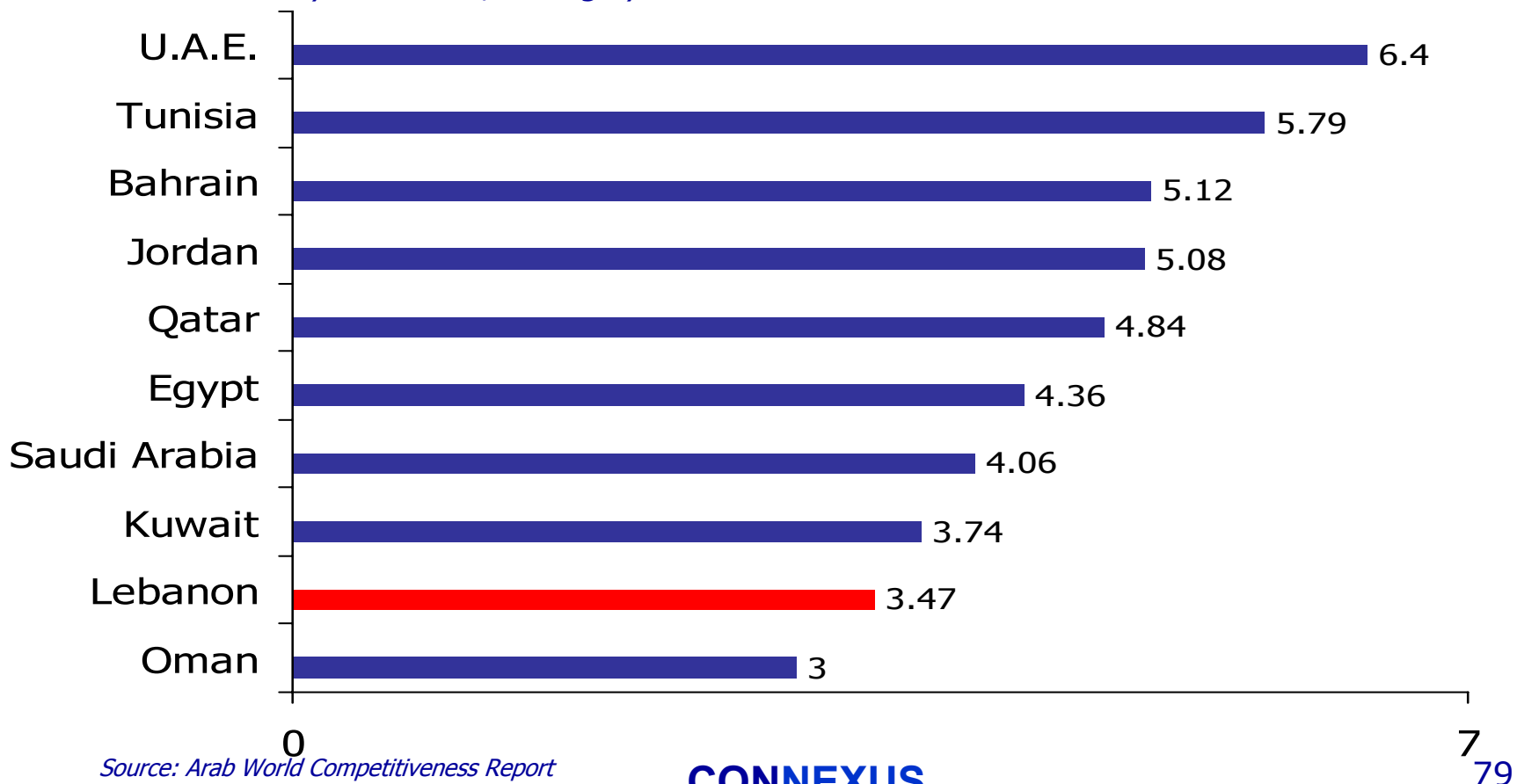
Components of Technology Infrastructure Index for Lebanon

Sub-index	Lebanon's score	MENA average score
Penetration of personal computers	0.106	0.084
Proportion of Internet users	0.193	0.129
On-line population	0.120	0.092
Penetration of telephone lines	0.216	0.168
Proportion of mobile subscribers	0.224	0.215
Penetration of television sets	0.383	0.320

Source: United Nations Technology Infrastructure Index 2003, Saradar Research

Lebanon has been rated the second least successful among a selection of regional countries when it comes to ICT promotion

