Lebanese American University

School of Arts and Sciences

Responding to Globalization Challenges
Lebanon’s Participation in the
Great Arab Free Trade Area

By

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Responding to Globalization Challenges
Lebanon’s Participation in the
Great Arab Free Trade Area

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To the Man and Woman who guided and lit my way

Dad and Mom
# TABLE OF CONTENTS

<table>
<thead>
<tr>
<th>Section</th>
<th>Page</th>
</tr>
</thead>
<tbody>
<tr>
<td>List of Tables</td>
<td>iv</td>
</tr>
<tr>
<td>List of Figures</td>
<td>v</td>
</tr>
<tr>
<td>List of Abbreviations</td>
<td>vi</td>
</tr>
<tr>
<td>Acknowledgements</td>
<td>vii</td>
</tr>
<tr>
<td>Abstract</td>
<td>viii</td>
</tr>
<tr>
<td>Introduction</td>
<td>1</td>
</tr>
<tr>
<td>Chapter I. The Global Trading System</td>
<td>7</td>
</tr>
<tr>
<td>A. The New Global Trading System</td>
<td>7</td>
</tr>
<tr>
<td>1. Basic features</td>
<td>7</td>
</tr>
<tr>
<td>2. Challenges and Gains from Trade Liberalization</td>
<td>15</td>
</tr>
<tr>
<td>a. opportunities offered by Globalization</td>
<td>15</td>
</tr>
<tr>
<td>b. Challenges</td>
<td>20</td>
</tr>
<tr>
<td>B. MENA Countries in the Trading System</td>
<td>26</td>
</tr>
<tr>
<td>1. Factors affecting the region’s Performance</td>
<td>26</td>
</tr>
<tr>
<td>a. High Population Growth and Low Productivity</td>
<td>27</td>
</tr>
<tr>
<td>b. Lagging Political and Institutional Reform</td>
<td>32</td>
</tr>
<tr>
<td>c. Large public Sector</td>
<td>33</td>
</tr>
<tr>
<td>d. Underdeveloped Financial Markets</td>
<td>34</td>
</tr>
<tr>
<td>e. High Trade Restrictiveness</td>
<td>35</td>
</tr>
<tr>
<td>2. Future Challenges and Reform policy</td>
<td>36</td>
</tr>
<tr>
<td>a. Changing the Role of the State</td>
<td>38</td>
</tr>
</tbody>
</table>
b. Upgrading the Infra structure

c. Privatization

d. Political and Institutional Reform

e. Fiscal Reform

f. Developing the Financial Market

g. The peace Process

h. forming regional Blocks

Chapter II. Lebanese Economy and Challenges of the Nineties

A. The Cost of the Civil War

B. Lebanese Post-War Economy

1. Post Civil War Reconstruction

2. Major Economic Sectors

   a. Services

   b. Industry

   c. Agriculture

3. The Debt Problem and International Assistance

   a. Public Debt

      a1. Domestic Debt

      a2. External Debt

   b. Government’s Measures and Efforts

   c. Paris II Conference and its Aftermath

C. The Lebanese Government and the Adjustment Process

1. Privatization Plan
2. Fiscal Development  

Chapter III. Lebanon’s Participation in the Great Arab Free Trade Area  

A. Lebanon and the Great Arab Free Trade Area (GAFTA)  

1. Origins and Importance of the GAFTA  

2. Position of Lebanon in the GAFTA  

   a. The Trade Agreement with Egypt  
   b. Trade Relations with Jordan  
   c. Free Trade Area with the GCC  

B. Basic Controversies in trade and Economic Relations with Syria  

1. Basic Facts about the Lebanese-Syrian Relations  

2. Trade Agreements with Syria  

C. Local Responses to Trade Liberalization with the Arab Region  

Conclusion  

Appendix I  
Appendix II  
Bibliography
Table

1.1 Share of different regions in world manufacturing output since 1970 12
1.2 Total population in the Arab countries 29
2.2 Distribution of Crop production over the Cultivated Area in 1998 63
2.3 Gross and Net Domestic Debt as percentage of GDP (1996-January 2004) 66
2.5 Domestic Debt Structure-by instrument (Billions of LBP) 69
2.6 Monthly Disbursement from paris II Lender countries (millions of US $) 83
2.7 Overall Weighted Average Cost of outstanding Public Debt 84
2.8 Evolution of Primary Market Treasury Bill Yields 85
3.1 Trade Partners (1997-2001) 96
3.2 Trade Patterns (1997-2001) 96
3.3 Intraregional Trade 107
3.4 Lebanese Exports 2000-2002 117
3.5 Lebanese Imports 2000-2002 117
Figure

1.1 Developing Region’s share in FDI, 1999  
3.1 Lebanese Trading Partners (total exports in 2000)  
3.2 Lebanese Trading Partners (total imports in 2000)
List of Abbreviations

APEC               Asia Pacific Economic Cooperation
ASEAN              The Association of South East Asian Nations
GATT               General Agreement on Tariffs and Trade
WTO                World Trade Organization
EU                 European Union
NAFTA              North American Free Trade Agreement
GCC                Gulf Cooperation Council
MTNs               Multilateral Trade Negotiations
MFN                Most Favored Nation
RTAs               Regional Trade Agreements
NICs               New industrialized Countries
GDP                Gross Domestic Product
GNP                Gross National Product
LDCs               Less Developed Countries
MNCs               Multinational Companies
OECD               Organization for Economic Cooperation and Development
MENA               Middle East and North Africa
TFP                Total Factor Productivity
FDI                Foreign Direct Investment
IMF                International Monetary Fund
BOT                Build-Operate-Transfer
VAT                Value Added tax
GAFTA              Great Arab Free Trade Area
FTA                Free trade Area
ACC                Agricultural Coordination Committee
IDAL               Investment Development Authority of Lebanon
ALI                Association of Lebanese Industrialists
NSSF               National Social Security Fund
OPEC               Organization of Petroleum Exporting Countries
UNDP               United Nations Development Program
FFD                Fund for the Displaced
COS                Council of the South
CDR                The Council for Development and Construction
CSB                Civil Service Board
NERP               National Emergency Reconstruction program
BCD                Beirut Central District
UNIDO              United Nations Industrial Development Organization
IFC                International Finance Cooperation
UNDCP              United Nations International Drug Control Programme
FATF               Financial Action Task Force
AMF                Arab Monetary Fund
UNESCO             United Nations Educational, Scientific and Cultural Organization
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I think if any of us honestly reflects on who we are, how we got here, what we think we might do well, and so forth, we discover a debt to others that spans written history. Many people have been a part of my graduate education, as friends, teachers, and colleagues. To try and thank everyone who contributed to this project would be impossible. Many people affected my thinking and gave me ideas for this project; I could certainly never remember all of them. The achievement of this study has been impossible without their assistance and support. I would like to gratefully acknowledge the enthusiastic supervision of Dr. Richard Friman, Dr. Sami Baroudi, Dr. Duane Swank, and Dr. Lowell Barrington for their attention, guidance, comments, encouragement and criticism during this research and the preparation of this thesis that enabled me to finish it. I also appreciate the assistance of Dr. Fawaz Traboulsi and Dr. Walid Moubarak.

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AN ABSTRACT OF THE PROJECT

Responding to Globalization Challenges
Lebanon’s Participation in the
Great Arab Free Trade Area

The objective of this study is to analyze the position of the Middle East and North Africa in the globalization era with Lebanon’s participation in the GAFTA as a case study. It aims to study in depth the position of the Lebanese economy in the region specifically and in the world generally. It studies all the challenges that are facing the MENA region and the Lebanese economy and what are the necessary steps that these countries must take to be able to benefit from the trade system. It also studies the history of the Lebanese economy and the redevelopment process. It tries to answer the question if the development of the Lebanese economy is enabling it to face the challenges of the trade liberalization and competition in the region. The study concludes by suggesting measures to be considered in the frame of a comprehensive economic reform plan.
No one single person can say with complacency, “your end of the boat is sinking.” In terms of economic, financial and social development, we are all in the same boat. We must set sail together.

Mike Moore (2000)

Introduction

For more than a century, the driving force behind globalization has been the expansion of trade in goods and services. Trade liberalization, or the removal of barriers to competition, is a dominant component of the new free market economic policy. Trade liberalization includes the removal of both border barriers, such as tariffs and exchange controls, as well as internal restrictions, such as directed credit and favored purchasing.

Successive rounds of multilateral trade negotiations under the General Agreement on Tariffs and Trade (GATT) have been an important part of globalization. These successive rounds resulted in trade liberalization, as well as replacing the GATT with the World Trade Organization (WTO). The flourishing of the WTO in addition to other international institutions such as the European Union (EU), the North American Free Trade Agreement (NAFTA), ASEAN, MERCOSUR and the World Bank has underpinned cooperation among states and helped global integration. The move toward trade liberalization and globalization has been facilitated by continuing advances in technology and infrastructure that have reduced the costs of transportation and communication between different parts of the world. Diminishing costs of communication and transport are increasing the pace of international economic integration, which has become the primary “driver” of globalization.
Clearly, social, political and economic circumstances have differed greatly among countries so that it was neither practical nor desirable that trade liberalization should take the same form, follow the same sequence in every country, or have the same effects on all countries. Indeed, a wide variety of specific reforms have been undertaken under the mantle of trade liberalization, often with different results. Such reforms have included macroeconomic stabilization policies, tax reform, liberalization of international capital flows, legal reforms, educational reforms and administrative and political reforms.¹

Trade liberalization in developing countries (including the Middle East and North Africa) has been largely promoted by the World Bank and IMF since the beginning of 1980s. The main argument of these institutions in favor of trade liberalization has been that it can lead to reallocation of resources between sectors to increase economic efficiency, and hence can benefit the nations. Policy makers of major developed countries, regional organizations including the EU and some multilateral organizations envision trade liberalization as one of the most efficient means of reducing poverty and creating development for all especially the developing countries. It is assumed that by “liberalization of barriers to trade in goods and services” and “establishing a hospitable environment for private sector investment… poor people will find routes out of poverty from the expansion in farms and enterprise.”² However, protests against globalization, such as those at the Seattle meeting of the World Trade Organization in 1999, and in Genoa in 2001, and the increase of the gap between the rich developed countries and the

poor developing countries show that there are problems with liberalization that must be solved.

In this era of globalization, almost all Middle Eastern countries and societies have felt the effects of neoliberalism, which has become the predominant global economic trend during the past twenty years. Questions such as how quickly to open markets to foreign competition, what sectors to focus upon and what sequence of policies to follow, all generate important differences in opinion.

These differences arise from a variety of factors, some political and social, others economic. One major reason for competing views and interests is that the reduction of barriers to trade will benefit some and hurt others. While economists emphasize the long-run gains from trade, policy makers are in many cases worried about the short-run costs. Trade liberalization will change the setting in which an economy functions and will set off a number of adjustments.

This study tries to answer several questions concerning the challenges and opportunities of the new trading system with respect to the Arab countries and with emphasis on Lebanon. How has the Middle East region coped with the impact of globalization? What kind of policies have respective governments implemented in response to the challenges of globalization? What are some of the perceived threats to the region? How have the Arab countries responded to these threats? What is in store to the region in the near and distant future, given current trends in response to globalization? Lebanese policy makers are certainly aware of the pressures of globalization and the potential competitive challenges posed by a peaceful relationship with Israel. To what extent have they developed the appropriate policies to deal with these pressures? What
are the problems and pressures that hinder the needed economic development to prepare Lebanon to face the challenges of globalization and an era of peace? What is the role played by Lebanon as an Arab country? How is Lebanon responding to globalization through regional integration?

While writing this research, I faced several problems. One was the collection of data which at several times was contradictory. To solve this problem, I relied on multiple sources to check for consistency. I also relied on my experience in dealing with Lebanese data sources. Also I faced a problem in addressing the unequal relationship between Syria and Lebanon, and the role of some self-interested political parties in the economic policy process. These subjects are considered taboo in Lebanon, given the prominence of the Syrian interpretation of the Lebanese sovereignty. However, I have sought to deal objectively and academically with these issues.

This study seeks to answer the questions posed in the introduction. I will deal with the Great Arab Free Trade Area (GAFTA), the agreements signed by Lebanon in pursuit of it, and the Lebanese government’s efforts to benefit from these agreements and from globalization. Lebanon, as well as all countries, cannot ignore globalization and its effects. In attempting to re-establish Lebanon’s position on the international economic map, Lebanon signed the Association Agreement with Europe on June 17, 2002. As for joining the WTO, Lebanon is currently working hard to be part of it. So, Lebanon is aware of globalization and its effects and is working hard to benefit from it and be able to face its challenges. For that reason, the first chapter will lay out the debate over the impact of globalization, its basic features, and the challenges and benefits from trade

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liberalization. It also will discuss the position of the Arab countries in this trading system examining the factors affecting the region’s performance, and necessary reform policies.

After talking about globalization, I thought it is important to discuss the Lebanese economic situation. I cannot discuss the GAFTA before knowing the Lebanese situation. Although it is a small country, but it is unique in the region since none of the GAFTA countries examined a 17-year civil war that destroyed the country. Given the vague situation prevailing at the end of the war, the Lebanese governments had to start reconstructing the economy. Will this small country, Lebanon, be able to face other small countries in the GAFTA? Therefore, the second chapter will lay out a broad overview of Lebanese economic and political history with a special emphasis on the domestic institutions and actors in trade policy making. Chapter two will deal with the cost of the civil war, the post-civil war period and the reconstruction process. Also it will talk about the costs of reconstruction, the debt problem, government’s efforts to develop the economy, and international and regional assistance. It will emphasize the problems facing the Lebanese government such as the political struggle, the influence of some political parties on the policy making, and the Syrian influence. These problems are hindering privatization and many other plans and contributing to the failure of the government to take the necessary steps to face economic problems and facilitate the adjustment process with respect to globalization and regional integration.

The third chapter will explore areas for cooperative policies in the future of Lebanon’s relations with Syria and other Arab countries. This chapter also will discuss the importance of the Great Arab Free Trade Area in the era of globalization, the effect of the GAFTA on Lebanon and its position in it. In addition, it will examine the different
fields of cooperation for Lebanon with each of Egypt, Jordan and the GCC where trade agreements were signed in the quest to form the GAFTA. It also will focus on the basic controversies and economic relations with Syria, where it will study the basic facts about the Lebanese-Syrian relationship and the agreements signed between the two countries.

The conclusion will contain some remarks and comments on the Lebanese economy not only domestically but also with respect to regional and international aspects. It will also suggest some recommendations that will be directed not only to the Lebanese government in its public sector, but also to the private sector that will play a major role in the era of the new trading system, and in the phase after peace with Israel.
Chapter I: The Global Trading System

A. The New Trading System

While economic theory suggests that countries should pursue liberal trade policies and exchange goods and services on the basis of their comparative advantage, in practice most nations actively intervene in international trade. Since 1947, the GATT has been the major focal point for industrialized countries seeking to lower trade barriers. The principles of the GATT helped governments to liberalize trade and to decrease the level of protection. This served in fostering greater integration of the global economy through trade.4

1. Basic Features

Although there might be some disagreements as to the beginning of globalization, many economic observers have documented the qualitative and quantitative changes in the nature of trade, investments, and capital flows.5 Capital flows and international trade are central to the globalization process. But trade in goods and services has captured special attention.

International trade has been the important driving force of globalization along with the rapid technological developments—especially in information and communication technologies, telecommunications, and transport. Trade has contributed to the enormous benefits that have flowed from mutual interdependence among nations and from integration of the global economy.6 The objective of this section is to introduce

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the reader to the World Trade Organization (WTO), and recent transformations in the
global trading system. A great deal of liberalization has taken place in both the
developing and industrial economies at an uneven pace over the last half-century.\(^7\)

The WTO is a vitally important multilateral body in a globalized economy. It
replaced the General Agreement on Tariffs and Trade (GATT) in 1995 after the Uruguay
Round.\(^8\) The new trading system has been built upon the old. Over the past half-century,
eight rounds of multilateral trade negotiations (MTNs) took place. The WTO has
inherited half a century of MTN-related knowledge and expertise of the GATT, which
established a substantial body of trading regulations. However, compared to the GATT,
WTO obligations apply to larger share of global commerce. The most significant
difference between the GATT and the WTO is the so-called “single undertaking”, which
implies that members must accept all the obligations of the GATT and its corollary
agreements negotiated in the Tokyo and Uruguay rounds. For developing countries, this
will obligate them to substantially more trade obligations than previously required under
the GATT.\(^9\)

As of April 4, 2003, the WTO is made up of 146 members with 30 countries
acting as observers, in the process of accession.\(^10\) Compared to the GATT, the WTO is
much more powerful because of its institutional foundation and its dispute settlement
system. Countries that do not abide by its trade rules are taken to court and can

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\(^7\) Ibid.
conference on Facing the Euro-Med Challenge: The Fiscal Dimension*, Marrakech-Morocco, 12-16 May
1997.
eventually face retaliation. The WTO includes several basic objectives: trade and economic endeavor should be conducted with the aim of raising standards of living, ensuring full employment, and a large and steadily growing volume of real income. It is considered a set of agreements that has binding rights and obligations for its members. The schedules of tariffs and other limitations on imports of goods and services attached to the respective agreements create similar binding rights and obligations for its members. Agreements and schedules are negotiated mutually and agreed upon by all WTO members. According to Sampson, the WTO is an intergovernmental forum where delegations from member countries meet to discuss and negotiate a number of trade matters. They analyze and discuss recent developments in the multilateral trading system. WTO members also negotiate to liberalize trade and to change the rules they consider necessary.

The basic philosophy of the WTO is the principle of non-discrimination. It has two components, the MFN rule (Most Favored Nation) treatment and the national treatment principle. Both components are embedded in the main WTO rules on goods, services and intellectual property. The principle of Most Favored Nation represents non-discrimination in treating other member states. Any treatment given to a certain member country had to be extended to all other member states. That is, foreign commodities have to be treated without differentiation from local products within the market. The members have the right to benefit from any advantage provided from one member to

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14 Bernard Hoekman and Michel M. Kostecki, op. cit, pp. 28-29.
another. It is a basic pillar for promoting and encouraging free trade on the international level.\textsuperscript{15} However, there are several exceptions to the Most Favored Nation principle. First, members are allowed to initiate free trade zones. This meant exempting products of certain countries from customs. This exemption contradicts with the principle of Most Favored Nation. But, such a contradiction to the WTO regulations would be tolerated in such a case. The second exception is bilateral agreement between two member states. Yet there are some conditions that need to be respected for the two exceptions to be accepted by the WTO. The National Treatment principle implies the equal treatment of the foreign and domestic products in the local market. As foreign products pass customs, they have to be treated as any local product.\textsuperscript{16} Although WTO obligations are legally binding, they do not rule out the possibility of members agreeing to forgo their rights by undertaking obligations in other agreements that provide for measures that would otherwise violate WTO rules.

As an institution, the WTO lays the legal foundation of the global trading system. There are also some international economic institutions that place legally binding obligations on their members. However, the WTO is unique both in the extent of its contractual obligations and in the enforcement mechanism built into its system for resolving disputes. At the end of an integrated dispute settlement process, there lie multilaterally agreed and authorized trade sanctions. This is a vitally important feature of the WTO, and colors everything that occurs in the WTO context.\textsuperscript{17}

\textsuperscript{15} Fadi Makki, \textit{Ma Bayn al-GATT wa Munazamat al-Tijarah al-`Alamiyyah: Lubnan Amam al-Istihqaq}, (Between the GATT and the WTO: Lebanon Faces the Challenge), Lebanese Center for policy Studies, Beirut, 2000, p. 32.
\textsuperscript{16} Ibid, p. 35.
\textsuperscript{17} Dilip K. Das, op. cit, p. 4.
The percentage of goods and services produced in the global economy and traded internationally is expanding progressively. International trade now encompasses a much larger share of commodities than it did at the beginning of the twentieth century. It increased from 20 percent in the late nineteenth century to more than 40 percent at the end of the twentieth. Trade in services has expanded from insignificant to almost one-third of total global trade. Against the background of a general decline in direct trade restrictions, market openness has increased considerably over the past half-century. The present volume of global merchandise trade has almost tripled as a share of GDP, where it became sixteen times what it was in the 1950. Trade in service transactions has also become one of the fastest growing components of world trade since the early 1980s.\textsuperscript{18}

During the past half-century, we can identify four trends in the global trading system: “uneven liberalization of markets for trade in goods in both developing and industrial economies (excluding agriculture), increasing differentiation of treatment for different levels of developing countries, a growing number of regional trading agreements (RTAs) among both developing and industrial economies, and the expanding scope and strength of trade regulations.”\textsuperscript{19}

At the dawn of the twenty-first century, the global system finds itself at a crossroads, since free trade has rarely been a popular cause. The brief history of the international free trade presents numerous glaring example of this. During the 1960s and the 1970s, industrial economies increasingly adopted trade liberalization. The GATT provided them with a framework for a coordinated multilateral liberalization of trade.

\textsuperscript{18} Ibid, p.5.
Successive GATT rounds of multilateral trade negotiations (MTNs) served in reducing tariffs. As for the developing economies, during the same period, they ignored liberalization and pursued inward-looking strategies, where tariffs, quotas, and exchange payment restrictions increased.\textsuperscript{20}

Developing economies were not able to ignore liberalization for very long. Since 1980, the developing countries have undergone a sea-change by abandoning import-substituting industrialization strategy under the pressure of debt and the balance-of-payments crises. The achieved greater success by integrating into the world economy through liberalization of trade, finance, and investments. Benefits from trade liberalization for developing countries were not even. From 1970 to 1995, the share of developing countries in world industrial output rose; however this was due to the rapid industrial growth in East Asia. Since 1980, the share of Latin America and Africa has fallen, while at the same time, industrialized countries’ shares in world industrial output fell.\textsuperscript{21}

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\textsuperscript{a}South Asia is composed of Bangladesh, India, Nepal, Pakistan and Sri Lanka

Source: Trade Development Report 1997, UNCTAD, p. 82.

Table 1.1 shows that in 1970, Latin America and Asia started with similar shares in world manufacturing output; but after 25 years, Asia finds itself far ahead of Latin

\textsuperscript{20} Dilip K. Das, op. cit, p. 6.
\textsuperscript{21} Alice Landau, op. cit, p. 71.
America. However, Asia is not so homogeneous a region; there are differences between a first tier composed of Hong Kong, the Republic of Korea, Singapore, and Taiwan and second-tier Asian countries, including Malaysia, Thailand, Indonesia, and China. Second-tier Southeast Asian (New Industrialized Countries) NICs have been less successful in anchoring in high-technology niches than the first-tier East Asian countries.\(^{22}\)

Trade in services transactions became the new area of trade liberalization. Most industrial economies took increasing interest in opening up global trade in services. Since the initiation of the Uruguay round, numerous developing economies started liberalization movements that covered their commercial services industries as well. By the early 1990s, developing economies were liberalizing their service transactions faster than the industrial ones. As a group, industrial countries are larger traders in commercial services. This does not mean that developing economies do not have significant stake in the performance of international trade in services. Over the last three decades, developing countries as a group have recorded faster growth of trade in commercial services than the industrial economies.\(^{23}\)

It has become a standard refrain in policy circles that expanded trade holds the key to prosperity for developing countries. According to this view, if the industrialized countries would reduce their trade barriers, especially in apparel and agriculture, this would provide a basis for growth in developing countries, pulling hundreds of millions of people out of poverty and unemployment. As the World Bank wrote in its latest *Global Economic Prospects*: “A reduction in world barriers to trade could accelerate growth,

\(^{22}\) Ibid, pp. 71-72.  
\(^{23}\) Dilip K. Das, op. cit, p. 7.
provide stimulus to new forms of productivity-enhancing specialization, and lead to a more rapid pace of job creation and poverty reduction around the world."^{24}

The evidence for this view is considerably less compelling than its proponents imply. While there are certainly reasons for believing that expanded trade can help to promote growth in developing countries, it is unlikely that trade liberalization, by itself, will qualitatively improve the plight of people in the developing world. In fact, there are possible scenarios in which trade liberalization can actually lead to worse outcomes for developing countries.

Moreover, it is not clear that trade liberalization is the key to rapid growth and development. It is worth noting that the major success stories in the developing world—most notably South Korea and Taiwan, which now have income levels comparable to the poorer industrialized countries, but also countries that have more recently experienced accelerated growth rates, such as China and India—have not followed a simple path of trade liberalization. In all of these countries the government has played an important role in guiding the economy. This guidance has included subsidies and protection for favored industries and restrictions on capital flows, policies generally opposed by the leading proponents of trade liberalization. In many respects, the path of trade liberalization currently promoted by the WTO, the World Bank and others can be seen as contradictory to the development strategies that have proven most successful in the post-war period.^{25}

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2. Challenges and Gains from Trade Liberalization

Adam Smith in his book *The Wealth of Nations* extolled the merits of trade liberalization, openness, and competition. It is easy to recognize the three essential sources of economic growth, specifically, growth in inputs, improvements in efficiency of allocation, and innovation. Being open to trade and investment contributes to each of the sources of growth. The process of trade and liberalization addresses the removal of incentives to import substitution.\textsuperscript{26}

Trade liberalization process addresses the elimination of incentives to import substitution. Growth spurred under an import substitution strategy slows over time; trade liberalization is associated with more rapid growth than the final phases of the import substitution strategy that precedes it. So trade liberalization offers the only known way to escape from the ever-slowing growth rates of developing countries. Any considerable degree of relaxation of restrictiveness can result in gains, unless there are other policies in force in the economy that prevent their impact. Trade liberalization undertaken from a period of declining growth rates or even falling GDP can lead to a period of growth above the rates previously realized.\textsuperscript{27}

In order to judge whether trade reform will benefit the country, policy makers need to have a reasonably good idea of both the expected costs of adjustment associated with the reform, especially, how these costs compare with the expected gains.

\textbf{a. Opportunities offered by globalization}

This era of globalization is opening many opportunities for millions of people around the world. Increased trade, new technologies, foreign investments, expanding

\textsuperscript{26} Dilip K. Das, op. cit, p. 9.
\textsuperscript{27} Ibid.
media and Internet connections are fuelling economic growth and human progress. All this offers enormous potential to eliminate poverty in the twenty first century. There is more prosperity and technology—and more commitment to a global community—than ever before. Global markets, global technology, global ideas and global solidarity can improve the lives of people everywhere, greatly expanding their range of choices, improving product quality, and exerting downward pressure on prices. It delivers an immediate gain to workers by raising the real value of their wages. However, today globalization is driven by market expansion—trade liberalization, opening national borders to capital, information—outpacing governance of these markets and their repercussions.  

Since the 1980s, many countries have seized the opportunities of globalization (economic and technological). Beyond the industrial countries, the newly industrialized East Asian tigers (Hong Kong, Singapore, Taiwan, and South Korea) are joined by Chile, the Dominican Republic, India, Mauritius, Poland, Turkey, and many others linking into the global markets, attracting foreign investment and taking advantage of technological advance. Their export growth has been more than 5 percent a year, and their standard of living is similar to that in industrialized countries.  

The Less Developed Countries (LDCs) have the most to benefit from engaging in the global economy. First, they gain access to much larger markets, both for imports and exports, especially after joining the WTO. On the import side, consumers gain access to a wide range of goods and services, raising their real standard of living. As for the domestic producers, they gain access to a wider variety and better quality of intermediate

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inputs at relatively lower prices. On the export side, domestic industries can enjoy a quantum rise in economies of scale by serving global markets rather than only a confined and underdeveloped domestic market.\(^30\)

Second, LDCs that open themselves up to international trade and investment gain access to a much higher level of technology. This confers on LDCs a “latecomer’s advantage”: rather than bearing the cost of expensive, up-front research and development, poor countries can import the technology off the shelf. They can incorporate new technology by importing capital equipment that embodies the latest developments and computers with the latest software. Subsidiaries of multinational companies (MNCs) also bring with them new production techniques and employee training, which improve the host nation’s stock of human capital.\(^31\)

Third, openness to the global economy can provide the infrastructure a developing economy needs for growth. Foreign capital can finance more traditional types of infrastructure, such as port facilities, power generation, and an internal transportation network. Moreover, multinational companies can provide infrastructure of what could be called “enabling services,” such as telecommunications, insurance, accounting, and banking. As China and India have realized, a protected and inefficient service sector weighs down an entire economy, hindering the development of manufacturing and other industries. LDCs need to discard the false idea that opening their economies up to international service competition is a “concession” to be made to gain access to farm and


\(^{31}\) Ibid.
manufacturing markets in the advanced economies. In reality, liberalizing their service sectors by opening them to foreign competition is a favor LDCs can do for themselves.32

Fourth, engagement in the global economy encourages governments to follow more sensible economic policies. Sovereign nations remain free to follow whatever economic policies their governments choose, but globalization has raised the cost that must be paid for inappropriate policies. With capital more mobile than ever, countries that insist on following anti-market policies will find themselves being dealt out of the global competition for investment. As a consequence, nations have a greater incentive to choose policies that encourage foreign investment and domestic, market-led growth. Thomas Freidman, in The Lexus and olive Tree, his 1999 book on globalization, describes these progrowth policies as “the Golden Straitjacket.” The increasingly manifest rewards of engagement encourage nations to unilaterally restrict the scope of government action. As Freidman explains:

“To fit into the Golden Straitjacket a country must either adopt or be seen as moving toward, the following golden rules: making the private sector the primary engine of its economic growth, maintaining a low rate of inflation and price stability, shrinking the size of its state bureaucracy, maintaining as close to a balanced budget as possible, if not surplus; eliminating and lowering tariffs on imported goods, removing restrictions on foreign investments, getting rid of quotas and domestic monopolies, increasing exports, privatizing state-owned industries and utilities, deregulating capital markets, making its currency convertible, opening its industries, stocks, and bond markets to direct foreign investment, deregulating its economy to promote as much domestic competition as possible, eliminating government corruption, subsidies and kickbacks as much as possible, opening its banking and telecommunications systems to private ownership and competition, and allowing its citizens to choose from an array of competing pension options and foreign-run pension and mutual funds.”33

32 Ibid.
While globalization may confront government officials with more difficult choices, the result for their citizens is greater individual freedom. In this sense, globalization acts as a check on governmental power, making it more difficult for governments to abuse the freedom and property of their citizens.

Any study nowadays, will confirm that nations relatively open to trade tend to be more prosperous than nations that are relatively closed. The wealthiest countries and regions of the world (Western Europe, the United States, Canada, Japan, Hong Kong, Taiwan, South Korea, and Singapore) are all trade-oriented. In contrast, the poorest regions of the world, such as the sub-Saharan Africa, remain the least friendly to foreign trade. As for those countries that have moved decisively toward openness (Chile, China, and Poland, among others) have reaped real gains in living standards.\(^{34}\)

Systematic studies confirm a strong link between openness and economic growth. A study of 117 countries by Jeffrey Sachs and Andrew Warner found that open economies grew much faster than closed economies. Specifically, they found that the developing countries that maintained open economies throughout the 1970s and 1980s grew at an average annual rate of 4.5 percent, compared with an average growth rate of 0.7 percent for closed economies. As a result, the open developing economies tended to converge toward the slower-growing rich economies, while relatively closed economies did not converge.\(^{35}\)

Globalization offers hope to the world’s poorest. Just as more open trade trends to promote economic growth, growth in turn leads to poverty reduction. A World Bank study found that periods of sustained economic growth are almost always accompanied

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\(^{34}\) Daniel T. Griswold, op. cit, p. 4.

by reductions in poverty. Specifically, the study found that poverty decreased in 77 out of the 88 decade-long periods of growth covered by the survey.\textsuperscript{36}

In the last two decades, great reductions in poverty occurred in countries that have moved decisively toward openness and domestic liberalization. The most impressive gains have been realized in East Asia. Between 1993 and 1996, the number of people living in absolute poverty—what the World Bank defines as less than 1 dollar per day—declined in the region from 432 million to 267 million. In China alone, the number of poor people decreased by 150 million between 1990 and 1997. The 1997-98 financial crises in East Asia brought a temporary halt to this progress, but poverty rates in the hardest-hit countries (Korea, Thailand, and Indonesia) have begun to decline back toward their pre-crisis levels. Globally, the number of people living in absolute poverty has declined in the 1990s to an estimated 1.2 billion in 1998.\textsuperscript{37}

Opponents of globalization try to blame poverty in the world on the spread of trade and investment liberalization. But those regions where poverty and inequality have been the most visible and intransigent for decades (Latin America, sub-Saharan Africa, and the Indian subcontinent) for most of that time self-consciously followed policies of economic centralization and isolation.

b. The challenges

The advance of globalization has not been a smooth or pain-free process. The changes it has caused, or is perceived to have caused, have spurred a political backlash—dramatically evident in the street protests that plagued the WTO ministerial in Seattle.


Two of the most common complaints against globalization are that it has undermined labor and environmental standards, and that it has increased the gap between rich and poor, both among and within countries.

Critics of globalization warn of its destructive results, as developed nations are obliged to weaken labor and environmental standards to compete with less-regulated producers in developing nations. This theory rests on the assumption that lower standards give LDCs a significant advantage in attracting global capital and gaining export markets at the expense of more developed countries. The OECD (Organization for Economic Cooperation and Development) has found that, in practice, a lack of core labor standards does not play an important role in attracting foreign investment or in enhancing export performance. The OECD did find evidence “that there is a positive association over time between sustained trade reforms and improvements in core standards.”38

In other words, trade liberalization encourages higher standards, not lower standards. For internal efficiency reasons, as well as public perceptions, multinational companies tend to impose higher standards on their overseas production plants than those prevailing in local markets, thus raising average standards in the host country. Free trade and domestic liberalization—and the faster growth they create—are the best ways to encourage higher standards. As per capita incomes rise in less developed countries, so does the domestic political demand for higher standards, and the ability of the productive

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sector to pay for them. Punishing LDCs with trade sanctions would only cripple their long-term ability to raise domestic labor and environmental standards.  

Another challenge of globalization is the opinion that economic liberalization has increased the gap between rich and poor countries, and between rich and poor within countries that have liberalized. This perception of the growing gap both among and within nations is broadly true. While some previously poor countries have managed to close the gap with the more advanced economies, a disturbingly wide number of countries have fallen further behind. According to the World Bank, the ratio of income per capita in the richest countries compared with that in the poorest rose from 38 in 1960 to 52 in 1985.  

Concern about the “marginalization” of poor countries in the global economic system has rightly focused on sub-Saharan Africa. Since the 1970s the region’s share in world trade has fallen from 3 percent to slightly more than 1 percent in the 1990s. While the flow of foreign direct investment to LDCs has risen dramatically in the 1990s, sub-Saharan Africa has been almost entirely overlooked. But the phenomenon of marginalization has not been a random event.

Poor nations that have fallen further behind rich nations are almost uniformly those that have clung to state-directed and inward-oriented economic policies. The most obvious variable that separates countries that are closing the gap from those falling further behind is their own domestic policy choices. Nations that have implemented more open, stable, and market-friendly policies began to catch up with advanced economies, while those that reject it become increasingly marginalized. There is nothing

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40 Poverty Trends and Voices of the Poor, World Bank: Social Indicators, op. cit.  
inherent in the process of globalization that would cause the gap between rich and poor nations to widen. In fact, the access to capital, new technology, and larger markets that comes with global integration should be expected to accelerate the convergence of less developed regions of the world and to make global trade and wealth less concentrated across countries. A 1998 study sponsored by the WTO found that global trade and investment flows have actually become less concentrated in the last two decades when adjusted for the growth in world trade. Moreover, the study found that the concentration of trade and financial flows has fallen among countries that have more rapidly liberalized, whereas it has increased among those that integrated more slowly. This proves that marginalization of individual countries from world markets can be explained by inward-looking domestic policies, and is not inherent to globalization.\textsuperscript{42}

Despite the progress in the post-war era, advanced-economy trade barriers remain stubbornly high against clothing, textiles, and agricultural goods, the very products in which the LDCs have a natural comparative advantage. The average tariff that rich countries impose on manufacturing goods from poor countries is four times higher than that average tariff rich countries impose on each other's goods, according to a study by Thomas Hertel of Purdue University and Will Martin of the World Bank.\textsuperscript{43}

Globalization can accelerate country's development, but only if its policymakers allow its citizens to hop onboard by opening the economy to international trade and investment. "This conveyor belt of growth provides new technology, investment capital, domestic competition, expanding export markets, and powerful incentives for further


\textsuperscript{43} \textit{Trade and development: White man's shame}, Economist, September 25, 1999, p. 89.
domestic policy reform." The result is faster economic growth and dramatic improvements in living standards within a generation or two. The fact that some nations insist on walking isolated, and often dead-end path is not the fault of globalization but their own policy makers.

There will always exist industries in which foreign competitors are more efficient than domestic producers. When import barriers on those industries' products are lowered, the foreign producers will be able to attract domestic consumers with lower prices. Domestic import competing firms in those markets will face downward pressures on sales and profits, which in turn can lead to pressure for lower wages, job losses and perhaps even company closures (as the case of most developing countries). Lower wages, job losses, and the prospects of lower returns to capital, will cause workers and capital to leave in order to find employment in other parts of the economy. Sometimes transitions from the previous employment to the new one take place relatively smoothly. When it is not, workers incur adjustment costs in the form of unemployment periods, along with moving expenses and retraining costs to gain new skills.\(^45\)

As for income inequality within nations is very complicated. The gap has been driven primarily by a difference in worker skills rather than by international trade. An information-based economy will naturally produce jobs that require more specialized and technical skills than a less developed economy, which is more weighted toward agriculture and industry. William Cline, in a study on the impact of trade on wages, concluded that international trade and immigration are unlikely to have the dominant effect in rising income inequality. He adds that skills-based technological change is by

\(^{44}\) Daniel T. Griswold, op. cit, p. 10.

far the largest identifiable contributor to the growth in income inequality. International trade and immigration together contribute only about one-tenth of the total unequalizing forces at work over this period.\textsuperscript{46}

Globalization is really just shorthand for expanding economic liberty across international borders. The debate it has spawned is the repackaging, on a global scale, of the long-running argument over whether the way to prosperity is through free markets or centralized government planning, or a way between the two. If you consider free markets as unleashing forces that are challenges to human happiness and must be controlled by effective government involvement, you will tend to see globalization as a danger. If you believe that free markets, operating within a rule of law, are essentially self-governing and lead, in the words of Adam Smith, “as if by invisible hand” to a greater general wealth, then you will tend to see globalization as a blessing.\textsuperscript{47}

As we saw, globalization brings opportunities as well as challenges for small states. The prospects for small states to benefit from globalization exist in both trade and other areas of endeavor as information and communications technology shrink distances and help overcome the disadvantages of remoteness and isolation. Small states have to respond to changes in the international environments and provide the right kind of public policy support—such as training and education, for example—to encourage new activities, many of which will be in the service sectors. In addition to the appropriate domestic policy, some small states need external support and advice. Globalization


\textsuperscript{47} Daniel T. Griswold, op. cit, p. 12.
affects different countries in different ways and a mix of unique responses will be needed to meet the individual circumstances of countries and regions.\textsuperscript{48}

**B. MENA Countries in the Trading System**

The MENA (Middle East and North Africa)\textsuperscript{49} region’s economy is at a crossroads. After more than a decade of poor or negative growth performance, a conjuncture of forces promises to change the region’s economic outlook. Globalization of the world economy, revolutions in transport and communications, and increasingly liberalized trade are creating new competitive challenges and new opportunities. Moreover, the new situation in the region after the invasion of Iraq and capturing Saddam Hussein, and the rise of fundamentalism are challenging traditional authoritarian regimes and policies. Young populations with weak employment prospects are calling for change, and opposition groups have become more active. Navigating these turbulent waters will require that the region’s leaders, businessmen, and citizens have a decisive vision of the way forward. So what is the situation in the Arab world? Why has growth in the region stalled? Will Arab countries be able to reform and modernize in good time? Does globalization represent a threat for the region, as many Arabs perceive, or is it an opportunity to accelerate the slow process of liberalization, modernization and integration in world economy?