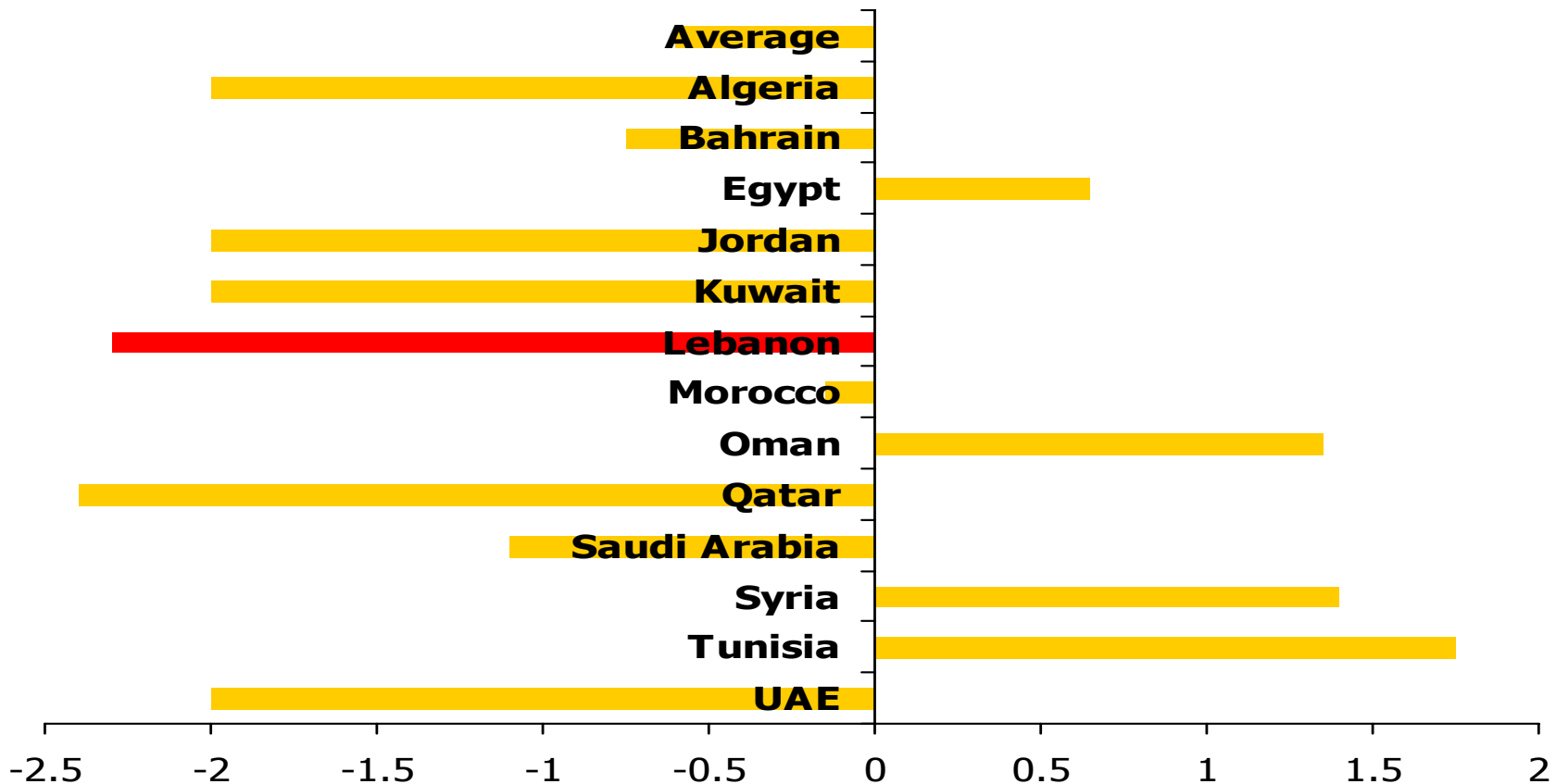
*Government programs promoting the use of ICT are:
Scale 1= not very successful, 7= highly successful*



Source: Arab World Competitiveness Report

Lebanon has suffered from a relatively high drop in Total Factor Productivity over the last 25 years

Total Productivity Growth in % (1975-2000)



Source: Martin, Artadi: World Economic Forum, Arab World Competitiveness Report

The Lebanese population is educated and relatively young, with UN estimates indicating around 60% aged between 15 and 59 in 2000

Adult Literacy Rates and School Enrollment

Adult Literacy Rate (95-99)		Primary School Enrollment (95 - 99, net)		Secondary School Enrollment (95 - 97, gross)	
Male	Female	Male	Female	Male	Female
91	77	-	-	78	85

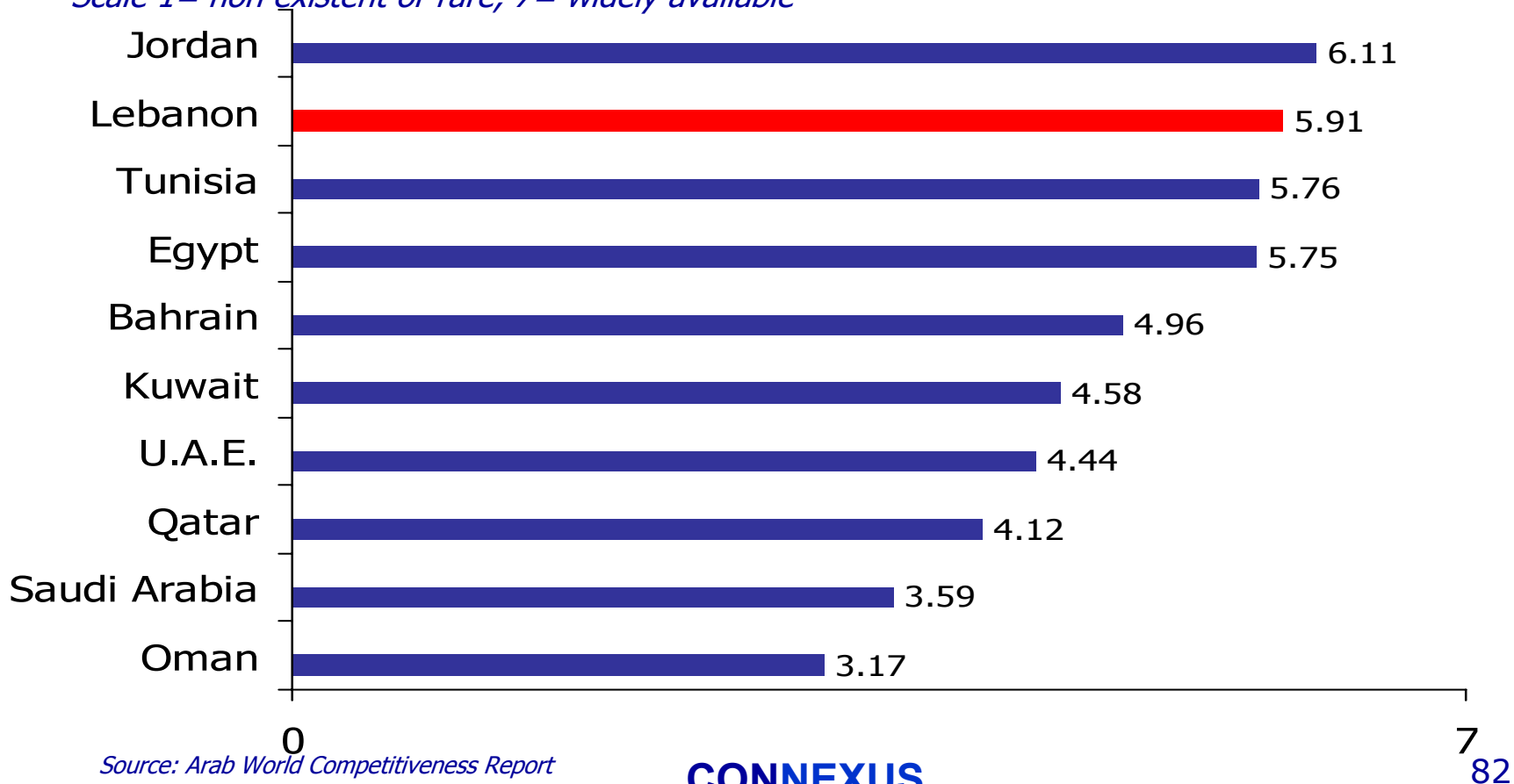
Lebanon ranks 65 in terms of Human Development Index (life expectancy at birth, adult literacy rate, combined primary/secondary/tertiary gross enrollment ratio and GDP per capita)