1. **Factors affecting the region’s Performance**

The MENA region is an economically diverse region that includes countries with a common heritage, at several levels of economic development, and with different

\textsuperscript{48} Small States: meeting Challenges in the global Economy, Report of the commonwealth Secretariat/World Bank Joint Task Force on Small States, World Bank, April 2000, p. 44.

\textsuperscript{49} MENA Region Countries are: Algeria, Bahrain, Djibouti, Egypt, Iraq, Jordan, Kuwait, Lebanon, Libya, Mauritania, Morocco, Oman, Qatar, Saudi Arabia, Somalia, Sudan, Syria, Tunisia, United Arab Emirates, and Yemen, in addition to Afghanistan, Iran, Pakistan, and West Bank and Gaza.
endowment of natural resources. In spite of the benefit that the MENA region gained from the wealth created by the sharp increase in the oil prices in the 1970s, the region’s economic performance during the last 30 years weakened as growth rates declined and failed to generate the employment opportunities sought by the expanding labor force. This deterioration in economic conditions brought about pressures for economic reforms, which were undertaken by a number of countries during the mid to late 1980s and early 1990s.50

Clearly, it is risky to make generalizations about the growth performance of the region as a whole because each of the 24 economies has had its own experience, which in some way remains unique. Differences also exist between oil producers and non-oil producers, and between countries that have moved forward in the reform process and grew at higher rates and those that were less vigorous in pursuing reforms and fell behind. Nevertheless, the economic structure and institutions of the MENA countries do tend to exhibit common features and, given the need for a policy focus on the challenges and opportunities that face the region, there is a strong case for treating the region as a unit of analysis. Viewing the region as a whole, one may attribute the region’s weak economic performance to several reasons such as, high population growth and low productivity, lagging political and institutional reforms, large and costly public sector, underdeveloped financial markets, and high trade restrictiveness.51

a- High population growth and low productivity: The MENA region has had one of the highest rates of population growth in the world with a 2.5 percent annual increase over

the past 20 years. This rate is one of the main factors in the slow growth prospects for real per capita GDP. In developing countries, the population growth averaged 1.7 percent per year (during 70s and 80s). There were substantial differences in population growth rates, for example, Saudi Arabia’s population grew at an annual average rate of 4.2 percent in the 1970s, and although it decreased, it remained relatively high at 3.2 percent in the 1990s. Tunisia’s annual population growth declined from 3.4 percent in the late 70s, to 1.3 percent in the late 90s.\textsuperscript{52} According to the Arab Human Development report, the combined population of the region was about 280 million in 2000. Population size varies substantially by country, where Egypt has the largest population (68 million), followed by Sudan (31 million) and Algeria (30 million). At the other end of the scale, Qatar, Bahrain, Comoros and Djibouti have a population of less than one million each (See table 1.2). In global terms, the Arab countries account for about 5 percent of the world population.

More than two thirds of the population in most of the MENA countries are below 30 years of age. Over the last two decades, the labor force has grown in excess of population growth and is projected to grow at 3 percent per annum through 2010.\textsuperscript{53} The ensuing high and rising share of working age population could, under the appropriate circumstances, be seen as a demographic gift capable of contributing positively to growth rate in the region. However, this gift is not automatic because it has to be translated into employment growth and a skill mix that is demanded in the global economy. Moreover, other policies and institutions conducive to complementary growth need to be in place to support the growing working age population.

\textsuperscript{52} Ibid.
Table 1.2: Total population in millions

<table>
<thead>
<tr>
<th>Country</th>
<th>Year 2000</th>
</tr>
</thead>
<tbody>
<tr>
<td>Algeria</td>
<td>30.31</td>
</tr>
<tr>
<td>Bahrain</td>
<td>0.64</td>
</tr>
<tr>
<td>Comoros</td>
<td>0.71</td>
</tr>
<tr>
<td>Djibouti</td>
<td>0.63</td>
</tr>
<tr>
<td>Egypt</td>
<td>67.89</td>
</tr>
<tr>
<td>Iraq</td>
<td>22.95</td>
</tr>
<tr>
<td>Jordan</td>
<td>4.91</td>
</tr>
<tr>
<td>Kuwait</td>
<td>1.91</td>
</tr>
<tr>
<td>Lebanon</td>
<td>3.5</td>
</tr>
<tr>
<td>Libya</td>
<td>5.29</td>
</tr>
<tr>
<td>Mauritania</td>
<td>2.66</td>
</tr>
<tr>
<td>Morocco</td>
<td>29.88</td>
</tr>
<tr>
<td>Oman</td>
<td>2.54</td>
</tr>
<tr>
<td>Palestine</td>
<td>-</td>
</tr>
<tr>
<td>Qatar</td>
<td>0.56</td>
</tr>
<tr>
<td>Saudi Arabia</td>
<td>20.35</td>
</tr>
<tr>
<td>Somalia</td>
<td>8.78</td>
</tr>
<tr>
<td>Sudan</td>
<td>31.10</td>
</tr>
<tr>
<td>Syria</td>
<td>16.19</td>
</tr>
<tr>
<td>Tunisia</td>
<td>9.46</td>
</tr>
<tr>
<td>United Arab Emirates</td>
<td>2.61</td>
</tr>
<tr>
<td>Yemen</td>
<td>18.35</td>
</tr>
<tr>
<td>Arab Region (Total)</td>
<td>281.22</td>
</tr>
</tbody>
</table>


As for the income in Arab countries, GDP (Gross Domestic Product) in all Arab countries combined stood at US$ 531.2 billion in 1999, less than that of a single European country such as Spain (US$595.5 billion). At the same time the average annual rate of growth was 3.3 percent in the Arab world, an average slightly above the world average of 2.9 percent.54 Low growth rates observed during the 1980s continued into the 1990s, though some economies began to recover by the end of the decade.

The region economic growth averaged only 4.2 percent between 1991 and 1999, below the 6.8 percent average annual export growth in world trade. Another reason for the low-growth performance is the region’s low or often negative growth of total factor

54 Ibid, p. 85.
productivity (TFP), that is, the efficiency with which factors of production such as physical capital and labor are employed to generate growth. Most of the output growth in the region has occurred as a result of increase in capital and labor rather than in TFP, particularly in non-oil economies. A sustained rise in living standards is difficult if higher rates of accumulation of physical capital and labor are not accompanied by positive TFP growth, which is often seen as a prerequisite for employing the largely young labor force in the region while avoiding real wage erosion. We should not underestimate TFP growth in any growth analysis, since research shows that TFP growth accounts for about 60 percent of cross-country variations in output growth. This research also shows that the importance of TFP growth increases further if allowance is made for the contribution of human capital—job experience and level of schooling—to output growth.\(^{55}\)

Recent studies on sources of TFP growth in the several regions, including the MENA region, show that to reverse the region’s low and negative TFP growth, policy makers should focus on improving governance and quality of institutions, investing in human capital, and establishing market—peaceful and friendly political environments. Fortunately, these are the same factors that promote investment and GDP growth, which in turn help boost employment growth.\(^{56}\)

Interregional trade has also been low compared to other regions, accounting for less than 10 percent of total trade since the mid-1980s. As for the FDI (Foreign Direct Investment), after being −0.7 percent of GNP (Gross National Product) in the 1980, it increased to US$ 2.8 billion (0.6 percent of GNP) in the 1990, to US$ 5.9 billion (0.8


\(^{56}\) Ibid.
percent of GDP) in the 1998 and to US$ 7.3 billion in 2000. Yet it remained much lower than in other developing regions, where FDI as a percentage of GDP in 1998 amounted to 2.9 percent for Latin America, 5.2 percent for East and South Asia and an average of 2.3 percent for the developing countries as a whole.  

Figure 1.1 Developing region’s share in FDI, 1999

![Pie chart showing developing region's share in FDI, 1999](chart_image.png)


A major consequence of this poor record is persistent high unemployment, which has been reinforced by years of high growth rates of population and labor force. Employment in the MENA region did grow, at times faster than in other developing countries, but rapid population growth inflated the ranks of the young and fed the labor market with a rising tide of job seekers that exceeded the economies’ capacity to absorb them. In addition to this feeble record of growth and employment comes the weak integration into the global economy. The experience accumulated to date indicates that economies that, over extended periods, embrace openness and globalization tend to grow faster than those that adopt inward—looking growth strategies. For this reason, the

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performance of the MENA region has fallen short, depriving many countries of reaping the full benefits of globalization. The challenges facing the region are daunting. The MENA countries' economic performance remains below its potential, giving rise to chronic unemployment and poor living conditions in large parts of the region.58

b- Lagging political and Institutional reforms: Although the MENA region has a geopolitical importance, its influence in the global economy is weak. Political fragmentation, recurring conflicts, and authoritarian rule have hindered the development of democratic institutions and remain major obstacles to the needed economic reform. According to the Arab Human Development report (2002) and Freedom House report (2002), the region performs poorly in the areas of civil rights and political freedom, gender equality, and opportunities for the full development of human capabilities and knowledge. To overcome these problems, modern institutions, such as independent judiciaries, and institutions that safeguard civil and human rights need to be strengthened.59

What encourages conflicts of interest and wide spread corruption is the unclear demarcation line between the public and private sector in many MENA countries. The situation of the civil society organizations tends to be weak and often co-opted by governments. Although of some exceptions, transparency in governments is poor and accountability remains a problem.

On most measures of good governance and institutions, especially regulatory quality, control of corruption, the MENA region did not fare as well as other developing and emerging based measures of governance. In most countries, elections for

58 George T. Abed and Hamid R. Davoodi, op. cit.
representative legislatures are becoming more open and effective political leadership is becoming more aware of the need for political reform. In part, this positive development reflects the impact of the citizen's vastly expanded access to diverse sources of information as well as internal and external pressures. The authorities' response to such demands remains uneven and leads to an easing of domestic political restrictions and some improvements in economic management, but very little in the way of genuine political reform. A deepening of political reform is widely considered as a prerequisite for firmly rooting badly needed economic reforms, otherwise the problems will continue to increase.  

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C- Large public Sector: Despite changes that are now occurring in several countries, the public sector still occupies an important role and is inefficient, and this causes negative effects on the economy such as "crowding out private sector demands for credit; high costs of revenue collection; delays in awarding licenses, permits, and contracts; arbitrary enforcement of existing regulations and laws; complex and opaque court systems with high case loads; poor quality of institutions."  
61 These deficiencies affect negatively the business and investment climate and increase the cost of doing business for both domestic and foreign investors. For example, according to the World Bank report (2003), the costs of complying with official requirements to set up businesses in the MENA region are five times as high as in East Asia and 2.5 times as high as in Eastern Europe and central Asia. In many countries of the MENA region, the public sector has served as the primary employer inflating public payrolls and wage bills. In a group of 12 MENA countries that disseminate fiscal data through the IMF’s Annual Government Finance

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Statistics—Bahrain, Djibouti, Egypt, Iran, Kuwait, Lebanon, Mauritania, Morocco, Pakistan, Syria, Tunisia, and Yemen—the wage bill has been growing steadily, accounting for 30 percent of government spending in the early 1980s and 35 percent in the late 1980s before leveling off by the late 1990s. By this time it was 4 percentage points of GDP higher than for all the developing countries.62

In addition, countries in the region continue to devote a large fraction of their budgets to military spending. In the 1990s, military spending in the region accounted for 20 percent of government spending compared with 12 percent for the developing countries. Although a certain level of military spending is needed, current levels are high by international standards. This high military spending did not seem to spare the region from civil strife and war, and did not help them to gain any of their struggles, especially with Israel.63

d- Underdeveloped financial markets: The existence of restricted and inefficient financial markets in the MENA region resulted in a low level of domestic savings, and fostered an inefficient distribution of resources, imposing an explicit/implicit tax on investment capital and lowering the rates of return. Market capitalization remained low, especially compared with other emerging markets. For example, Jordan with 70.9 percent of GDP in 1995 had the highest rate of market capitalization, where as Egypt had 13.4, Morocco 17.8, and Tunisia 22.1. In the same year, the rate for Thailand was 84.7, and for Chile 108.3 percent.64 In several countries of the region, restrictions on the establishment of foreign banks have hindered the transfer of know-how and technology.

62 Ibid. p. 12.
63 Ibid.
For instance, while in Jordan there are basically no restrictions on private or foreign ownership of banks, in Egypt no more than 49 percent of a domestic bank can be held by foreigners. In many cases, banking systems remain dominated by public ownership or control with considerable exposure to government debt, weak regulatory and enforcement capacity, management skills that need upgrading, and weak links to international capital markets. With some exceptions, equity and debt markets, insurance, leasing and long-term financing remain weak and underdeveloped.\(^65\)

A look at common quantitative measures of financial depth provides similar analysis. While the ratio of broad money to GDP increased in the MENA region from 50 percent of GDP to 70 percent in 2002, and credit to domestic private sector from 30 percent to 40 percent of GDP, these rates remain at half their corresponding levels in East Asia. Moreover, the increase in private investment during that time has not kept pace with credit expansion. The resulting liquidity growth has increased capital outflows, inflated valuations in the equity and property markets, and subsidized construction activity. Heavy reliance on real estate collateral in some countries has led to poor provisioning policies.\(^66\)

e- High trade restrictiveness: Elements of trade regimes that inhibit the competitiveness of the MENA region firms include high average rates of effective protection by the governments, lack of transparency, and substantial depression of such protection across the industries. High levels of effective protection reduce firm’s incentives to enter world markets, since profit rates are often higher in protected domestic markets, and this causes the economies to remain relatively closed. These distortions have resulted in a somewhat

\(^{65}\) Ibid.

\(^{66}\) George T. Abed and Hamid R. Davoodi, op. cit, p. 16.
dualistic economic structure, with export-oriented firms having few links to the rest of the economy and most firms concentrating on domestic market. Excessive protectionism and distorted incentives led to production structures inconsistent in some cases with the comparative advantages of the individual countries. This resulted in turn in limited complementarity in the production and trade structures among the countries in the region, and hence little intraregional trade.\textsuperscript{67} Moreover, Arab countries have been slow to join multilateral liberalization initiatives such as the WTO.

2. Future Challenges and Reform policy

In the near future, the MENA economies are unlikely to be able to compete with the Asian economies in low skill manufacturing exports. With the build-up of foreign debt, continued subsidization of this type of manufacturing exports also becomes increasingly problematic. Furthermore, new competition from the central and east European countries with roughly similar per capita incomes and wages as the MENA region, but with much higher levels of education and industrial skills, is going to increase market pressures on the MENA countries. Under these conditions, it is also difficult for the MENA region to be able to attract foreign direct investments in industry. It is essential for the region to build up its human capital and skill levels in order to be able to benefit from the opportunities provided by the global economy by developing possible sources of dynamic comparative advantages.\textsuperscript{68} So how can the MENA region reignite and


sustain high output and employment growth, and better integrate with the global economy?

The past twenty years have seen some progress in implementing macroeconomic reforms and in moving toward structural reforms. However, neither has gone far enough to address the deep-rooted structural problems nor seriously tackled the governance and institutional reform issues. There is a need for accelerated and broad action on this front, including a fundamental reassessment of the role of the state in the economy, reform financial and labor markets, improve transparency, and the quality of state institutions.

The main policy challenge facing the MENA region is to implement much more far-reaching liberalization, privatization, and deregulation. The creation of the WTO increases the urgency of this challenge, where the implementation of the Uruguay Round will increase competition in third markets. At the same time, the WTO offers the opportunity to adopt better trade policies and improve trade institutions. Many countries in the region are still outside the WTO and this make it difficult for them to attract foreign direct investment and the know-how they need to diversify production and compete in the global market.69

The region has made some progress on trade liberalization since the late 1980s. For example, several countries have implemented reforms that reduce their anti-export bias. But much remains to be done; especially since competitor countries are moving faster. The efforts undertaken by many countries of the region recently provide a strong base toward further integration with the global economy. The tradeoff in this regard is between the political unfeasibility of rapid reforms and the opportunity costs of

gradualism. The slower and less comprehensive is reform, the larger will be the gap between the region and the rest of the world. The problems constraining export-led growth in the region relate as much to institutional weaknesses as to policy measures. Thus changes in policy must be complemented by a reduction in and the strengthening of implementing institutions.\textsuperscript{70} So what are the major policies that the region’s countries must take, in order to face the challenges of globalization and benefit from it, in addition to be able to compete in the global economy? I briefly explore eight policies here:

a- Changing the role of the state: Historically, the region’s governments have acted as major players in their economies, investing directly in industrial capacity, financial institutions and utilities. However, the fiscal constraints of the recent few years and increasing globalization of trade and investment flows have caused a profound move towards greater dependence on private instruments. This will eventually lead the governments to change their role from the direct actor in the economy to a regulator in the competitive free markets. MENA governments are called upon to take a back-seat role and act as catalysts, providing a stable macroeconomic environment and preparing the legal and administrative ground for the private sector to participate more actively in the overall development process.\textsuperscript{71} There is a need for structural reforms to improve export performance and the competitiveness of the region. Such measures should include reducing the role of the public enterprises in the export sector and barriers to imports through privatization, and encouragement of private investments.

\textsuperscript{70} Ibid, pp. 104 -105.
\textsuperscript{71} Henry T. Azzam, op. cit, p. 8.
b- Upgrading the infrastructure: Although policies of trade and investment liberalization are a necessary condition for development, they are by themselves not sufficient. The drivers of globalization are the companies and not governments. Allowing foreign companies to operate in the domestic market implies making their business activities feasible. In this regard, the infrastructure of many Arab countries compares unfavorably to other fast-growing developing countries. Moreover, technological transfer in the form of knowledge or physical capital undoubtedly plays a crucial role in helping MENA countries to adapt and compete in the global market. To sustain growth, MENA countries will need to upgrade their infrastructure, especially transportation, telecommunications and power supply. The challenge will be to do all this without unduly straining public finances or external positions. To this end, private sector participation can be very helpful, although some countries will need to increase the transparency of their regulatory regimes, break up monopolies and revise their pricing policies to phase out subsidies in order to attract substantial private interest in such investment which will serve in the needed technological transfer. In this context, Lebanon and Tunisia started to implement build-operate-transfer (BOT) schemes with private investors in infrastructure and technology, such as roads and power generation. 

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c- Privatization: Although public ownership in itself is not necessarily a cause for inefficiency in the operation of public entities, the full development of productive ventures in an increasingly competitive global environment has often called for private ownership within a framework of sound corporate governance structure.

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72 Patricia Alonso-Gamo, Annalisa Fedelino, and Sebastian Paris Horvitz, op. cit, pp.25-36.
As a result, privatization of state-owned enterprises has been viewed as one approach in the rationalization of public sector activities. Available data proves that the privatization process in the MENA region is slow. For example, the World Bank’s *Global Development Finance Report* (2001) notes that, privatization receipts in the MENA region during the 1990s amounted about US$ 8.2 billion, the same as for Sub-Saharan Africa during the same period. However, this amount is small compared with US$ 178 billion for Latin America and the Caribbean, US$ 65 billion for Eastern Europe and Central Asia, US$ 44 billion for East Asia and Pacific, and US$ 12 billion for South Asia.73 Throughout the world, major infrastructure areas, such as telecommunications and power, have generally been the sectors that generated the largest proceeds from privatization. This is also the case for the MENA region. MENA region governments have been talking about privatization of public enterprises but not enough has been done so far. Implementing privatization plans could help reduce the financial burden of the governments, cut the wage bill of the public sector, and render several public-sector institutions more efficient. Moreover, the income generated from privatization could be used to withdraw existing public-sector debt and lower the debt-service bill that is threatening to become a burden on the budgets of several Arab countries including Lebanon. What is needed also is empowering the private sector which could be done by the following: “First, reforming regulatory, legal, and civil service frameworks to reduce the administrative burden on the private sector, secure contracts and property rights, and promote

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competition. Second, improving supervision and prudential regulation of the banking system, increasing entry of foreign banks, and privatizing state banks to promote competition and increase efficiency. Third, fostering the concept of public-private partnerships among the region’s civil services and political elites to promote rapid growth while preserving social equity.74

d- Political and Institutional Reform: Recent empirical studies prove that democracy; political corruption, civil society organizations, institutions’ qualities and governance are weak very weak in the MENA countries and this have negative effects on growth and development. However, some progress has been made recently though it has yet to influence perception-based measures of governance. In some Arab countries, elections are becoming more open and meaningful, and the political leadership is becoming more aware of the need for political reform. In part, this positive development reflects the impact of the citizens’ vastly expanded access to various sources of information as well as internal and external pressures. The authorities’ response to demands for accountability has been uneven and hesitant, often leading to an easing of domestic political restrictions and some improvement in economic management, but very little in the way of true political reform. A deepening of political reforms is widely viewed as a prerequisite for firmly rooting badly needed economic reforms.75

75 George T. Abed and Hamid R. Davoodi, op. cit. p. 10.
e- Fiscal Reform: Faced with persistent deficits since the early 1970s, some MENA countries initiated fiscal reforms that, starting in the mid-1980s, began to improve fiscal balances. In the tax area, nine countries, including Lebanon, introduced the VAT (Value Added Tax) between 1986 and 2002. A poorly administered tax system is another channel through which the public sector can impose significant costs on the economy. Therefore, some fiscal reforms have aimed at reducing the cost of domestic resource mobilization by improving the administration of the tax system. Implementation of the VAT and its associated tax administration improvements has tended to develop the efficiency of the entire tax system. Other fiscal reforms have targeted an expansion of the tax base through reduction or elimination of tax exemptions (e.g. Jordan), the modernization of procedures including computerization (e.g. Lebanon), and the reform of customs administration (e.g. Lebanon, Morocco, some of the GCC countries, and, more recently, Egypt). On the expenditures side, significant reforms have taken place in the area of public expenditure management systems (e.g. some of the GCC countries, Jordan, and Mauritania).76 However, several countries from the MENA region are still far behind, and need to start fiscal reform and improve their fiscal balances.

f- Developing financial markets: Development of financial sectors in the MENA region made significant strides from the 1970s through the mid-1980s. As many of the other factors underlying growth, the performance on financial development is differentiated across countries in the region. Some countries such as Lebanon, Jordan, and the GCC countries, now have well-developed financial, mainly

banking, sectors. Other countries in the region, such as Egypt, Morocco, and Tunisia have made important advances over the past 30 years, although further steps remain to be taken. Recent banking sector and monetary policy reforms include strengthening of banking regulation and supervision (such as in Bahrain, Jordan, Lebanon, Morocco, Sudan, and Tunisia), introduction of greater flexibility in exchange rates and a move toward the use of indirect monetary policy instruments.\textsuperscript{77}

g- Peace Process: Some argue that without peace and security, many business challenges will continue to hamper the economic development the region so desperately needs. Others counter that economic development is a prerequisite for peace and security. However, the peace agreements in the region would be followed by a significant reduction in military spending in the Arab countries as well as in Israel. The reallocation of substantial resources from the military to the civilian economy would stimulate and finance greater investment in infrastructure, as well as in educational and health services. Regional infrastructure projects in transportation, communications, water and power, and the like, would be supported by foreign aid, which will be more likely to come to a region without conflicts. Moreover, joint Arab-Israeli economic ventures would be fostered especially in industry, agriculture and tourism.\textsuperscript{78} A large and growing inflow of foreign private investment and financial flows would ensue, which

\textsuperscript{77} Ibid, p. 17.

would give a strong boost to the regional economies, raise personal incomes, and steadily reduce the high levels of unemployment prevailing in the Arab states.

- Forming regional blocs: Little progress has been achieved in the MENA region integration. Intraregional trade in the Middle East accounts for only 9 percent of the region's total trade, compared to 60 percent in Europe and over 35 percent in Asia. Intraregional trade in Latin America has been increasing since 1991, while that of the Arab states has declined in relative importance. Globalization and regionalization are not necessarily antagonistic, but rather reciprocally reinforcing. A wider policy to increase integration in the global market could at the same time favor more dynamic regional integration efforts. The Arab countries need to integrate their economies with the rest of the world, and in doing so they must come together and establish their own regional economic bloc. In today's world, no nation can realize its full economic potential on its own. Only cross-border, regional cooperation will maximize prosperity for each of the member states in the MENA region, especially for small countries such as Lebanon.79 Trade liberalization could be pursued along two parallel routes. The first is to have each country fending for itself by getting accession to the WTO, and/or negotiating separate association with the EU. The second is to have the Arab countries implement regional trade liberalization and arrangements similar to the Arab Free Trade Agreement (AFTA), which I will be talking about in the following chapter. Aside from issues of economic solidarity, a regional market would diminish excess capacity and duplication, facilitate negotiations with other regional groups, and lead to substantial economies of scale. Because of the small

79 Henry T. Azzam, op. cit, p. 10.
size of the local markets, several industries that may not be feasible in one country would become so at a regional level. Furthermore, the existence of a regional bloc would encourage FDI currently attracted to the region’s larger market.\textsuperscript{80}

As we see in this chapter, trade liberalization offers a lot of opportunities, but at the same time these opportunities fit more the developed world, while the developing countries’ benefit is limited. On the other hand, trade liberalization brings with it problems and challenges that countries have to pay attention to them. This chapter also deals with the effect of trade liberalization on the MENA countries. It talks about the problems found in these countries, and what policies they have to take to face the challenges of globalization and be able to compete.

After this analysis, and before talking about Lebanon response to globalization through the participation in the GAFTA, I will deal in the next chapter with the Lebanese economic situation since it is necessary to understand the Lebanese uniqueness in the region. I have to talk about the Lebanese economy, because without knowing the situation in Lebanon, the reader will not be able to understand if Lebanon is able to benefit from the GAFTA and other agreements signed in favor of trade liberalization. Also I will discuss if the government is going forward in trade liberalization process in order to face the challenges of the new century. Otherwise, my research will be incomplete and missing a very important part which is the Lebanese trade policy and development.

\textsuperscript{80} Ibid, p. 11.
CH II: Lebanese Economy and Challenges of the Nineties

Seventeen years of chaos and destruction have had a devastating effect on the Lebanese economy; whether in terms of physical destruction, loss of human capital, decline in production potential or massive contraction in per capita income. Naturally, Lebanon is not unique in this regard, as all post-war economies have had similar characteristics in terms of the effects of turmoil on economic activity. Once security and political stability were restored in 1992, the newly formed Lebanese government was confronted with the challenging task of rebuilding the economy and making up for lost ground in an era of globalization and a rapidly changing world economic environment. Peace has enabled the central government to restore control in Beirut, begin collecting taxes, and regain access to key port and government facilities. A financially sound banking system and resilient small-and medium-scale manufacturers, with family remittances, banking services, manufactured and farm exports, and international aid as the main sources of foreign exchange have helped economic recovery. In this chapter, I talk about the Lebanese postwar economy. Also, I address the post war economy and the development process, specifically the steps taken by the government to reconstruct the economy within the frame of globalization and the extent to which the government succeeded. The aim of this chapter is to understand the situation in Lebanon after the war and its ability to compete other countries (at least MENA countries), and to see if Lebanon is on the right track to face globalization’s challenges.

A. The Cost of the Civil War

The 1975-91 civil war seriously damaged Lebanon’s economic infrastructure, cut national output by half, and all but ended Lebanon’s position as a Middle Eastern financial and banking hub. According to the UNDP, from 1975 to 1990, among a population of 3 million, about 150,000 people lost their lives, 200,000 were injured and 50,000 were left with serious disability. In addition, nearly half a million were displaced and about one third of the population, or around 900,000, left the country. Losses in terms of infrastructure were estimated at US$ 25 to US$ 30 billion, ten to twelve times the national income. As the war damaged the Lebanese economy, most of the Middle East experienced an economic boom, and businesses moved from Beirut to other Middle East economic centers. Lebanon’s economy did not collapse completely during the war, however, largely because foreign aid to competing militias fueled the wartime economy.

One of the striking by-products caused by the civil war noted by Nasser Saidi was the rapid increase in government spending. Prior to the war, Lebanon’s traditional style of laissez-faire economic management, in which the government did not play an active role in the development of the economy, led to relatively few pressures on the state’s purse strings exerted by demand for public spending. As a result, Lebanese government expenditure amounted to LBP 1,219 million, or a relatively modest 14.9 percent of GDP in 1974. However, with GDP decreasing throughout the first ten years of the war, and government spending increasing, this share expanded with alarming rapidity.

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84 Dr. Nasser Saidi is first vice governor of the Bank of Lebanon; he was also the Minister of Economy and Trade, and Minister of Industry of the Lebanese Republic from December 1998 till summer of 2000.
so that, by 1982, government expenditure as a percentage of GDP had reached 37.6 percent. Subsequently, it rose to 39.2 percent in 1983, 42.3 percent in 1984 and 45.4 percent in 1985.\footnote{Written in April 1986 and presented in May 1986 at a conference organized by the \textit{Institut Français des Relations Internationales (IFRS)}. Quoted from: Philip Moore, op. cit, p. 38.} Saidi added “since aggregate output and real income was falling during this period, the net result [was] a tripling of the relative size of government.”\footnote{Ibid.}

Saidi advances several reasons for this dramatic expansion in government expenditure over the first decade of the war. First, the government was unwilling (and unable) to dismiss superfluous workers during the conflict. The size of the public workforce rose during the first ten years of war, with wages and salaries consistently adjusted upwards for inflation. Second, the government subsidized a number of key commodities during the war, such as petrol, sugar, and wheat, while domestic prices were kept at a fraction of prevailing world prices. Third, there was a large increase in budget allocations towards expenditure on defense, which became the single biggest drain on the budget after 1992, combined with sporadic spending on reconstruction. Fourth, there was a vast increase in the government’s public debt (from LBP 52 million in 1974 to LBP 6,271 million in 1985—or from 0.6 percent of GDP to 127.2 percent over the same period) that led to a spiraling level of interest payments.\footnote{Ibid, pp. 38-39.}

This massive increase in government expenditure during the first decade of the war resulted in a number of disastrous consequences. First, the increased spending was accompanied by a sharp fall in the government revenues. With the government losing control over key revenue-generating facilities such as the ports of Beirut and Tripoli, and with war giving individuals and companies a great opportunity to avoid paying taxes, tax
revenue from taxation dropped. While in nominal terms tax revenue rose from LBP 1,270 million in 1974 to LBP 4,858 in 1985, in real terms it dropped from LBP 1,270 million to LBP 562 million over the period, with tax revenues as a percentage of GDP falling from 15.6 percent to 11.4 percent.\footnote{Ibid. p. 39.}

In February 1995, the IMF released a comprehensive report entitled *Economic Dislocation and Recovery in Lebanon*, in which it estimated that the loss of output between 1975 and 1993 was “at least LBP 98 billion at constant 1974 prices, or about 24 times the value of Lebanon’s 1993 real GDP (at constant 1974 prices).”\footnote{Ibid.}

Lebanon’s ability to export industrial goods was damaged by internal unrest and external pressures. The good reputation once enjoyed by Lebanese clothing manufacturers was undermined by imports of cheaper garments that were relabeled and exported as “Lebanese.” By the end of 1981, Iraq had halted all imports of Lebanese garments, and Egypt had frozen preferential terms for Lebanese industrial exports because of false labeling. Although the Egyptian and Iraqi measures were rescinded in 1982, they were symptomatic of the pressures that Lebanon faced throughout the 1980s.\footnote{Lebanon: Civil War and Partial Recovery. United States: Library of the congress, 1988. Online. Internet. April 13, 2004. Available: \text{http://countrystudies.us/lebanon/69.htm}}

Events elsewhere in the region also had an impact on Lebanon. A tripling of world fuel prices between 1973 and 1981 reduced the country’s competitive edge. When Syria imposed restrictions on transit trade, freight forwarders found it increasingly unprofitable to ship goods to Persian Gulf destinations via Beirut. The prices of imported raw materials were higher than ever, while export markets were increasingly restricted.
Thus, even before the Israeli invasion of 1982, the Lebanese economy was in bad shape.\footnote{Ibid.}

Foreign banks began selling and moving out. The decline of the Lebanese pound intensified, hyperinflation set in, and public debt soared. By 1986 the inflation rate was well over 100 percent. Government revenues from taxation and customs duties continued to erode. And one account declared that at the end of 1986 “currency speculation and black marketeering have become the principal areas of business activity.” Economic control was falling into the hands of those who possessed hard currency. The militias’ tight grip on customs revenues gave them increasing control over what was left of the national economy; and their strength increased as the central government’s control over national finances weakened. Although the Central Bank was still the guardian of one of the highest volumes of per capita foreign assets in any developing country, the government’s ability to use these assets to reconstruct the country’s shattered financial system or national economy was doubtful.\footnote{\textit{Lebanon: Invasion and Trauma, 1982-87}, United States: Library of the congress, 1988. Online. Internet. April 13, 2004. Available: \url{http://countrystudies.us/lebanon/70.htm}}

By 1990, according to estimates, the Republic’s per capita was about US$ 820 barely one third of its 1975 level in real terms. According to the United Nations estimates, damage to infrastructure and physical assets due to the conflict amounted to US$ 25 billion, with none of the principal sectors emerging from the conflict undamaged. While limited investment and maintenance expenditure led to the erosion of the capital base, the sizeable emigration of skilled manpower constituted a major loss to the economic potential of Lebanon. As a result, from 1975 to 1990, aggregate national output steadily declined. In addition, the confidence in, and credibility of, the Lebanese
Pound and economic stability began to erode. The shift in authority from the government to non-official entities gave rise to a parallel economy that severely hindered the government’s ability to collect revenues and taxes. These negative developments, along with prevailing economic uncertainty, plunged the Lebanese economy into a vicious cycle of large budget deficits leading to monetary expansion and inflation, which translated into dollarization of the economy and capital flight. This in turn led to a dramatic depreciation of the value of the Lebanese Pound and further inflation.\textsuperscript{93}

B. Lebanese Post-war Economy

The cessation of hostilities was followed by a recovery in the economy in 1991; according to IMF estimates, GDP increased by almost 40 percent, and inflation moderated in the course of the year. Large capital inflows, along with a partial recovery of exports, resulted in an overall balance of payments surplus of over US$ 1 billion. However, the fiscal deficit remained high in 1991 at 56 percent of expenditures. By the beginning of 1992, the Central Bank had stopped supporting the Lebanese Pound, the value of which declined to all-time lows. The cycle of deficit financing, dollarization and capital outflows led to escalating inflation and exchange rate depreciation, with the values of the Lebanese Pound reaching LBP 2,420 per US dollar in September 1992.\textsuperscript{94}

Following the appointment of the first Hariri government in October 1992, the government took measures to restore economic stability and renew confidence and trust in the Lebanese Pound.\textsuperscript{95} Between 1993 and 1998, the economic program of the successive Hariri governments rested on the dual, and sometimes conflicting, tasks of economic revival and stabilization. This agenda aimed to rehabilitate the country’s

\textsuperscript{93} Ibid.
\textsuperscript{94} Ibid.
damaged infrastructure, replenish the depleted capital stock, reinstate traditional public services, and implement programs for the return of displaced persons to their villages and provide a favorable environment for the return of the expatriate Lebanese community, while pursuing exchange rate stability and anti-inflationary policies. This strategy has been successful to a certain extent. As the government-led reconstruction program got underway and with the normalization of the economic environment, real economic growth averaged 5.7 percent over the period from 1992 to 1997. At the same time, the foreign exchange rate gradually appreciated, reaching LBP 1,516 per US dollar at the end of 1998. The inflation rate was reduced from over 120 percent in 1992 to around three percent in 1998. Interest rates have gradually declined since 1995 but remained high. However, efforts at improving monetary stability and expenditures on large-scale reconstruction projects contributed to increased fiscal deficits and consequential public borrowings. As at December 31, 1997, the fiscal deficit represented 23.64 percent of GDP.\textsuperscript{96}

The Hoss government that held office from December 1998 until October 2000 continued to foster monetary stability. Inflation was reduced to 0.25 percent in 1999, the foreign exchange rate remained stable and the balance of payments registered a surplus in 1999. The Hoss government prepared and adopted a five-year fiscal reform plan, which was designed to reduce the budget deficit and gross public debt to 5 percent and 95 percent of GDP respectively by the end of 2003.\textsuperscript{97}

\textsuperscript{96} Lebanese Republic: Ministry of Finance, The Lebanese Republic: Country Profile, p. 11.
\textsuperscript{97} Lebanon's economy received a post-war boost induced by regional optimism following the 1993 Oslo Accords, and the government's ambitious reconstruction program. Financing the "Horizon 2000" reconstruction program through heavy borrowing, Prime Minister Rafiq al-Hariri's created discontent and criticism in regions and sectors outside the Beirut Central District and business circles. In 1997 the public-sector debt stood at US$ 22 billion. Using almost half of the government's budget for debt serving, the government had little flexibility on expenditure. Consequently, neglect of social and regional development
When Hariri government assumed power by the end of 2000, it faced a number of challenges including an economic slowdown, a large fiscal deficit and a significant debt service burden. By the end of 1999 and 2000, the fiscal deficit represented approximately 14.4 percent and 23.65 percent of the GDP respectively, and debt service represented about 74 percent and 88 percent of total revenues respectively. Net Public debt represented approximately 120 percent of GDP by the end of 1999 and 142 percent by the end of 2000.\(^\text{98}\)