Combined primary/secondary/tertiary gross enrollment ratio for Lebanon: 78%

Source: Arab World Competitiveness Report, from United Nations Population Division, UNICEF, UNDP

In addition, professional labor (scientists and engineers) is perceived as widely available

*Scientists and engineers in your country are:
Scale 1= non existent or rare, 7= widely available*



Source: Arab World Competitiveness Report

At the same time, the cost of this labor is very competitive, although social security contributions for employees are sizeable

Labor cost

Position	Average monthly wage (US\$)
General Manager	5,000-8,000
Manager	3,500-5,000
Senior Engineer	2,500-4,000
Skilled worker	600-900
Unskilled worker	200-300
Minimum wage	200

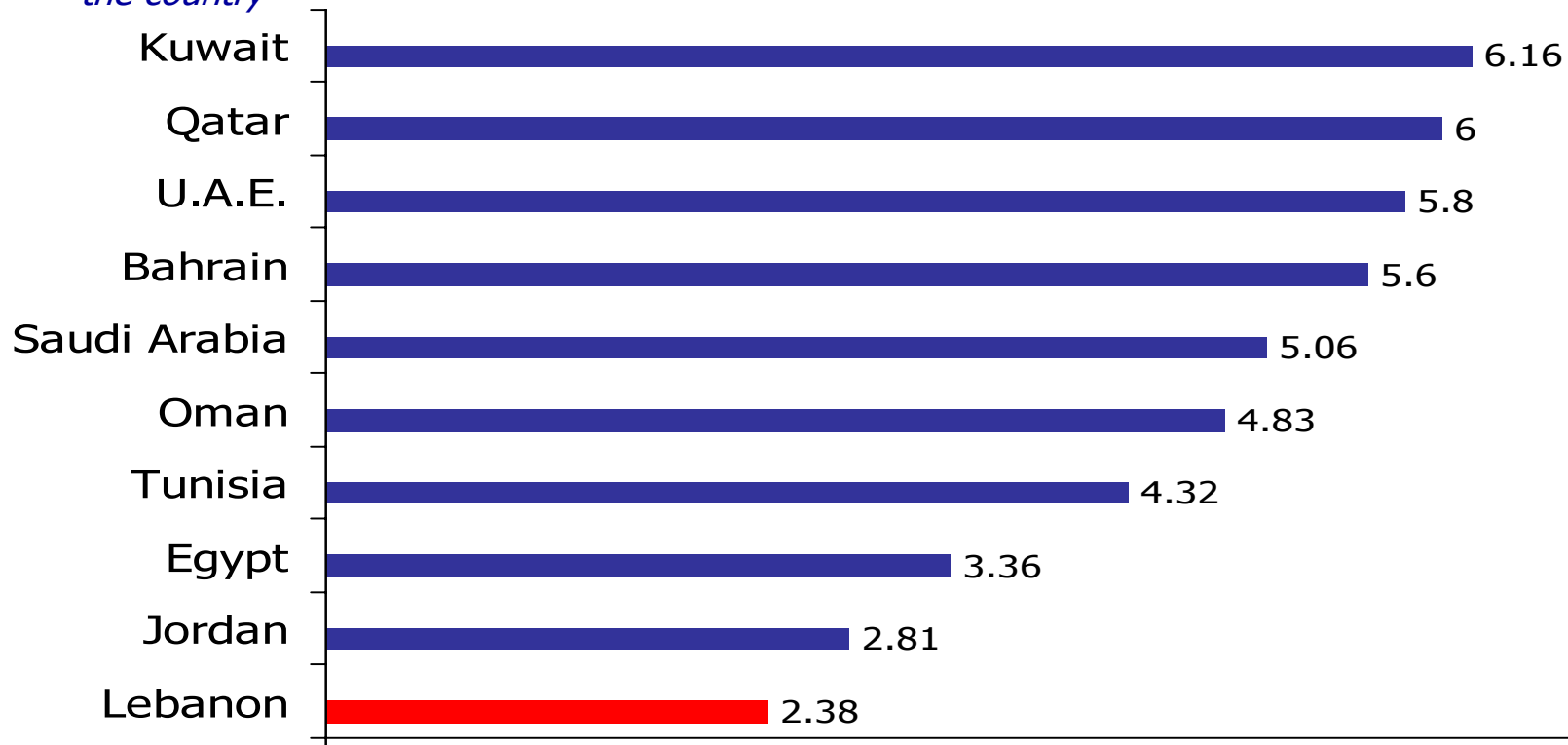
Social security contribution

Contribution type	Employee's contribution (%)	Employer's contribution (%)
Sickness and maternity	2	7
Family allowances		6
End of service allowance		8.5

However, there is high incidence of brain drain

Scientists and engineers in your country:

Scale 1= normally leave to pursue opportunities in other countries , 7= almost always remain in the country



0
Source: Arab World Competitiveness Report

Hiring and firing workers in Lebanon is inflexible relative to OECD benchmarks

Indicator	Lebanon	Middle East and North Africa Average	Latin America Average	OECD Average
Flexibility of hiring index	53	42	56	49
Conditions of employment index	50	65	79	58
Flexibility of firing index	35	35	48	28
Employment laws index	46	48	61	45

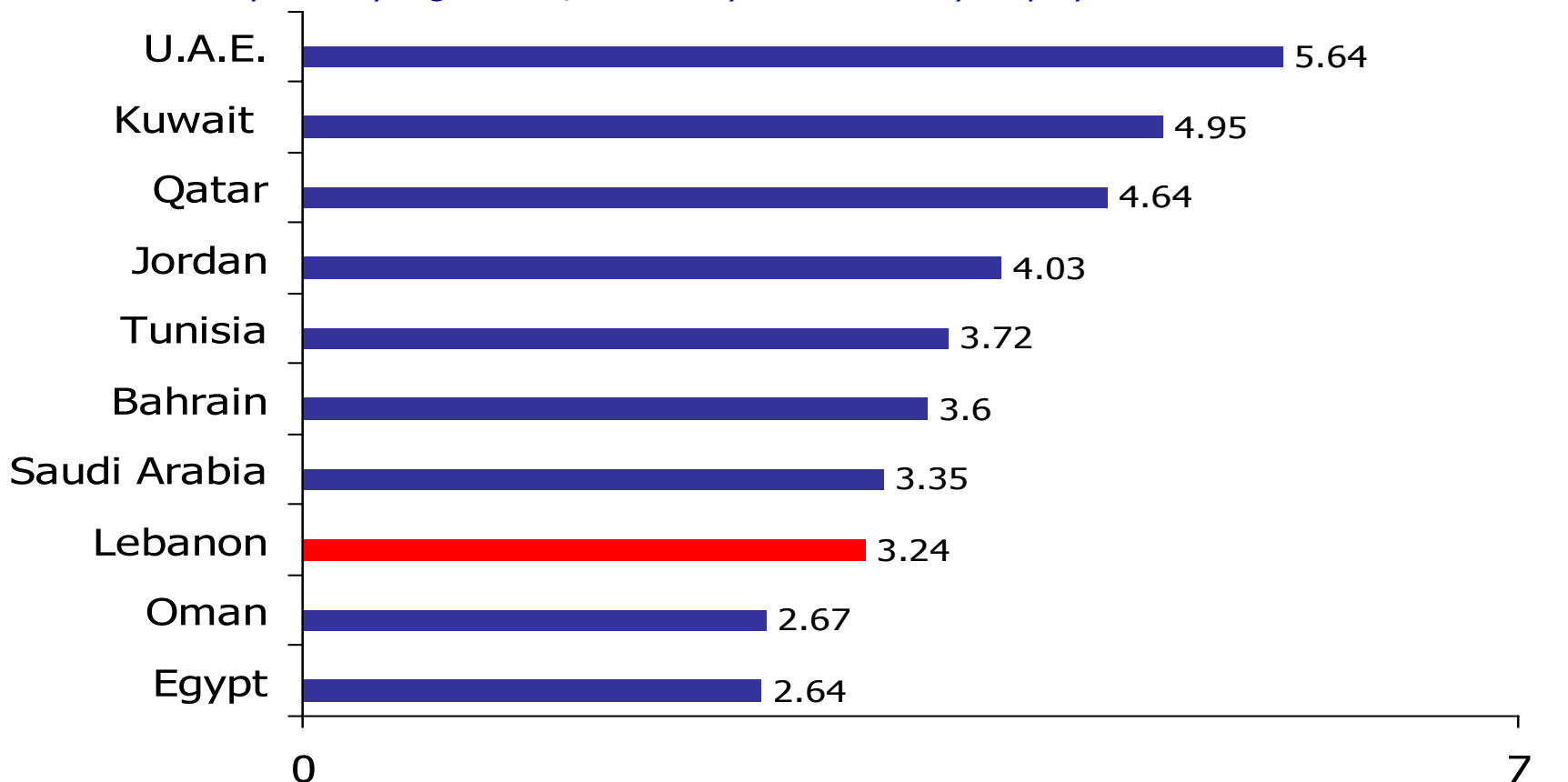
Index components are scored from 1-100, with 100 representing the highest level of regulation

Employment laws index is the average of the other three

Lebanese businessmen rightly perceive both hiring and firing as relatively inflexible

Hiring and firing of workers is:

Scale 1= impeded by regulations, 7= flexibly determined by employers



Source: Arab World Competitiveness Report

Existing and potential trade agreements offer investors in Lebanon promise of broad access markets