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Source: Lebanese Republic: Ministry of Finance/Central Bank

The current government (Hariri Government) focused initially on revitalizing the economy through measures designed to encourage the development of the private sector and the integration of Lebanon into the global economy. The current Government’s objectives consist of maintaining monetary and price stability and improving fiscal programs caused criticism, and eventually led to Hariri’s fall from power in December 1998. Along with the new president, former Army General Emile Lahoud, the new Prime Minister Salim al-Hoss vowed to reform the economy, and presented a five year fiscal adjustment plan (1998-2003). Important elements of the plan include the restructuring of the public-sector debt from high cost short-term domestic debt to lower cost and longer-term foreign debt. Lebanon has an excellent international debt-serving record, and the country has successfully tapped into international capital markets by selling a total of US$ 4.6 billion Eurobonds on increasingly better terms. The most recent issuance took place in April 2001, placing US$ 1.4 billion of Eurobonds at a coupon rate of under 10 percent. The proceeds are largely earmarked to retire higher interest domestic debt. In the context of a traditional laissez-faire economy and a culture of tax evasion, the Hoss government—also not helped by the national debt, corruption, overstaffing and red tape—implemented virtually none of its planned reforms. The government improved tax collection practices and increased income and corporate taxes, but a combination of the administration’s weakness and parliamentary opposition hindered the exploitation of important revenue sources such as value-added tax (VAT) and the privatization of state companies. The failure to bring the economy back on track was a major contributing factor to a decisive victory by the opposition in this fall’s parliamentary elections. Ironically, much seems to point to the return of Rafiq al-Hariri as Lebanon’s Prime Minister and increased faith in the recovery of the Lebanese economy. Check: International Finance Center: Lebanon, Yahoo Finance, 2004. Online. Internet. April 15, 2004. Available: http://biz.yahoo.com/ifc/lb.html


\(^{99}\) I will be talking about the debt problem in details later in this chapter.
performance through a reduction in the debt service burden, the reduction of other public expenditures and privatization of state assets. As a result of these policies, economic activity slightly improved, recording a growth rate of 1.5 percent, while inflation remained at 0 per cent. The fiscal deficit declined by 7 percentage points of GDP to 16.7 per cent.\textsuperscript{100}

The balance of payments was in overall surplus during the period from 1993 to 1997, despite growing trade deficits. The balance of payments was US$ 1.13 billion in surplus for 1994. In 1995, 1996, and 1997, the balance of payments registered a surplus of US$ 256 million, US$ 786 million, and US$ 420 million respectively. However, the balance of payments registered a deficit of US$ 487 million for 1998. For the year 2000, the balance of payments recorded a deficit of US$ 289 million, as compared to a surplus of US$ 261 million for 1999. During 2001, the balance of payments recorded a deficit of US$ 1.17 billion mainly due to a large trade deficit and the effect of regional developments.\textsuperscript{101}

1. Post Civil War Reconstruction

The economic consequences of the war could be grouped into three broad areas: First, the destruction of productive facilities and infrastructures. Second, indirect damages caused by the failure to renew capital assets and to develop human resources. Third, the migration overseas of hundreds of thousands of the educated elite and of skilled manpower, which resulted in a great loss to the country.\textsuperscript{102}

\textsuperscript{100} Lebanese Republic: Ministry of Finance, \textit{The Lebanese Republic: Country Profile}, op. cit. p. 11.
\textsuperscript{101} Ibid.
In brief, the tail end of the civil war, which was dominated by years of destruction, killing and theft, left the Lebanese state in need of being rebuilt from scratch. This reconstruction was not entrusted to statesmen but rather to the same warlords, who had committed the crimes, the robberies and the damage. Distributing the state assets and institutions amongst as many of those warlords as possible was the interpretation of national reconciliation adopted after the war. It would only seem a natural consequence of handing the militia leaders the political authority that they issue themselves a general amnesty covering all the crimes of the war and its atrocities. Their ambition extended from the existing institutions to the ones to be set up within the reconstruction/reconciliation process. The Fund for the Displaced (FFD), the Council of the South (COS), the Council for Development and Reconstruction (CDR) were created and turned into tools of nepotism and rent seeking for some of the war patrons. The whole affair of reconstruction started looking like an appealing enterprise or investment where one would be able to invest in an institution, a fund or a ministry and collect the profit of the investment in both political and financial currencies.\(^{103}\)

The reconstruction effort did not seem full-fledged until the end of what turned out to be a transitional period. In 1992, a new Prime Minister was appointed, Rafiq al-Hariri, made reconstruction a central point for his policy. In initially trying to rally the country under his plan for reconstruction, Prime Minister Hariri attempted to institute a program for administrative reform. He gave redundant public employees the option to resign before the government conducted a comprehensive purge, which resulted in more than 3000 resignations. Subsequently, approximately 600 civil servants were dismissed

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for corruption, and 1800 more were dismissed for permanent abstention from their jobs. This reform was undertaken by the Civil Service Board (CSB) and the Central Inspection Agency, whose main functions were to counter corruption, mismanagement and failure to comply with existing rules within the bureaucracy, and which had been dormant during the civil war. The reform program came under great criticism though as no high-ranking officials were dismissed and certain institutions were spared from the project due to confessional and political considerations. The dismissed officials appealed their dismissals to the Council of State and won.\(^\text{104}\) Combined with other failures, the reversal of the purge made Hariri give up on institutional reform and substitute for it by setting up parallel structures to the administration that were fully loyal to him. Those structures would design and sometimes implement the plans that he would impose through the regular political structures that he was having an increasingly stronger grip on through appointing many of his trusted staff members in key government and administration position. Some of such examples are the urban reconstruction projects of the Beirut’s central district and its suburbs.\(^\text{105}\)

\section*{2. Major Economic Sectors}

At the end of the conflict, all sectors of the Lebanese Economy were characterized by widespread damage to physical assets and an obsolescence of remaining facilities, given the reluctance during the years of conflict to invest in new capital or spend funds on maintenance. Moreover, there was an outflow of professional and entrepreneurial skills from Lebanon. A lower production capacity, together with rigidities in internal

\(^{104}\) Charles D. Adwan, \textit{Reform in Independent Lebanon: The Roller Coaster of Trial and Error}, The Lebanese Transparency Association, Beirut, 2002, p.*. Those officers return back to their jobs under the pressures of the War leaders who became part of the government.

flows of goods and labor, led to very low levels of output. The end of the civil war in 1989 marked the unification of the internal market and an upsurge in output in most sectors of the economy. Since then, there has been an increase in investment and a gradual return of skilled workers to the country. But are the economic sectors able to compete at least among the GAFTA countries?

a. Services

The services sector consists mainly of tourism, commerce and financial services. After the end of the civil war, tourism is becoming the major industry of Lebanon once again (especially for Arab neighbors). The strategic position of Lebanon, its mild climate and natural beauty, consisting of snow-capped mountains, valleys and the Mediterranean Sea, make it a natural tourist attraction. Apart from its privileged geographical and natural situation, Lebanon benefits from qualified and experienced human resources in the tourism industry. Significant private investment is currently being made in the modernization and expansion of this sector and international hotel companies have returned to Lebanon. In 1998, around 631,000 tourists\textsuperscript{106} spent an estimated US $1.3 billion, and the expansion of the sector remains a top government priority. The enlargement of the Beirut airport, the reopening of prestigious hotels as well as the rapid opening-rate of cafés, restaurants and nightclubs, reflect strong faith in the potential of tourist sector.\textsuperscript{107} However, several things such as regional instability in addition to air and sea pollution affect tourism negatively. Also, the industry lacks an overall strategy, and

seems to cater to upper-middle and upper class travelers—not tapping into potential of the large masses.

Despite these hindrances, the number of tourists is increasing year after year. According to the Lebanese Ministry of Tourism, the overall number of tourists visiting Lebanon has steadily increased since 1996 to reach 1.1 million in 2003. On one hand, the September 11 incidents have affected the number of European and American visitors but on the other hand it increased the number of visitors of Arab origin due to the difficulties they faced in getting visas to Western countries. Lebanon is the only country in the region where one can find a lifestyle, nightlife and entertainment facilities as the one encountered in Western countries. Important events are taking place in Lebanon throughout the year, with a peak during the summer with the Baalbek and Beit Ed Dine festivals. Tourism professionals noticed a significant raise of Far East and south East Asian travelers in addition to Maghreb's tourists. It is important to say that the Beirut International Airport is now fully operational.  

Significant private investment is currently being made in the modernization and expansion of this sector and international hotel companies have returned to Lebanon. Casino du Liban, which historically constituted a major tourist destination, reopened in 1996. Lebanon is the only country in the Arab world that offers skiing and related winter sports activities. The largest ski resort in the country has been expanded and modernized. Lebanon's tourism industry also relies on the large number of Lebanese living abroad, who return regularly to the country during the summer season.

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Another source of revenue has come to light in the past few years: business tourism. Many exhibitions, trade shows and conferences—such as the Arab Summit in 2002 and the Le Sommet de la Francophonie in October 2002—are now organized in Beirut. The small size of the country and its multilingual and open-minded inhabitants make it ideal for this kind of corporate tourism.110

The tourist potential is far from being fully exploited, and the government (including citizens) has good reason to believe that Lebanon will recover its past glory. Having two million visitors per year is a common expectation, and achieving this level would create jobs and give the tourism industry its pre-war prominence of economic importance. This sector once employed roughly 20 percent of the active Lebanese population.111

As for financial services, from the 1950s to the beginning of the civil war, Beirut was the region’s financial services center. At the onset of the oil boom starting in the 1960s, Lebanon-based banks were the main recipients of the region’s petrodollars. Currently, the main financial services offered are commercial banking, investment banking and insurance. The Lebanese banking sector witnessed unprecedented growth from 1992 to the present. Total deposits with commercial banks increased from US$ 6.5 billion at the end of 1992 to US$ 40.1 billion at the end of 2001. In addition, since 1996, Lebanese banks have been successfully accessing the international capital markets. Since 1996, several banks raised over US$ 2.5 billion on the international debt markets and three banks raised approximately US$ 300 million through the issuance of global depositary receipts on the international equity markets. The banking system is seen as

110 Lebanon: Tourism, University of Balamand, op. cit.
111 Ibid.
having a key role by being the entry point for capital inflows for the region’s development. At the same time the authorities are aiming at widening and deepening the financial sector by facilitating the establishment and evolution of, and providing a regulatory framework to, more diversified private financial institutions. Several investment banks, with capital raised offshore, have been established in Beirut and offer a variety of traditional investment banking services, including debt and equity raising and corporate finance advisory services. Several commercial banks have established investment-banking subsidiaries offering similar services.\(^{112}\)

As part of the Government’s strategy of re-establishing Beirut as a regional financial services’ centre, the Central Bank established in 1994 a central depositary, settlement and clearing agency, MIDCLEAR, which is a joint stock company organized under the laws of the Republic. The Government reopened the Beirut Stock Exchange in 1996.\(^{113}\)

b. Industry

In theory, Lebanon ought to be a profitable center for investment in industry. In practice, this potential has never been realized, partly as a result of the country’s shortage of raw materials, and partly in reflection of the ruling powers’ reluctance to support industrial development. Lebanese industry is poorly equipped to compete in international markets. In mid-1996, staff members from the Beirut-based Lebanese Center for Policy Studies (LCPS)\(^{114}\) visited 150 Lebanese industrial companies, covering a wide range of

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\(^{113}\) Ibid.

\(^{114}\) The Lebanese Center for Policy Studies (LCPS), founded in 1989, is an independent, non-profit research institute based in Beirut. It is concerned with issues of political, social, and economic development in Lebanon, the Arab region and the world. LCPS publishes studies and organizes conferences that analyze and aim to improve public policy. It also publishes electronic and printed material to increase public
sectors, to evaluate the level to which they were ready and equipped to compete in the developed markets of Europe. The findings of the survey were unpromising, since a very small number seemed to be able to compete in the international market. This appeared to confirm a depressing finding of the state of Lebanese industry published by the UNDP, which noted "the sector suffers from the absence of an industrial strategy and well-thought out policies and from a lack of statistics and information, including on exports and on new markets; lack of adequate financing; absence of industrial zones and reliable public services; shortage of skilled and specialized workers; complicated and bureaucratic procedures."  

Nevertheless, Lebanese industrialists continue to invest with enthusiasm in the development of new manufacturing facilities. In 1995, a total of 431 new factories were built in Lebanon, with a total capital of just under LBP 100 billion and employing 3,451 workers. In 1995, the industrial sector (mainly production of cement, furniture, paper, detergents, cosmetics, pharmaceutical, batteries, garments and processed food) accounted for 17.3 percent of GDP, and increase from 15.9 percent of GDP in 1972.

Exchange rate and price stability coupled with the gradual decline in Lebanese Pound interest rates have contributed to a better environment for investment and growth in industry. Infrastructural bottlenecks resulting from the conflict are being addressed as improvements in roads, telephones and electricity supply are realized. The government provides various incentives for the establishment of industrial facilities in Lebanon, including fiscal incentives in the form of reduced customs duties and tax exemptions. So,

\footnotesize

awareness of critical policy issues. It is registered with the Lebanese Ministry of Interior as a non-profit association, file no. 2354/4/96. For more information check: http://www.lcps-lebanon.org

115 Philip Moore, op. cit. p. 93.
a number of measures have been introduced to help boost the size and efficiency of the Lebanese industrial sector. United Nations Industrial Development Organization (UNIDO), for example, has helped the Ministry of Industry to develop an industrial strategy to encourage for the introduction of new technology in the country and to develop sub-contracting arrangements.\textsuperscript{117}

From 1993 to February 2001, the International Finance Cooperation (IFC)\textsuperscript{118} carried out 34 investments and financing projects in Lebanon in an aggregate amount US$ 336 million, with an additional US$ 256 million raised by the IFC through loan participation. Investments during 2000 included loans to three companies for US$ 21 million. As of February 28, 2001, US$ 219 million representing IFC loans, loan participations and equity investment had been disbursed and remained outstanding.\textsuperscript{119}

c. Agriculture

The location of Lebanon south of the mild region of the northern half of the earth and east of the Mediterranean Sea, at the border of the Syrian Desert, results in a climatic and environmental diversity. The temperate climate and semi-tropical on the littoral, the cold climate on the high mountains, the dry weather at the center and the arid on the north east of the Beqaa valley reflect this diversity. These multiple ecosystems lead to richness in both the agro-ecological zones as well as in the agricultural production over the 10,452 Km\textsuperscript{2} area of Lebanon. However, the agricultural sector, including forestry and fishing,

\textsuperscript{117} For more information about UNIDO's support and its projects in Lebanon, check: http://www.unido.org/geodoc.cfm?cc=LEB

\textsuperscript{118} Established in 1956, IFC is the largest multilateral source of loan and equity financing for private sector projects in the developing world as a way to reduce poverty and improve people's lives. It promotes sustainable private sector development primarily by: financing private sector projects located in the developing world; helping private companies in the developing world mobilize financing in international financial markets; and providing advice and technical assistance to businesses and governments. IFC is a member of the World Bank Group and is headquartered in Washington, DC. For more information, check: http://www.ifc.org

\textsuperscript{119} Lebanese Republic: Ministry of Finance, The Lebanese Republic: Country Profile, op. cit. p. 15.
contributed to almost 12.4 percent of Lebanon’s GDP and employed only 7 percent of workers. Agricultural products represent about 10 percent of the country’s exports. Related activities such as storage, refrigeration and food processing represent a further 10 percent of the GDP. Lebanon imports around 75 percent of its food needs, which amount to US$ 1.5 billion in 1998.  

An estimated 67 percent of agricultural production is made up of crop production while the remaining 33 percent represent livestock products. Crop production consists of fruits, vegetables, floriculture and field crops. In 1998, an estimated 43 percent of the cultivated area was dedicated to fruit crops, 25 percent to vegetables and 32 percent to field crops, as shown in the table below.

<table>
<thead>
<tr>
<th>Cereals</th>
<th>Potatoes</th>
<th>Vegetables</th>
<th>Garlic and Onions</th>
<th>Citrus Fruits</th>
<th>Apples</th>
<th>Grapes</th>
<th>Bananas</th>
<th>Various fruits</th>
<th>Total</th>
</tr>
</thead>
<tbody>
<tr>
<td>11%</td>
<td>13%</td>
<td>9%</td>
<td>14%</td>
<td>14%</td>
<td>19%</td>
<td>6%</td>
<td>5%</td>
<td>9%</td>
<td>100%</td>
</tr>
</tbody>
</table>

Source: [http://csrd.lau.edu.lb/Publications/StudentReports/Agriculture%20in%20Lebanon.htm](http://csrd.lau.edu.lb/Publications/StudentReports/Agriculture%20in%20Lebanon.htm)

However, agriculture is still facing number of basic conditions that have hindered its development. The most serious problem according to the UNDP was the virtual opening of the market to Syrian products (Syrian products cost one-half of those of the Lebanese) without any regulations to protect local production. The reason for high production costs (in Lebanon) include the cost of agricultural land due to a lack of zoning

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Available: [http://csrd.lau.edu.lb/Publications/StudentReports/Agriculture%20in%20Lebanon.htm](http://csrd.lau.edu.lb/Publications/StudentReports/Agriculture%20in%20Lebanon.htm)

121 The land useful for agricultural activities occupies an area of 360,000 hectares (ha) of the country’s 1,020,000 ha of land (around 36%). In 1996, the FAO (Food and Agriculture Organization) estimated that 26000 ha are technically possible for cultivation. However the surface currently exploited is around 215,000 ha. Yet, around 88000 ha (41% of cultivated areas) is irrigated, of which 58,000 ha are perennially irrigated and the rest seasonally irrigated. The average size of farm holding is very small; over 60% of these holding are smaller than 2 ha and over 85% are smaller than 5 ha. The district with the largest land used for agriculture is Baalbeck (74000 ha), Akkar (45,000 ha), Zahle (53%) and Sidon (51%). Fifty-two thousand hectares were used for olive cultivation, 15,400 ha for apples and 56,000 ha for growing grain. Forestland is calculated at 120,000 ha, equating to 11% of total areas. This figure however is exaggerated, because it takes into consideration any land that has trees or intensive plant growth on it.
laws and uncontrolled encroachment by real estate developers, outdated technology, lack of education at the farmer’s level, lack of specialized credit forcing farmers to borrow elsewhere at high interest rates, lack of modern facilities, and the high costs of labor. There is also an absence of a modern marketing infrastructure.\(^{122}\)

There are some efforts to develop the agricultural sector. The government’s Green Plan\(^{123}\) authority, with the help of the World Bank, aims to revitalize the agricultural sector, and in the process, help the environment and relieve the city from overpopulation. Over the next five years, the Green Plan plans to spend US$ 98.5 million on rebuilding the nation’s agricultural infrastructure, with US$ 42 million coming in the form of a loan from the World Bank. The government is expected to provide US$ 13 million, with the remaining to be contributed by farmers. Moreover, there are a lot of internationally funded projects by the United States, the European Union (EU), FAO, UNDP, and UNDCP, which are giving loans, funding, technical assistance and training to the farmers.\(^{124}\)

In addition, the World Bank offered loan of US$ 57 million to finance five main irrigation projects that have been completed in 1998. This project covers an area of 14,300 Ha in various Lebanese regions. It includes the rehabilitation of the irrigation infrastructure and the delivery of technical assistance to the relevant management bodies.\(^{125}\)

\(^{122}\) Philip Moore, op. cit, p. 103.

\(^{123}\) With the objective of developing the rural areas and assisting the Lebanese farmer, the Lebanese Government established the Green Plan in 1963 by the decree no. 13785 as a special office in the Ministry of Agriculture for studying and executing land reclamation projects. For more information about the Green Plan, check: [http://www.greenplan.gov.lb/history.html](http://www.greenplan.gov.lb/history.html)

\(^{124}\) There is an absence of Arab funding in the Agricultural sector, and if found it is very small. Jawad Haidar, *Agriculture in Lebanon*, op. cit.

\(^{125}\) Ibid.
3. The Debt Problem and International Assistance

Once security and political stability were restored in 1992, the newly formed Lebanese government was confronted with the challenging task of rebuilding the economy and making up for lost ground in an era of globalization and a rapidly changing world economic environment. Between 1993 and 2001, Lebanon’s net debt increased by 646 percent, driving the country’s debt-to-GDP to 168 percent. Numbers like this have led specialists like Novaid Farooq, a credit analyst at Standard and Poor’s, to wonder whether Lebanon could pay its bills if it wanted to.\textsuperscript{126}

Over the last two years, the Lebanese government has been working to bring large public deficits and mounting debt under control, but with limited success. Lebanon’s mounting debt problem and stagnant economic growth are making politicians increasingly willing to take drastic and unpopular measures to revert the situation. The critical state of the country’s finances is forcing politicians to form a consensus on economic policy. The Lebanese government needed to get out of the vicious cycle of mounting national debt and lackluster economic activity. The Paris II conference came to help Lebanon settle its economic situation, and to help the government restructure the debt, but the question that needs to be explored further in this extent to which the Lebanese government has benefited from Paris II conference and fulfilled its pledges.

a. Public Debt

The most serious problem that faced the Lebanese recovery program, and the economy as a whole, was the high debt burden associated with the perennial budget deficit accumulated by the Lebanese government and the increasingly high levels of

foreign borrowing. The problem became so serious that the World Bank revealed in autumn of 1995 that Lebanon had been placed on its shortlist of states that were at high risk of bankruptcy.

During 1991-97, Lebanon’s government finances resulted in primary deficits, reflecting large current expenditures (excluding interest payments), a slow recovery of the revenue-generation capacity, and reconstruction-related surge in capital expenditures. Accordingly, gross public debt rose from LBP 4,651 billion at the end of 1992 to LBP 23,874 billion at the end of 1999, which is equivalent to an increase from 48 percent of GDP to 136 percent. During the same period, net public debt, which does not include Treasury Bills issued for sterilization purposes, increased from 37 percent of GDP to 120 percent. Gross Public Debt has risen by almost 20 percentage points a year since the end of 1998 and reached 185 percent of GDP at the end of 2003 (see table 2.3).

| Table 2.3 Gross and Net Domestic debt from 1996 through January 31, 2004 (as percentage of GDP) |
|-----------------------------------------|---------------------------------|---|---|---|---|---|---|---|---|
| Gross Public Debt               | 99%  | 103% | 114% | 136% | 153% | 170% | 181% | 185% | 179% |
| Net Public Debt                | 80%  | 97%  | 105% | 120% | 142% | 162% | 170% | 174% | 167% |


Within the period 1992-1997, two phases in the evolution of Lebanon’s public debt can be distinguished. During 1991-93, both the gross and the net public debt as a percentage of GDP decreased despite sizable primary deficits on account of a combination of high growth and negative real interest rates. The debt dynamics reversed

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in 1994, when the restrictive monetary policy stance implied by the exchange-rate-based nominal anchor policy reduced inflation to single-digit rates, which, in turn, led to positive growth-adjusted real interest rate on the public debt.\textsuperscript{131} Thus, while the interest rate dynamics and the deficit-related flows had offsetting effects on the overall debt dynamics in 1991-93, they both contributed to an increase in the debt-to-GDP ratio in 1997.

According to data released by the Ministry of Finance, net total public debt reached LBP 46,140 billion as of end-October 2003. During the year, this debt increased by LBP 554 billion (1.2 percent) since end-November 2002.\textsuperscript{132} In 2002, the growth rate of net public debt ranged between a minimum of 8.73 percent and a maximum of 16.32 percent. In February 2004, the volume of net public debt increased, reaching LBP 4,779.62 billion (see table 2.4 for more details about the debt).\textsuperscript{133}

<table>
<thead>
<tr>
<th>Table 2.4 Gross and Net Domestic Debt from 1996 through January 31, 2004 (in billions of Lebanese pounds)</th>
</tr>
</thead>
<tbody>
<tr>
<td>-------</td>
</tr>
<tr>
<td>I. Gross Domestic Debt</td>
</tr>
<tr>
<td>II. Public External Debt</td>
</tr>
<tr>
<td>Gross Public Debt (I+II)</td>
</tr>
<tr>
<td>III. Public Sector Deposits</td>
</tr>
<tr>
<td>IV. Net Domestic Debt (I-III)</td>
</tr>
<tr>
<td>Net Public Debt (II+IV)</td>
</tr>
</tbody>
</table>

Notes: a: Amount translated into Lebanese Pounds at end of period rates; includes accrued interest.
b: Represent public sector deposits with the Central Bank and commercial banks.

\textsuperscript{131} International Monetary Fund, Guidelines for Fiscal Adjustment, IMF Pamphlet series, September 1995, p. 64.
a1. Domestic Debt

Reflecting considerable political and macroeconomic uncertainties immediately after the war, Lebanon initially had only very limited access to either the international capital markets or foreign official financing, and had to resort to domestic capital markets to finance its budget deficits. Short-term Treasury Bills denominated in Lebanese Pounds with maturities from 3 to 12 months were the only available instruments. In mid-1991, the authorities also started issuing 24-month Treasury Bonds with semiannual coupon payments. For a while, Treasury Bills with a maturity of 18 months were also available, but their issue was discontinued given the limited interest by the investor community.\textsuperscript{134}

Domestic debt constitutes the bulk of the Lebanese public debt financing accounting to as high as 91.2 percent out of gross debt in year 1993. This big reliance on domestic borrowings (during 1992-99) is mainly due to two factors: First, the absence of the promised Arab financial assistance. Second, the disastrous experience of monetizing the debt during the years of the civil war, which meant that money financing was simply out of question. During the war, the Lebanese economy passed in a series of bumps, which led to a misguidance of expenditures, and thus a useless spent of money.\textsuperscript{135}

Reflecting these developments, Lebanon’s debt structure has been characterized by a high, albeit gradually declining share of short-term Treasury Bills dominated in Lebanese Pounds in total public debt. Increasingly, 24-month Treasury Bonds have become the dominant Lebanese Pound debt instrument and have, on average, accounted for 53 percent of all outstanding Treasury Bills and Bonds during 1993-97.

\textsuperscript{135} Ibid.
Nevertheless, given an uneven distribution of new issues and a strong tendency for the bunching of new issues at peak dates, the effective maturity of the outstanding Treasury Bills and Bonds has on average been only 9-10 months.\textsuperscript{136}

\begin{table}[h]
\centering
\begin{tabular}{lcccccccc}
\hline
\hline
Total domestic debt & 19,787 & 21,686 & 25,383 & 27,161 & 28,214 & 25,302 & 26,843 & 27,464 \\
Long term bonds & 13,271 & 16,957 & 19,593 & 20,861 & 24,069 & 22,268 & 24,691 & 24,828 \\
60 months & 0 & 0 & 0 & 0 & 0 & 650 & 650 & 650 \\
54 months & 0 & 0 & 0 & 0 & 0 & 616 & 616 & 616 \\
36 months & 261 & 261 & 733 & 1,207 & 1,340 & 339 & 884 & 1,369 \\
30 months & 0 & 0 & 0 & 0 & 0 & 3,033 & 3,033 & 3,033 \\
24 months & 12,430 & 16,102 & 18,166 & 18,973 & 21,998 & 21,214 & 18,986 & 18,648 \\
Coupon Interest & 580 & 594 & 654 & 681 & 730 & 715 & 522 & 512 \\
Short term bills & 6,307 & 4,479 & 5,562 & 6,374 & 3,974 & 2,866 & 1,799 & 2,208 \\
12 months & 4,618 & 3,296 & 3,355 & 3,960 & 2,186 & 1,522 & 796 & 769 \\
6 months & 1,270 & 852 & 1,650 & 1,643 & 1,111 & 1,028 & 424 & 782 \\
3 months & 419 & 331 & 557 & 771 & 677 & 317 & 579 & 657 \\
Accrued interest & NA & NA & 269 & 197 & 172 & 117 & 44 & 14 \\
\hline
\end{tabular}
\caption{Domestic Debt Structure—By Instrument (Billions of LBP)}
\end{table}

The Central Bank has generally refrained from budgetary financing. Accordingly, most Treasury Bills have been held by commercial banks and non-bank private entities. Treasury bills have been the main short-term Lebanese pound assets in Lebanese financial markets and, given the role of commercial banks as the principal intermediaries, are the main determinants of quasi-monetary Lebanese Pound liabilities. Treasury bill holdings by the non-bank entities have been increasing, in particular since 1995. This change in the structure of Treasury bill holdings has been attributed to the staggering interest rate setting by commercial banks and the deepening of financial markets. The latter has allowed for a larger investor base, including foreign, that is, non-resident

\textsuperscript{136} Ibid.
investors. At the end of 1997, non-resident investors held about 7 percent of the outstanding Treasury Bills.\textsuperscript{137}

**a2. External Debt**

Foreign currency debt, as a share of GDP, was relatively low during 1991-1993, but started to increase since 1994. Initially, the foreign currency debt was largely composed of debt owed to commercial banks and to bilateral official creditors. Since 1994, however, the Lebanese government has also been able to tap international capital markets for budgetary financing: seven Eurobonds denominated in US dollars and one bond in Deutsche Mark, for a total of about US$ 2.4 billion, have been issued.\textsuperscript{138}

The foreign currency debt has been characterized by an average effective maturity that is significantly longer than of the domestic currency debt. The foreign loans contracted by the Council for Development and Reconstruction CDR have maturities of ten years and more and are typically concessional with a significant grant element and a grace period.\textsuperscript{139} The maturity of the international bonds issued in Lebanon has also increased. While the first Eurobond issued in 1994 had a maturity of three years, more recent bond issues have maturities of up to ten years.\textsuperscript{140}

The outstanding public external debt as at the end of 1992 and 1993 was approximately US$ 362 million and US$ 429 million respectively.\textsuperscript{141} In 1994, public external debt rose to US$ 873 million following a US$ 400 million Eurobond issue. By the end of 1995, public external debt was US$ 1,322 million, reflecting a further US$ 300

million Eurobond issue. By the end of December 1996, public external debt was US$ 1,883 million reflecting continued reconstruction expenditures and a US$ 100 million Eurobond issue. Public external debt reached US$ 2,405 million by the end of 1997, reflecting a US$ 100 million Eurobond issue guaranteed as to principal only by the World Bank, a Deutsche Mark 250 million issue and continued CDR borrowing.\textsuperscript{142} In addition, the government issued a US$ 400 million Eurobond of the same principal amount. Public external debt reached an estimated US$ 4,104 million by the end of December 1998, reflecting a US$ 1,000 million Eurobond issue in October 1998. The proceeds of the bond issue, which took place in 1998, were applied in the refinancing of public debt denominated in Lebanese Pound. In March 1999, the government issued US$ 200 million five-year Notes and Euro 300 million five-year Notes under its US$ 2.5 billion Global Medium Term Note Program. In October 1999, the government issued US$ 400 million ten-year Notes and Euro 300 million five-year Notes under the same program. The proceeds of these issues were applied in the refinancing of public debt denominated in Lebanese Pound.\textsuperscript{143} Over the medium term, public external debt is expected to grow due to the refinancing of public debt denominated in Lebanese Pound. The external public debt has been increasing where it reached by January 31, 2004 US$ 15.57 billion (LBP 23,465 billion) accounting for about 49.5 percent of net total public debt.\textsuperscript{144}

\textbf{b. Government’s Measures and Efforts}

Economic conditions have worsened in Lebanon in the past few years. Growth has stagnated, leading to a fall in per capita real GDP. The fall in growth is related to the

\textsuperscript{142} Thomas Helbing, op. cit. p. 43.
slowdown in residential housing construction and in the government's reconstruction program, but it is also attributable to the very large and persistent macroeconomic imbalances, the loss of competitiveness, and structural and administrative impediments. Stubbornly high fiscal deficits in the context of decelerating growth and high interest rates have led to a rapid accumulation of public debt. Competitiveness has been adversely affected by a substantial appreciation of Lebanon’s real effective exchange rate—mainly a consequence of de facto peg of the Lebanese Pound to the US dollar since late 1998 and the latter’s strength vis-à-vis world currencies—and rapid growth in unit labor costs.\textsuperscript{145}

The Hariri government that took office in late 2000 has been seeking to stimulate growth and address the macroeconomic imbalances. Policies intended to spur growth, included measures to enhance competitiveness through a reduction in import duties and in social security contributions and jot encourage capital inflows through the liberalization of foreign investment in real estate and the banking sector.\textsuperscript{146}

The Lebanese government initially faced a dilemma with respect to fiscal adjustment in the context of a stagnating economy, and declines in per capita real income. With an economy drifting into a recession, and thus threatening the already narrow government revenue base, and stagnating exports in 2000, the government took a number of fiscal stimulus measures to revive domestic production and exports, and initiated structural reforms aimed at further liberalizing and deregulating the economy. At the same time, it began to develop a program for medium term fiscal adjustment and


privatization so as to reverse the trend of rising public debt. The government’s program was presented on the occasion of the Paris I meeting, during which it was agreed that external support would be considered once Lebanon had demonstrated progress in the implementation of its program.  

During the Paris I meeting in February 2001, the Lebanese government presented its strategy for structural and institutional reforms aiming at reducing public debt and promoting economic growth. It requested support from the international community to complement its efforts, so as to be able to lower public deficit and interest rates, thus encouraging private sector investment.  

Fiscal adjustment in 2001 was achieved primarily through strict control over non-interest expenditures. Overall non-interest expenditures were as much as 22 percent lower in 2001 than they had been in the previous year. Part of this outcome reflected a spillover of expenditures against the 2001 budget and some delayed payments to private contractors into 2002. However, even without this, the reduction in expenditures in 2001 would be sizable. Despite the spillover of expenditures from 2001 and the payment of the end-2001 arrears during 2002, the ratio of non-interest expenditures to GDP is expected to be further reduced to less than 20 percent of GDP in 2002, from more than 27 percent of GDP in 2000.  

The fiscal adjustment during 2001 and 2002 amounted to the equivalent of 9.8 percent points of GDP, with the primary balance moving from a deficit of 7.6 percent of GDP in 2000 to a surplus of 2.2 percent in 2002. This is well in line with the

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government’s target of a 20 percent points cumulative fiscal improvement over a five-year period, with frontloading. The reduction in the overall fiscal deficit was somewhat smaller than the improvement in the primary balance as interest payments rose further from 17 percent of GDP in 2000 to an estimated 18.1 percent in 2002. For 2002 as whole, the overall fiscal deficit is estimated at 15.6 percent of GDP. The actual fiscal performance in 2001 and 2002 exceeded the targets envisaged in the informal Medium Term Economic Framework that had been developed in collaboration with the IMF 2001 Article IV Consultations mission.150

The improvements on the revenue side are a result of a range of revenue measures. Tax collection improved upon taking severe procedures by the Ministry of Finance against tax violators. By far, the most important recent development was the introduction of the Value Added Tax (VAT) (at a rate of 10 percent on goods and services, with few exemptions), which accounts for a significant part of the increases in revenue in 2002 and 2003.151 The efforts to reduce government expenditures also reflected the results of the initial structural measures taken to rationalize public sector employment and redefine the role of the state. The government’s television station, Télé-Liban, and the national airline, MEA, were restructured, with layoffs totaling about 2000 staff. Surplus employees in a number of public institutions are being redeployed to fill civil service vacancies elsewhere. Major improvements occurred in the performance of the public power company (Electricité du Liban-EDL), which now covers its operating costs before debt service.152

150 Ibid
With the overall fiscal deficit still at high levels, driven in large part by very high levels of interest payments, the accumulation of debt continued, albeit at a somewhat slower rate. Whereas financing during the latter part of the 1990s had relied heavily on intermediation of the deposits of the domestic banking system, became increasingly difficult to tap during 2001 and the first half of the 2002, and, instead, the Central Bank increasingly provided resources to the government for the financing of its deficit.\textsuperscript{153}

In the meantime, at current levels, interest payments on the public debt are absorbing the bulk of government revenues (and exceed all of tax revenues), indicating the need to both reduce the stock of debt and the cost of servicing it. The government has set out to undertake a major program of the corporatization and privatization of public infrastructure to bring about a reduction in the stock of the debt, as well as improvements in efficiency of operations, that will also have a positive fiscal effect and will reduce the cost of services to business. This program will lay the basis for a deepening of Lebanon’s capital markets. The parliament adopted a framework privatization law in 2000 that formed the basis for developing sector specific laws to underpin specific privatization operations in various sectors. The law provided for the establishment of Higher Privatization Council, which became operative in 2001. Three specific laws were enacted in 2002 to set the stage for privatization of two existing cellular phone systems, and to corporatize and privatize the power sector.\textsuperscript{154}

Preparation for privatization in two key sectors—telecommunication and power—with the help of international investment banks and financial and legal advisors, are thus well underway by now. The Lebanese government has already implemented a program

\textsuperscript{153} Ibid.
\textsuperscript{154} Ibid.
of restructuring of the national airline, providing the basis for attracting a strategic investor. Preparations are also underway for legislation to support privatization in the water and wastewater sectors. In the case of ports and the Beirut Airport, initial preparations are also underway for privatization through concessions. Finally, legislation adopted in 2002 framework privatization law can be used as the main vehicle for initially bringing down the level of outstanding debt and the debt to GDP ratio. The same legislation also authorizes the government to establish special-accounts for certain revenues to be used solely for debt payment and servicing.

In order to promote private investment, and in particular to attract more foreign investment, an investment promotion law was adopted in 2001 that establishes a one-stop agency for investors and selective tax incentives, while another law eased limitations on foreign ownership of land. The adoption of strict new law for fighting of money laundering in 2002, enhanced the international standing of Lebanon’s banking system, and encouraged bona-fide foreign financial investments.

Despite the signs of some recovery in terms of GDP growth and exports, the economic and financial situation has been difficult in 2001 and the first part of 2002. A host of factors contributed to significant pressures on Central Bank’s international reserves and pushed interest rates on new government debt upward. On the domestic side, delays in enacting the legislation required for privatization, and the increased Central Bank financing of the government, reduced confidence that Lebanon’s debt situation would be resolved not withstanding government’s stated commitments. A

156 Ibid.
number of external factors compounded the situation, including the perception that the Paris I meeting had not resulted in specific commitments to support Lebanon, as well as the 9-11 events and their immediate aftermath and impact on economies and financial markets around the world.  