Greater Arab Free Trade Agreement

- **Lebanon member**
- **Access to the whole Arab region**

EuroMed Partnership

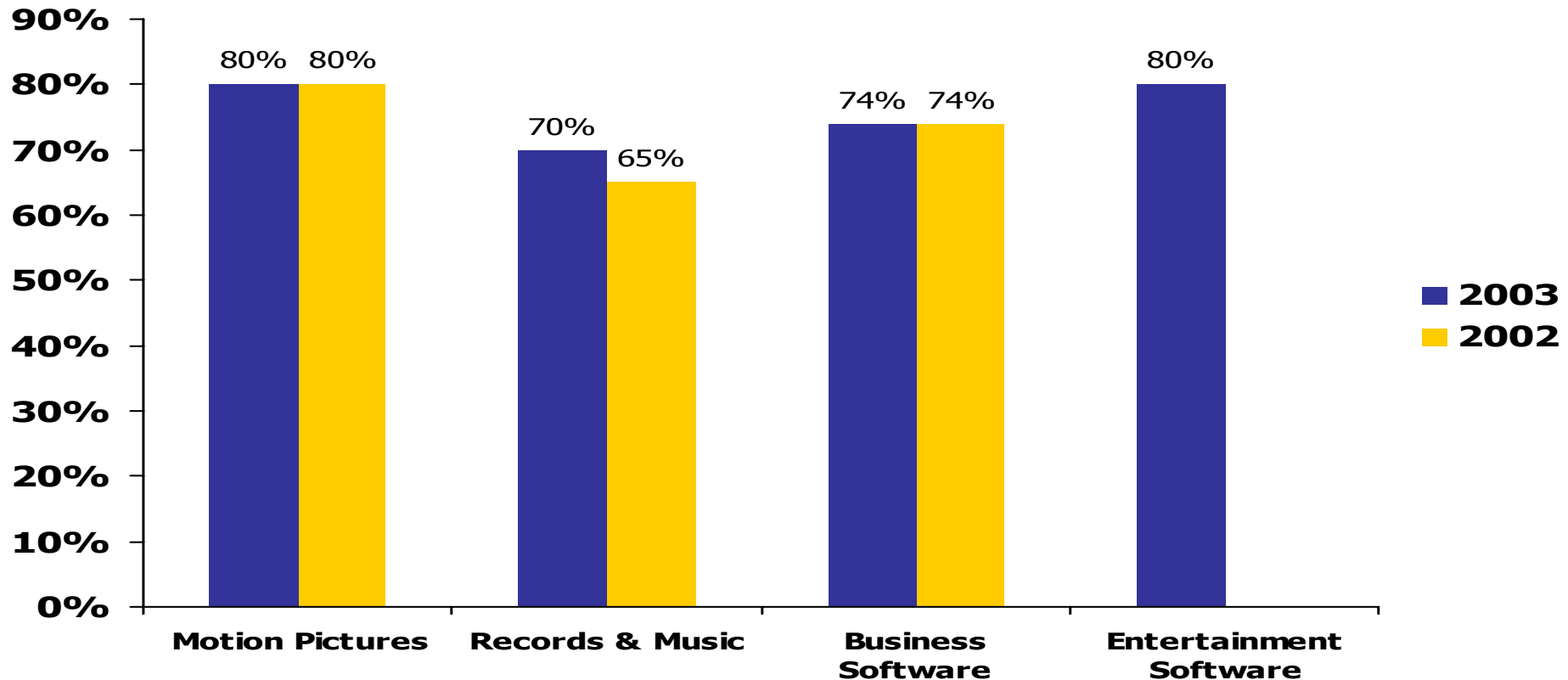
- **Member since March 1, 2003**
- **Access to the European Union**
- **Lebanon has signed a preliminary agreement with the European Free Trade Association**

World Trade Organization

- **Lebanon observer member since 1999**

The enforcement of Intellectual Property Rights remains weak

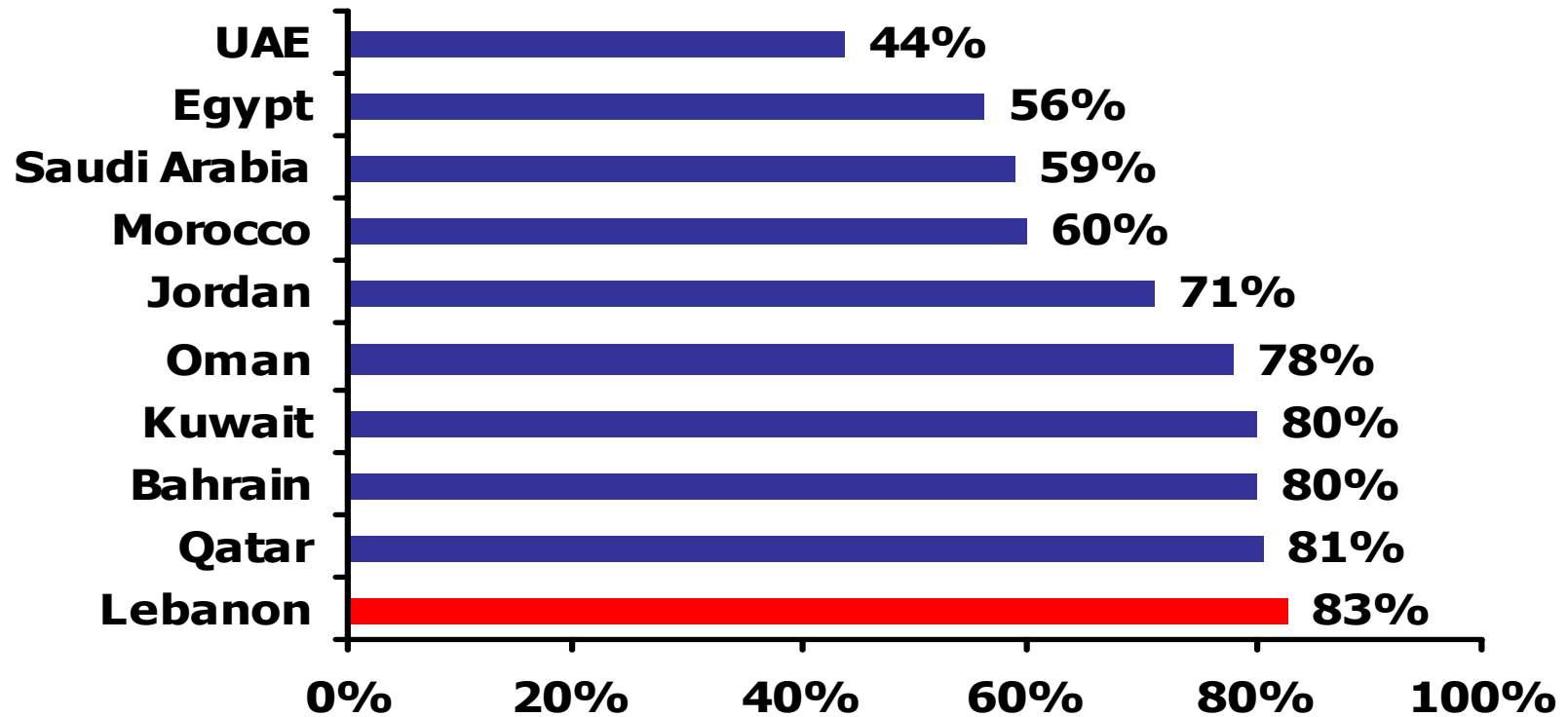
**Estimated Losses Due to Piracy and Piracy Levels in Lebanon
(Losses in US\$ millions)**



Source: International Intellectual Property Alliance

Lebanon has the highest software piracy rate in a selection of Arab countries

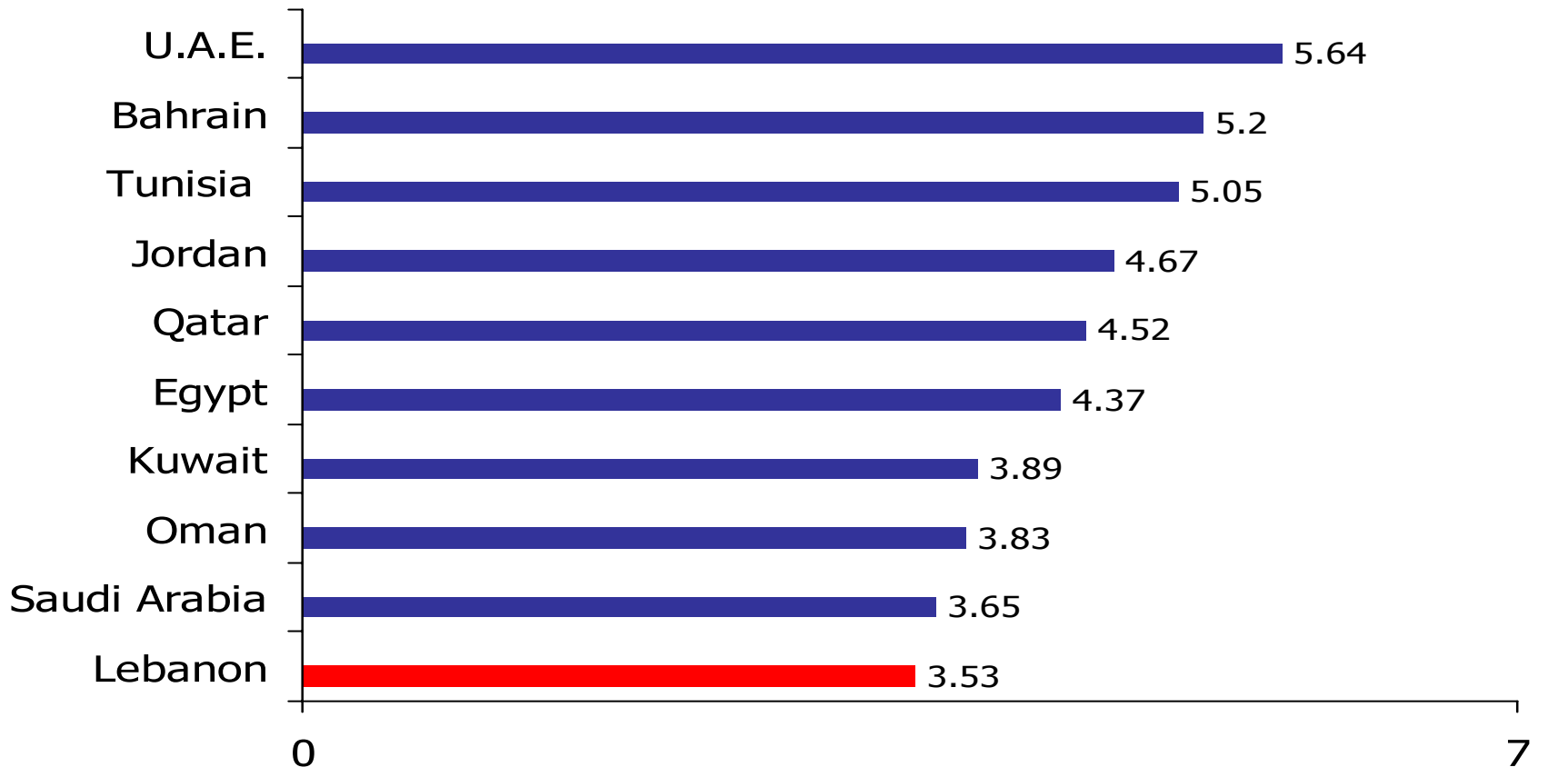
Arab Software Piracy Rates, 2000 (in Percent)



Source: Business Software Alliance, 2001

Intellectual property protection is judged as weak/non-existent

*Intellectual property protection in your country is:
Scale 1= weak or non-existent, 7= equal to the world's most stringent*