Since middle of 2002, there has been a reversal of the negative trends, resulting again from a combination of domestic and external factors, with some recovery of reserves. The fiscal outcome for 2001 and 2002 to-date (including in particular the successful introduction of the VAT) and the enactment of legislation allowing for privatization in the telecommunications and power sectors, reflecting the national consensus that had finally evolved, demonstrated the seriousness of government’s intentions with respect to fiscal adjustment and privatization. Geopolitical developments subsequent to the 9-11 events increased the interest of regional investors in Lebanon, and the de-listing of Lebanon by the Financial Action Task Force (FATF), after the adoption of a strict new law for fighting money laundering, enhanced the international standing of Lebanon’s banking system. The government had already exerted serious efforts to get the economy out of the vicious cycle of high debt. It had taken some measures using “Paris I” meeting that will qualify Lebanon for a bailout. All these efforts served in the successful “Paris II” meeting in November 2002.

c. Paris II Conference and its Aftermath

France’s efforts to help Lebanon in its economic crisis are laudable and consistent with the centuries-old friendship between the French and the Lebanese people. The “Paris II” donors’ conference was the culmination of more than a decade of lobbying by

\[\text{\footnotesize 158 Ibid.}\]
\[\text{\footnotesize 159 “International Monetary Fund (IMF) Statement on Lebanon,” op. cit.}\]
the Lebanese government, which had long complained that of all the protracted conflicts of the 20th century, only the Lebanese civil war ended without some forms of international aid to rebuild the country. Several small-scale events, such as the “Friends of Lebanon” donor conference in Washington in late 1996, resulted in only limited support, including soft development loans.160

On returning to power in late 2000, Prime Minister Rafiq al-Hariri stepped up his efforts to generate foreign support, and building on his close personal friendship with the French President, Jacque Chirac, organized a conference in February 2001. The meeting, now known as Paris I, was relatively small-scale, however, and resulted in offers of development finance worth around US$ 500 million.161 On November 23, 2002, the Paris II meeting was held, with the participation of several countries, in addition to international and regional institutions and funds.162

In the presence of President Jacque Chirac, France was represented by its Prime Minister Jean Pierre Rêfêran. Lebanon was represented by its Prime Minister Rafiq al-Hariri, with the presence of Minister of Finance, Fouad Saniora, and (Former) Minister of Economy and Trade, Bassil Fuleihan. The German Chancellor, Gerhard Schroeder, also participated, in addition to the prime ministers of Spain, Italy, Belgium, Denmark, Malaysia, Canada, Qatar, the British deputy prime minister, Saudi Foreign Minister, Kuwaiti Minister of Finance, Bahraini Minister of Finance, and representatives of the United States, Japan, United Arab Emirates and Oman.163

161 Ibid.
The institutions and funds that participated included the European Commission, European Bank for Investment, World Bank, International Monetary Fund, Arab Monetary Fund, Arab Fund for Development, Saudi Fund for Development and the Kuwaiti Fund for Development.\textsuperscript{164}

Lebanon won pledges for US$ 4.3 billion in low-cost loans at Paris II. Loan pledges came mainly in the form of low-interest bond issues, grantees from lender countries and syndicated loans. Saudi Arabia was the main donor with US$ 700 million, followed by France and the Arab Development Fund (US$ 500 million each), the European Investment Bank (US$ 350 million), United Arab Emirates, Kuwait and Malaysia (US$ 300 million each), Italy, Qatar, Canada and Bahrain (US$ 200 million each), Japan and the Arab Monetary Fund (US$ 100 million each), Belgium (US$ 70 million), and Oman (US$ 50 million).\textsuperscript{165} The aid package would be split between around US$ 3 billion going directly to the Lebanese Treasury, and US$ 1.3 billion to be used in development projects in the country.\textsuperscript{166}

The Lebanese Government presented an official paper at the meeting. The government made a commitment with a strict timetable for privatizing state-owned enterprises (SOEs). It was expected that US$ 5 billion would come from privatization in 2003, and US$ 1 billion per year for 2004 and 2005.\textsuperscript{167} The most important other key targets presented at Paris II were: proceed in lowering government’s expenditures, where 2003 budget recorded a decrease in expenditures by 9 percent compared with 2002; and

\textsuperscript{164} Ibid.


\textsuperscript{166} Ibid.

improve the government's revenues, which are expected to increase by 16 percent compared with 2002.\textsuperscript{168} The targets also included moving the primary balance from a deficit of 7.5 percent of gross domestic product in 2000 to a surplus of 5 percent in 2003; reaching a fiscal deficit of 10 percent in 2003 and 1 percent in 2005, with a surplus in 2006; and reducing interest rates on public debt by about one-third in 2003 and 1 percent in 2004 (according to pre-Paris II rates). The government provided a five-year plan outlining different reforms and measures to better prepare the economy for long-term positive growth. The government asked for around US$ 5 billion for the substitution of debt into long-term maturities with a grace period of five years. During that time, the government intends to eliminate the overall fiscal deficit and payment period of 10 years, and expects to repay the obligations arising from the Paris II meeting. The government has also established by law a special Treasury account at the Central Bank that is earmarked exclusively for servicing the interest and principal of outstanding debt obligations, including forthcoming resources from Paris II. The aforementioned law states that all privatization and securitization proceeds must be channeled to this account for the exclusive purpose of debt reduction. The government's plans for reform were accepted by the international community with few modifications. The International Monetary Fund, which received the government plan, had indicated that the government's strategy of fiscal adjustment would lead to a viable scenario only if external support of the magnitude and type requested at the Paris II meeting was delivered.\textsuperscript{169}

\textsuperscript{169} "Privatization Plan is Key to national recovery," op. cit.
The major political, economic and strategic goals that the participating countries agreed on in Paris II were: First, all the participants confirmed that stability in Lebanon and the region is important, and Lebanon plays an important role in this stability, however, this depends on the improvement of its situation (especially economically). Second, assisting Lebanon in the efforts to improve its economic situation is important to addressing the economic and social conditions that can lead to terrorism. Third, the participating countries agreed also to help Lebanon to settle its relationship with the IMF in order to reach an agreement. This emphasis on the necessity of reaching an agreement with the IMF does not mean that countries, which support this condition, do not want to help Lebanon, but they believe that if Lebanon received aids from all the participating countries without reaching an agreement with the IMF, then a lot of countries will ask for the same thing.

The Paris II agreement has opened the way for further debt restructuring steps, which taken together will have a more substantial impact on Lebanon’s fiscal profile. In particular, the government has negotiated a deal with the commercial banks that will see them provide several billion dollars in interest-free lending to the government. Under the agreement, which was concluded in the weeks after Paris II, each bank forgoes all interest on government debt they own up to the equivalent value of 10 percent of their deposit base (as measured at the end of October 2002). The banks will surrender local-currency Treasury Bills and concessional debt will be swapped for high-cost Treasury Bills. Banks agreed to buy US$ 4 billion in zero-cost debt foreign-currency Eurobonds equal to this amount to the Central Bank, which will be replaced with an instrument of the same
value, denominated in the same currency, which carries no interest. The instruments will have a two-year term, and on maturity will be reimbursed or replaced with interest-yielding bills. The swap will take place over the first five months of 2003, with banks surrendering the equivalent of 2 percent of their discount base each month, beginning January 17, 2003. Total banking sector deposits at the end of October 2002 stood at around LBP 60 trillion (US$ 40 billion), and across the sector the agreement is expected to generate US$ 4 billion in interest-free credit for the government. Based on an average yield of around 12 percent, the deal will save the treasury some US$ 480 million a year or close to US$ 1 billion over the two-year term.

The savings to the treasury are effectively income that the banks have given up to bail the government out of its financing crisis. Although the term was avoided, the deal amounts to a rescheduling the first Lebanon has ever had on public debt, and which analysts had long warned was inevitable given the public finance dynamics. Moreover, while it was presented as a voluntary agreement, it is clear that the deal was concluded in large part as a result of heavy pressure from the Central Bank. Nevertheless, there is also a distinct element of self-interest underpinning the banks’ decision to support the government. All of the commercial banks are heavily exposed to public debt, and despite sovereign guarantees, have become increasingly concerned about the quality of their holdings.

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171 Ibid.
172 Ibid.
173 Ibid.
174 "The Economic Intelligence Unit Lebanon’s report," op. cit., p. 15.
By May 2003, proceeds totaling approximately US$ 2.4 billion have been received from seven countries. These amounts correspond to around 77 percent of the total US$ 3.1 billion pledges of support for debt management. They have been deposited in the Special Account for Debt Management\textsuperscript{175}, and have been subsequently used to retire and replace maturing debt (both principal and interest). (See table 2.6)

<table>
<thead>
<tr>
<th>Month</th>
<th>Malaysia</th>
<th>Oman</th>
<th>UAE</th>
<th>Kuwait</th>
<th>France</th>
<th>KSA</th>
<th>Qatar</th>
<th>Total</th>
</tr>
</thead>
<tbody>
<tr>
<td>Dec-02</td>
<td>300</td>
<td>50</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td>350</td>
</tr>
<tr>
<td>Jan-03</td>
<td></td>
<td>300</td>
<td>300</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td>600</td>
</tr>
<tr>
<td>Feb-03</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td>0</td>
</tr>
<tr>
<td>Mar-03</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td>540*</td>
<td>700</td>
<td></td>
<td>1,240</td>
</tr>
<tr>
<td>Apr-03</td>
<td></td>
<td></td>
<td></td>
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<td></td>
<td></td>
<td></td>
<td>0</td>
</tr>
<tr>
<td>May-03</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td>200</td>
<td></td>
<td>200</td>
</tr>
<tr>
<td>Total</td>
<td>300</td>
<td>50</td>
<td>300</td>
<td>300</td>
<td>540</td>
<td>700</td>
<td>200</td>
<td>2,390</td>
</tr>
</tbody>
</table>

Source: Lebanese Republic, Ministry of Finance
Note: *Counter value of contributions in Euro at US$/Euro 1.08 rate.

In addition to the US$ 2.4 billion received, contributions have been received from two multilateral institutions: First, the Arab Monetary Fund (AMF) contributed US$ 15 million in the form of a medium, term loan for structural adjustment. Moreover, the AMF extended a US$ 40 million trade finance facility to be used for the financing of fuel imports by Electricité du Liban. Second, the European Union contributed Euro 12.25 million as a grant to be used for structural adjustment and fiscal reforms. As of end-September 2003, the entire US$ 2.42 billion\textsuperscript{176} of the amounts collected from the Paris II lender countries were utilized on a weekly basis to retire market debt denominated in

\textsuperscript{175} The Special Account for Debt Management has been opened in accordance with Law No. 430, allowing for the creation of a separate account at BDL to place funds from loans and grants dedicated for debt management as well as potential privatization and securitization receipts.

\textsuperscript{176} The amount is approximate given the volatility of the Euro/US$ exchange rate in the calculation of the Euro 500 million contribution of France which was used at different times and at different Euro/US$ rates.
Lebanese Pounds, US Dollars, and Euros, by paying back maturing principal and coupons.\(^{177}\)

As a result of the implementation of the Paris II financial package (from lender countries, Banque du Liban, and commercial banks), the overall weighted average cost of total public debt outstanding (domestic and foreign combined) declined by 361 basis points, from 11.97 percent (of the total public debt) in November 2002 (at the time of Paris II conference) to 8.36 percent as of the end of November 2003. The overall average cost of outstanding domestic debt declined by 459 basis points from 13.82 percent to 9.23 percent and the overall average cost of outstanding foreign debt declined by 181 basis points from 9.21 percent to 7.39 percent during the same period.\(^{178}\)

<table>
<thead>
<tr>
<th>Table 2.7 Overall Weighted Average Cost of Outstanding Public Debt</th>
</tr>
</thead>
<tbody>
<tr>
<td>Date</td>
</tr>
<tr>
<td>----------</td>
</tr>
<tr>
<td>Before Paris II Nov-02</td>
</tr>
<tr>
<td>After Paris II Nov-03</td>
</tr>
<tr>
<td>Change</td>
</tr>
</tbody>
</table>

Source: Lebanese Republic: Ministry of Finance.

The financial markets have reacted favorably to the outcome of the Paris II conference. Most interest rates on public debt recorded a substantial drop while the value of Lebanese republic securities increased. Primary market interest rates on Lebanese Pound Treasury bills of all categories have declined by more than 30 percent following the Paris II conference, and the yield curve flattened between the 12 and 24-month maturities. The issuance of T-bills was halted for 9 months (February-November 2003) given the liquidity provided by the Paris II package. In November 2003, the Ministry of Finance resumed its Treasury bill issuances, and the yields dropped further. The yield


\(^{178}\) Ibid, p. 16.
curve was also extended with the introduction of the longer 3-year maturity treasury bills.\textsuperscript{179}

Table 2.8 Evolution of Primary Market Treasury Bill Yields

<table>
<thead>
<tr>
<th></th>
<th>Pre-Paris II (End-October 2002)</th>
<th>Post-Paris II (January/February 2003)</th>
<th>Nov-03</th>
</tr>
</thead>
<tbody>
<tr>
<td>3-months T-bills</td>
<td>11.18%</td>
<td>6.96%</td>
<td>5.37%</td>
</tr>
<tr>
<td>6-months T-bills</td>
<td>12.12%</td>
<td>8.18%</td>
<td>6.55%</td>
</tr>
<tr>
<td>12-months T-bills</td>
<td>13.43%</td>
<td>9.13%</td>
<td>6.89%</td>
</tr>
<tr>
<td>24-months T-bills</td>
<td>14.64%</td>
<td>9.41%</td>
<td>7.84%</td>
</tr>
<tr>
<td>36-months T-bills</td>
<td>0</td>
<td>0</td>
<td>8.66%</td>
</tr>
</tbody>
</table>

Source: Lebanese Republic, Ministry of Finance.

Even if the bulk of the US$ 3 billion loan going to the Lebanese treasury was used to repay the most expensive debt, this would only lower the public debt service by an estimated US$ 300 million per year. Obviously, that will not be sufficient to reverse the explosive trajectory of the public debt.\textsuperscript{180}

The World Bank, in a report released in January 2004, criticized developments relating to the country’s fiscal affairs and privatization program since the ‘Paris II’ donors’ conference, which have fallen short of initial expectations. “Although Paris II cash flows have definitely helped stabilize the financial situation, increasing foreign reserves and lowering borrowing rates for the government, they were not supported by enough progress on the fiscal and privatization fronts to start reversing the debt dynamics,” stated the report. According to the World Bank, the main causes of the shortfall were due to lower-than-anticipated contributions from donors and banks, a slippage in Treasury expenditures, higher-than-expected debt service and divergences among the authorities on which strategy to adopt regarding privatization, which in turn

\textsuperscript{179} Ibid.

\textsuperscript{180} “Lebanon: Paris II Bonanza,” op. cit.
blocked any tangible steps to secure proceeds in the foreseeable future. Moreover, the political commitment does not seem to indicate that the government will be able to abide by the timetable and figures provided in Paris, especially when it comes to the privatization program. Political conflicts among the government’s member and the disagreement between the president and the prime minister are hindering the progress in the promises that were given at the Paris II conference especially the privatization plan (discussed below). This atmosphere of political divergence and tension affected the economy negatively. It impeded the reform drive and hindered the activity of public sector administrations and institutions. Political and administrative struggle also hampered private sector initiatives and as a consequence the process of adapting to the developments Lebanon was supposed committed to—as mentioned in the paper presented by Lebanon at the Paris II Conference. This situation is preventing many of the projects funded by the World Bank, the European Union, and several European and Arab Monetary Funds.

C. The Lebanese Government and the Adjustment Process

Throughout the past years, Lebanon was able to accomplish a significant increase in the size of tax and non-tax revenues as compared to the GDP. Conversely, this was accompanied by a significant increase in the size of expenditures because the Lebanese state was faced with dealing with the problems that emerged after the war. This situation was coupled with a political environment that conveyed a gloomy and complex image

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that caused the slow in the process of dealing with the real problem of the Lebanese citizens, and the economy especially the privatization process and the fiscal reform. It also masked the real picture of the problems from which Lebanon is suffering and the importance of the methods that need to be adopted in economic, financial and social solutions. The government must go ahead and adopt policies that achieve economic and social growth and sustainable development, and improving employment opportunities regardless of the political and sectarian disagreements.

The current Hariri government focused initially on revitalizing the economy through measures designed to encourage the development of the private sector and the integration of Lebanon into the global economy. The current government’s objectives consist of maintaining monetary and price stability and improving fiscal performance through a reduction in the debt service burden, the curtailment of other public expenditures and privatization of state assets.

Lebanon has failed to implement many aspects of the structural and fiscal reform agenda presented to the participants in the “Paris II” conference on November 23, 2002, which was based on the unanimous approval by the Council of Ministers of the 2003 budget proposal that was itself based on the same premises. The government is not able to solve the problems and to fulfill its promises to the international community because of internal political struggles among the government members. The problems are increasing, rather than reducing the size and cost of the public sector, it has increased in several institutions due to hiring people as a result of political bickering under the theme of distribution of spoils or that of sectarian balance. Moreover, the privatization plan was completely frozen. Concerned officials have to decide if privatization was an efficient
solution or if it should be postponed and improve the state's income from services, instead of selling such services partially or totally.\textsuperscript{183}

1. Privatization plan

The Lebanese authorities have decided to embark on a privatization program that encompasses most public sector enterprises. Privatization has mainly been prompted by the need to improve efficiency in the delivery of public services. The government has set out to undertake a major program of the corporatization and privatization of public infrastructure to bring about a reduction in the stock of the debt, as well as improvements in efficiency of operations, that will also have a positive fiscal effect and will reduce the cost of services to business. This program will lay the basis for a deepening of Lebanon's capital markets. The parliament adopted a framework privatization law No. 228 in May 2000 that formed the basis for developing sector specific laws to underpin specific privatization operations in various sectors. The law provided for the establishment of Higher Privatization Council, which became operative in 2001. Three specific laws were enacted in 2002 to set the stage for privatization of two existing cellular phone systems, and to corporatize and privatize the power sector.\textsuperscript{184}

Preparation for privatization in two key sectors—telecommunication and power—with the help of international investment banks and financial and legal advisors, is well underway by now. The government already has implemented a program of restructuring the national airline, providing the basis for attracting a strategic investor. Preparations are also underway for legislation to support privatization in the water and wastewater


sectors. In the case of ports and the Beirut Airport, initial preparations are also underway for privatization through concessions. Finally, legislation has been adopted in the 2002 framework privatization law for initially bringing down the level of outstanding debt and the debt to GDP ratio.

However, the privatization plan, which was expected to bring more than 3 billion dollars and reduce the public debt, has failed. International rating agency Moody’s downgraded the country's credit to negative due to the government's failure to implement privatization and securitization. Moody’s opinion update said the negative rating outlook for Lebanon reflects the severe constraints on the targets laid down in its economic program. “Moody’s believes that the government’s economic program is admirable in view of the competitive and fractious nature of domestic politics. However, we note that the margin for error in achieving these targets is practically zero, and success hinges on the stop-gap financing provided by privatization and leases of state-owned companies,” the report said. Other rating agencies such as Standards and Poor’s and Fitch also expressed concern about the performance of the economy and the government’s inability to achieve any of the targets.