Source: Arab World Competitiveness Report

Dispute resolution is highly burdensome in terms of cost, duration and overall complexity

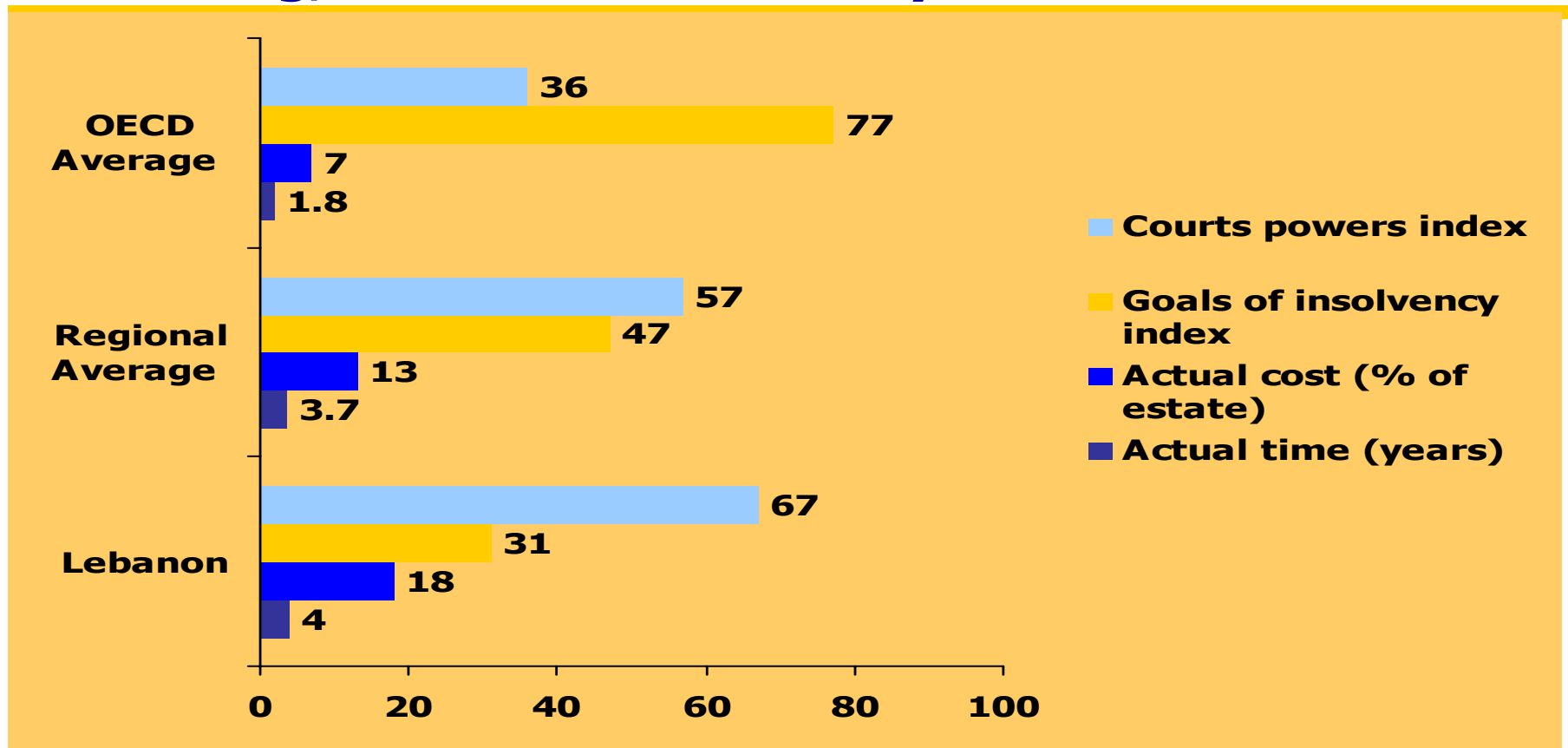
Indicator	Lebanon	Regional Average	OECD Average
Number of procedures	27	22	17
Duration (days)	721	297	233
Cost (% of Gross National Income per capita)	54.3	15.6	7.1
Procedural complexity index	67	61	49

Costs include court costs and attorney fees, as well as payments to other professionals like accountants and bailiffs

Procedural complexity index ranges from 0-100

C. Exit

Closing a business in Lebanon is also costly and time-consuming, with assets relatively insolvent

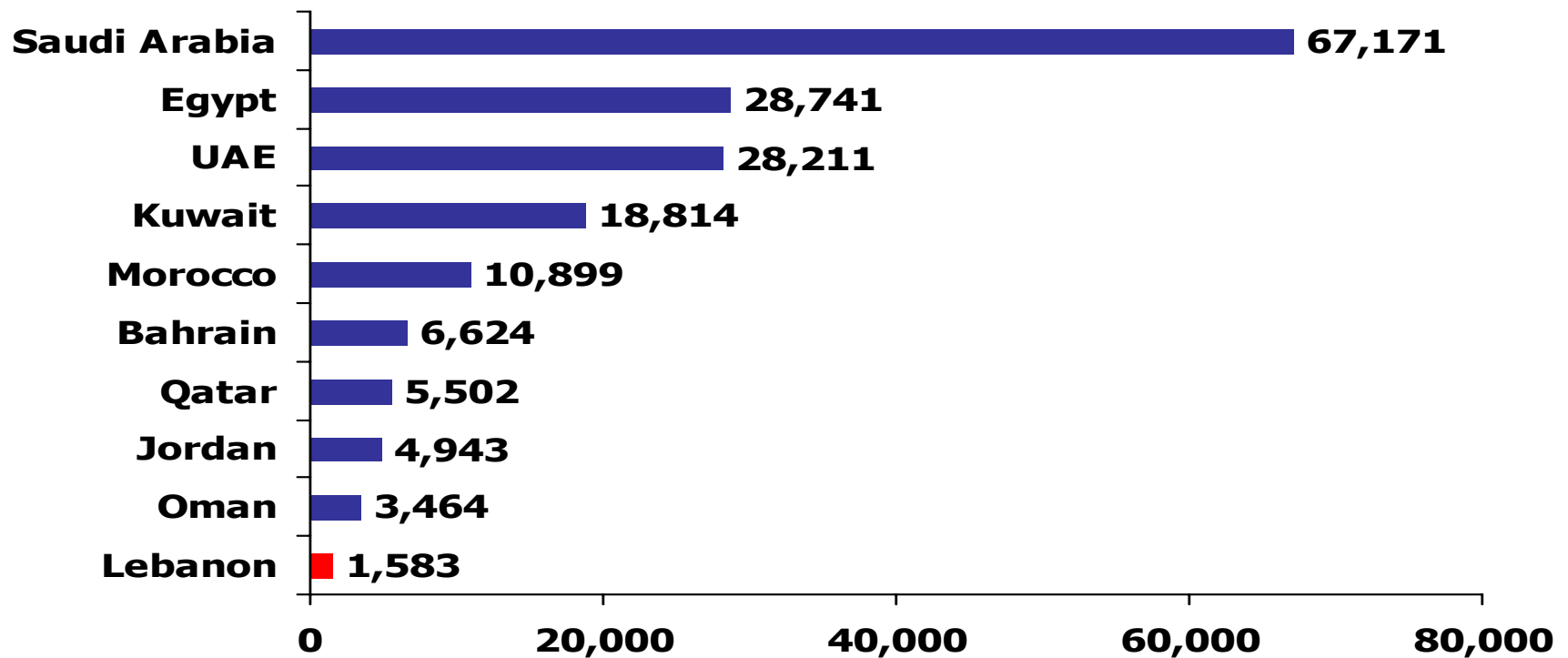


scores indicate less cost), time or insolvency (rescaled from 0 to 100, where higher scores indicate less time), the observance of absolute priority of claims, and the efficient outcome achieved. The index ranges from 0 (insolvency system does not function at all) to 100 (perfect efficiency)

Courts power index is an average of three indicators: whether the court appoints and replaces the insolvency administrator with no restrictions imposed by law, whether the reports of the administrator are accessible only to the court and not creditors, and whether the court decides on the adoption of the rehabilitation plan. The index is scaled from 0 to 100, where higher values indicate more court involvement in the insolvency process

Lebanon's capital markets remain underdeveloped, which leaves no exit strategy to investors

Market Capitalization as of December 31, 2000 (US\$ millions)



Source: World Bank and Middle East Economic Digest, July 2002

V. Policy Recommendations

The biggest challenge to investment in Lebanon is the critical macroeconomic environment, which detracts new investments

CCIAB and private sector can lobby for the following

- ▶ **Government has to seriously address deteriorating fiscal situation (deficit, debt service)**
- ▶ **This is needed to reduce risk rating and to lower cost of capital to investors (i.e. lower interest rates in Lebanon)**
- ▶ **Government has to continue and give more priority to market expanding strategies (via trade agreements and deepening of trade liberalization), and CCIAB should be more involved in such agreements**

Another challenge is the lack of accurate and comprehensive data on investment

Immediate

CCIAB and private sector can do the following

- ▶ **Collect data from government agencies**
- ▶ **CCIAB to establish its own Investment Observatory**
 - ▶ **Monitor and document investments**
 - ▶ **Produce studies on the productivity of investments in Lebanon**
 - ▶ **Act as advocate for any investor**

A third challenge is the uncertainty resulting from the inadequate regulatory and administrative environment

CCIAB and private sector can lobby for the following

- ▶ **CCIAB to lobby GOL for**
 - ▶ **Re-engineering of all administrative processes interfacing with the private sector (investors in particular)**
 - ▶ **Clarity in requirements and transparency in administrative procedures**
 - ▶ **Upgrading of legislation**
 - ▶ **Commercial code: corporate governance**
 - ▶ **Labor laws and social security**
 - ▶ **Judicial reform: efficiency, speed**
 - ▶ **Strengthening IDAL**

A fourth challenge is the shortage of attractive large-scale, new investments

CCIAB and private sector can lobby for the following

- ▶ **Privatization and private participation in greenfield projects**
- ▶ **IDAL to serve as incubator and market large projects (e.g. BETZ)**

... Keeping in mind that over 90% of FDI in developing countries has come from privatization

Direct impact

Privatization attracts foreign investors who acquire SOEs, the right to develop a new infrastructure facility, or the right to deliver infrastructure services

When accompanied by measures to liberalize the market and open it up to competition, privatization brings in new investments

Indirect impact

Privatization attracts foreign portfolio investments through developing capital markets that provide investors with a liquid market (an exit strategy)

Catalytic impact

Privatization puts the developing country on investors' "radar screen"

Commitment to privatization and liberalization gives firm evidence to investors that political and regulatory risks are being reduced

The "demonstration effect" of a successful privatization can convince other foreign investors to follow suit and participate in subsequent privatization transactions

In addition, there is an urgent need to address the high cost of doing business in Lebanon

CCIAB and private sector can lobby for the following

- ▶ **Streamlining business processes to lower transaction cost**
- ▶ **Reform of VAT regime to maintain incentives for investments**
- ▶ **Privatize and liberalize infrastructure sectors**
 - ▶ **Telecom**
 - ▶ **Electricity**

Finally, and somewhat paradoxically, Lebanon needs to provide exit options in order to attract investors

CCIAB and private sector can lobby for the following

- ▶ **Capital markets reform**
 - ▶ **New regulatory framework**
 - ▶ **Incentives for private savings to be invested in equity funds**