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186 Ibid.
187 Moody’s Investors Service is among the world’s most respected, widely utilized sources for credit ratings, research and risk analysis. The firm publishes market-leading credit opinions, deal research and commentary that reach more than 3,000 institutions and 20,000 subscribers around the globe. Moody’s Corporation (NYSE:MCO) comprises two subsidiaries: Moody’s Investors Service and Moody’s KMV. The corporation had reported revenue of $1.2 billion in 2003. The corporation employs nearly 2,300 people worldwide and maintains offices in 18 countries. For more information, check: http://www.moodys.com/cust/default.asp
The World Bank warned that little progress was achieved in reducing Lebanon’s macro-imbalance. “In 2003, the public deficit was 56 percent higher than budgeted and the privatization program was put on hold. The 2004 budget, as endorsed by the Cabinet, does not provide for major reforms to reverse the debt dynamics.” The public debt has spiraled out of control due to lack of policies and overspending. It currently exceeds US $33 billion, or 190 percent of the Gross Domestic Product (GDP), making it one of the highest debt-to-GDP ratios in the world. “Debt will continue to grow in 2004 and its law of motion continues to be unsustainable, as it mechanically increases government’s financing needs. Whereas Lebanon is showing a high degree of resilience to crisis, no country is immune in the face of growing imbalances.” The World Bank advised the Lebanese government to engage in a public debate to spell out the risks of non-action, available policy options, distributional implications of such policies and steps to mitigate their effects on the most vulnerable groups. The result of non-action “would threaten the prospects of future recovery with devastating effects on the financial sector, the social fabric and the quality of public governance. Policy options would include fiscal and monetary policies, as well as debt management and privatization,” said the World Bank. The Lebanese government has set aside the privatization program it promised to engage in because authorities believe that the sale of the mobile, electricity and aviation sectors would not reap sufficient financial benefits to reduce the public debt.189

The political problems between the president and the prime minister in addition to other political problems among the government members due to sectarian issues are stopping necessary reforms. The Economist Intelligence Unit (EIU) has repeated its

cautious outlook of Lebanon, emphasizing again that Lebanon cannot move forward as long as Lahoud and Hariri are both in power. The tug of war between Lahoud and Hariri has not only crippled all institutions, according to the report, but it has also dealt a severe blow to all economic and political reform plans. The international community, especially those countries that backed the Paris II conference, is very disappointed by the government’s failure to implement privatization and other reforms—a stance that is seen as damaging to Lebanon’s efforts to obtain more economic assistance from Europe and the Arab states. EIU noted that either Lahoud or Hariri would have to remain outside of the political picture if reforms are to take place. “The failure of government efforts to auction two mobile phone licenses has confirmed our view that there is unlikely to be any substantial progress on the main aspects of the economic reform program until the power struggle between the President and the prime minister is resolved,” as the report added.\(^{190}\)

2. Fiscal Development

The Government's program of fiscal reforms was strengthened in 2003 in order to increase the level of the primary budget surplus by further controlling expenditures and increasing revenues through new tax measures. Among the main successes of this program is the introduction of the Value Added Tax in February 2002 that resulted in a marked increase in revenues.\(^{191}\) The launching of the value-added tax was an integral part of the government’s program to institute fiscal and structural adjustments, introduce reforms, and modernize the functions of the state. It represented a landmark in the country’s tax modernization efforts. Building on the experience of over 125 countries


\(^{191}\) Lebanese Republic: Ministry of Finance, One-Year Progress after Paris II, op. cit, p. 21.
that have already adopted this type of tax, Lebanon was able to benefit from the lessons these countries offered. Based on their experience with various tax rates, unified and multi-tiered, and the various sets of goods and services that these countries exempted, Lebanon came up with a simple, uniform rate of 10 percent and a wide basket of exemptions from the tax that take into consideration the consumer behavior of low-and middle-income families.\textsuperscript{192}

The Government is also preparing for the introduction of the General Income Tax in 2005. In addition, the program involves complementary fiscal reforms and financial consolidation summarized below. The success of these fiscal reforms, however, will hinge on the implementation of other prerequisite reforms, such as the privatization plan, presented at the Paris II Conference.\textsuperscript{193} As we can see from the situation, the success is very limited because of the political struggles among the government’s members.

Some of the major revenue enhancing developments were: The introduction of a new 5% tax on interest generating income in all currencies, which generated since its effective implementation date in February 2003 LBP 95 billion by end-September 2003; the establishment of a Large Taxpayers Unit (LTU) in order to audit and review large taxpayers’ income tax declarations, and hence expand the audit capacity at the Ministry of Finance; the modernization of the Deduction at Source on Salaries (DASS, Title II of the Income Tax Law) administration by creating a reliable and exhaustive database covering the active and retired labor force in both the private and public sectors. This is in addition to the increase in the frequency of tax filing and payment from semi-annually to


\textsuperscript{193} Lebanese Republic: Ministry of Finance, \textit{One-Year Progress After Paris II}, op. cit, p. 21.
quarterly resulting in lower tax arrears; the lowering of the mandatory VAT threshold from the current minimum annual turnover of LBP 500 million to LBP 300 million which came into effect in April 2003; the increasing in some fees including fixed phone line fees (monthly subscriptions and fees per minute), and road usage fees; and the installment of outstanding tax regularization dues pursuant to the tax amnesty law ratified in December 2002 through payments to be made during 2002-2005. The total sums due amount to LBP 162 billion out of which LBP 94 billion were collected in 2002 and the remaining will be paid in installments through 2005.\textsuperscript{194} In addition to the above-mentioned revenue enhancing measures, the Ministry of Finance is currently implementing a number of fiscal reform projects that will lead toward rationalization of expenditures.

\textsuperscript{194} Ibid.
Ch III: Lebanon’s Participation in the Great Arab Free Trade Area

Since the end of the Lebanese civil war (1975-1990), the state has assumed a growing role in the economy. This intervention by the government in the economy however has been far from successful. With public expenditures by 1998 running almost 40% of GDP and the trade deficit at US$ 6,345 million, both public accounts and foreign trade reflect worrying imbalances.\textsuperscript{195} At the same time globalization, which is increasing interdependence and competition in world markets, compels Lebanon to reform and modernize its economy. The country cannot keep ignoring international trends that favor free trade, especially with the Arab countries and the European Union (EU).

Within the MENA region, the Gulf States are the main consumers of Lebanese products, owing to their relatively high-income levels, their hosting of large Lebanese expatriate communities, and the success of Lebanese capitalists in establishing footholds in these countries since the 1960s. The dominance of exports to the Arab World in Lebanese exports is largely responsible for the efforts of Lebanese governments in the postwar era to foster closer trade and other economic ties with the Arab countries.\textsuperscript{196}

In the postwar era, the geographic distribution of Lebanese exports became more diversified. Nevertheless, the Arab bloc of countries continues to receive the largest portion of Lebanese exports. In 1998, for example, the share of the Arab bloc in Lebanese exports was 52.1 percent, which is more than 50 percent higher than the share of all Europe which is 22.3 percent. Yet, figures reveal the growing importance of exports to the EU, other European markets, and North America. Between 1993 and 2000,


\textsuperscript{196} Sami Baroudi, Lebanon's Foreign Trade Relations in the Post-civil war Era: Scenarios for Integration (1990-present), (Paper presented to the MESA 2001), Washington D.C., 2001, pp. 3-5.
the share of the EU in the Lebanese exports grew from 17 percent to 27 percent; the share of North America grew from 4 percent to 7.2 percent (figure 3.1), while the share of the Arab countries was 46 percent.\textsuperscript{197} As for the imports, the EU has the greatest percentage with 51 percent, and the Arab countries only 12 percent in 2000 (Figure 3.2).\textsuperscript{198}

\begin{figure}[h]
\centering
\includegraphics[width=\textwidth]{figure31.png}
\caption{Lebanese Trading Partners}
\end{figure}

Commodities: Prepared foodstuff, vegetable products, pearls, stones, and imitation jewelry, machinery, chemical products, mechanical and electrical appliances, pulp of wood and recycled paper.


\begin{figure}[h]
\centering
\includegraphics[width=\textwidth]{figure32.png}
\caption{Lebanese Trading Partners}
\end{figure}

Commodities: Machinery, vehicle and transport equipment, electrical equipment, metallic equipment, raw material, chemical products, prepared foodstuffs, textiles.


\textsuperscript{197} Banque du Liban, \textit{Al Taqir al-Sanawi} (Annual Report), Beirut, 1994-1997.

Table 3.1 Trade Partners

Table 3.2 Trade Patterns

Trade Patterns: 1997-2001

<table>
<thead>
<tr>
<th></th>
<th>1997</th>
<th>1998</th>
<th>1999</th>
<th>2000</th>
<th>2001 (proj)</th>
</tr>
</thead>
<tbody>
<tr>
<td>EU</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Imports</td>
<td>3,538 (47%)</td>
<td>3,274 (46%)</td>
<td>2,877 (46%)</td>
<td>2,745 (44%)</td>
<td>2,997 (45%)</td>
</tr>
<tr>
<td>Exports</td>
<td>149 (23%)</td>
<td>155 (23%)</td>
<td>176 (26%)</td>
<td>142 (20%)</td>
<td>130 (18%)</td>
</tr>
<tr>
<td>Revenues</td>
<td>698 (54%)</td>
<td>650 (46%)</td>
<td>675 (48%)</td>
<td>587 (47%)</td>
<td>457 (42%)</td>
</tr>
<tr>
<td>Imports</td>
<td>691 (9%)</td>
<td>609 (9%)</td>
<td>558 (9%)</td>
<td>767 (12%)</td>
<td>858 (13%)</td>
</tr>
<tr>
<td>Exports</td>
<td>315 (49%)</td>
<td>324 (49%)</td>
<td>294 (44%)</td>
<td>327 (46%)</td>
<td>345 (49%)</td>
</tr>
<tr>
<td>Revenues</td>
<td>200 (15%)</td>
<td>234 (17%)</td>
<td>208 (15%)</td>
<td>218 (17%)</td>
<td>265 (25%)</td>
</tr>
<tr>
<td>ARAB</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Imports</td>
<td>3,227 (43%)</td>
<td>3,173 (45%)</td>
<td>2,772 (45%)</td>
<td>2,716 (44%)</td>
<td>2,874 (43%)</td>
</tr>
<tr>
<td>Exports</td>
<td>179 (28%)</td>
<td>183 (28%)</td>
<td>207 (31%)</td>
<td>245 (34%)</td>
<td>236 (33%)</td>
</tr>
<tr>
<td>Revenues</td>
<td>403 (31%)</td>
<td>531 (38%)</td>
<td>532 (38%)</td>
<td>456 (36%)</td>
<td>356 (33%)</td>
</tr>
</tbody>
</table>


In this chapter, I am going to talk about the position of Lebanon in the Arab region, and the Lebanese government efforts in support of trade liberalization with the Arab countries. I also will deal with trade agreements signed with other Arab countries (Egypt, Jordan, Syria and the GCC). After that I will talk about the responses of the Lebanese private sector (Lebanese industrialists and agricultural committees and farmers) to these agreements.
A. Lebanon and the Great Arab Free Trade Area (GAFTA)

Lebanese governments in the postwar era sought to strengthen Lebanon’s trade and economic ties with the MENA region for economic, political and ideological reasons. Economically, it made sense to reestablish trade ties with the Arab countries, especially the Gulf economies, which comprised the main markets for Lebanese exports in the post-war period. Politically, the Lebanese governments saw in trade and other economic agreements a mechanism to strengthen bilateral relations with regional players, such as Egypt, Jordan, Saudi Arabia, and Syria. Almost every single Lebanese delegation that visited an Arab capital in the 1990s felt the importance of signing some economic agreements with the host country, partly to confirm the closeness of the relationship with that country. At the level of ideology, Lebanese officials saw in reinforcing trade and economic relations with the Arab region an act of confirmation of Lebanon’s Arab identity that was emphasized in the Ta’if constitution of 1989. This eastward orientation in Lebanon’s foreign trade relations manifested itself in Lebanon’s support for the creation of GAFTA.

1. Origins and Importance of the GAFTA

The last two decades have witnessed deepening economic integration among nations through formal regional trading arrangements. Spearheaded by the United States and the European Union, regionalism spread rapidly in the Americas, Europe and at a later stage in the Asia-Pacific region, but was slower to take hold in the MENA region.

199 Sami Baroudi, Lebanon’s Foreign trade Relations in the Post-civil war Era: Scenarios for Integration (1990-present), op. cit.
200 Members of the Lebanese Parliament met in Ta’if, Saudi Arabia, in September 1989 and reached agreement on political reform, the ending of the war in Lebanon, the establishment of special relations between Lebanon and Syria, and a framework for the beginning of Syrian withdrawal from Lebanon. The Lebanese parliament passed the agreement on November 4, 1989, and went ahead to elect Deputy Rene Muawwad to the Presidency on November 5, 1989. For the complete agreement, see: http://www.geocities.com/CapitolHill/Parliament/2587/taef.html
Regionalism is now understood to be a process of regional integration, which contributes to a successful merger with the world economy, that is to say, a process that goes hand in hand with multilateral liberalization. The extent to which countries in different regions of the world have increased their integration into the world economy varies significantly. Some countries, such as China, have greatly increased their participation in the global economy in the last decade. Others, including many countries in the MENA region, have been less dynamic. Although several MENA countries have pursued economic reforms, including trade liberalization, the pace of integration into the world economy achieved by the region has been slow.

Despite the attention paid to the cooperation and integration by Arabs, no real or considerable progress was achieved. The Arab league was the first to call for agreements for economic cooperation among Arab countries. It made the proposal more than forty years ago before most of the international economic cooperation projects now underway were even proposed. However, Arab politicians did not pay enough attention to economic cooperation and integration and began talking about political and military cooperation. Economic cooperation was thus downplayed from their agenda. The Arab League has never been able to grasp the importance of the economy as a means of realizing political goals. Business and commerce were things that Arab politicians considered them the effects and not the causes of any political action. But now, with the emergence of various international blocs, the issue cannot be argued.

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The failure of the first wave of Arab regionalism led some countries to devote their efforts to pursuing smaller-scale regional groupings in the 1980s. Three regional groupings were founded: the Gulf Cooperation Council (GCC) established in 1981 by Bahrain, Kuwait, Oman, Qatar, Saudi Arabia and the U.A.E, the short lived Arab Cooperation Council between Egypt, Iraq, Jordan and Yemen, and the Maghreb Arab Union established by Algeria, Libya, Mauritania, Morocco, and Tunisia. The empirical evidence indicates that although intratrade of these smaller scale groupings grew, this expansion was far less than that which occurred in external trade.204

The discouraging history of previous Arab efforts at regionalism was due to economic and political factors. Some of the economic reasons are: most Arab countries, with the exception of the GCC countries, have implemented industrial strategy founded on import substitution and a large public sector. Both of these has led to high protection across industries, non-transparent pursue of trade policies and huge investments in state owned industrial enterprises and human skills unsuited to a competitive market economy. Moreover, Arab governments ended up relying on import duties as a main source of revenues and lacked the administration capacity to introduce broad-based domestic consumption taxes.205 Bureaucratic red tape to protect rents that accrue to interest groups among domestic producers, politicians and governments officials also contributed to the failed legacy of Arab regional trade arrangements.

As for the political reasons, Arab countries did not seem to have sufficient incentives to integrate. This was translated into mistrust in binding commitments for a

regional liberalization scheme covering substantial trade. Finally and not least, political differences among the Arab leaders have weighted heavily in the Arab economic relations.206

Indeed, Arabs have all now woken up to certain basic realities. All of them have realized the fact that the world has been transformed into economic blocs that carry political weight. They are even at last admitting the failure of political and military cooperation. In the same way, they have realized that the idea of the Arab Common Market forgotten by themselves has become a focus of interest to others who have proposed a Middle East Market project with parameters being drawn by alien hands207 (Shimon Peres proposal for the Middle East in his book “The New Middle East”).

The Greater Arab Free Trade Area (GAFTA), launched by the member states of the Arab League on January 1, 1998, is a recent example of renewed attempts at regional integration in the MENA region.208 The purpose of the GAFTA is the elimination of import duties and other barriers to trade on goods of Arab origin over a ten-year period. As a result, by 2008 intra-Arab imports will enter each country of the region—spanning Morocco in the west to Oman in the East—without encountering tariffs or tariff-like barriers.209 Incentives for Arab countries to achieve economic integration are legion, although this process should not revert to protectionism. Among these incentives are

207 Mosad Zineldin, Globalization and Economic Integration among the Arab Countries, (The fourth Nordic Conference on Middle Eastern Studies: The Middle East in Globalizing World), Växjo University, Oslo, 13-16 August 1998, pp. 11-12.
208 The fourteen member states that signed the GAFTA are: Bahrain, Egypt, Iraq, Jordan, Kuwait, Lebanon, Libya, Morocco, Oman, Qatar, Saudi Arabia, Syria, Tunisia, and UAE. The six remaining member states (Algeria, Djibouti, The Comoros Islands, Mauritania, Sudan, and Yemen) have not ratified the agreement yet. Palestine also signed the GAFTA, but is excluded from this analysis as it has customs union with Israel and does not have free trade movement with the other GAFTA members.
economy of scale, as a market of more than two hundred million people is involved, and
the dynamisation of the Arab private sector, which is expected to substitute for the public
sector in leading economic development efforts, and exploiting investment
opportunities.210 Other benefits for the Arab economic integration would be reflected if
the transition from import substitution to an export-led policy were accelerated. It would
allow for the improvement of Arab economic complementarity and the use of inter-Arab
competitive advantage and the possibilities of intra-industry cooperation to upgrade Arab
industry, so as to meet challenges created by WTO trade liberalization and reduce the gap
with other similarly endowed regions as far as competitiveness in global market and
contribution to world trade are concerned.211

The economic independence or interdependence in form of cooperation and
integration instead of merely competition is today’s most important issue for Arab
prosperity and development. There could also be products manufactured in different
parts of the region and marketed for the whole region. For example, a car assembled in
Lebanon, with the engine manufactured in Egypt, plastic parts produced in Saudi Arabia,
furniture in Morocco, etc. This is a dream that could exist after arranging the Arab house
from the inside and working harder to reach total integration among the Arab
countries.212

Two factors have been advanced for the recent interest in establishing a region-
wide FTA (Free Trade Area). First, many countries in the MENA region have
implemented reforms to reduce the economic role of the public sector and shift away

210 Ibid.
211 Arab Commercial and Economic Co-operation: The Greater Arab Free Trade Area. Online. Internet. 18
212 Mosad Zineldin, op. cit, p. 13.
from import substitution. As a result, there is greater scope for the region to expand intra-trade and to exploit investment opportunities. Second, the post-Uruguay Round tariff and non-tariff reduction and the strengthening of the multilateral trading system have raised fears of marginalization of MENA economies that have relied on preferences for their exports to industrial markets.213

Responses to this challenge have included increased interest in WTO membership and the conclusion of a series of “Association Agreements” between the EU and the Southern Mediterranean countries. Such agreements involve the complete liberalization of trade with the EU over a twelve-year period. The agreements are expected to foster trade and development and to attract FDI in the Southern Mediterranean region. However, there is a danger that the association agreements will give rise to trade diversion and discourage intraregional economic ties. If all the MENA countries do not have comparable FTAs with each others—that is, if they do not conclude a single free trade area—then the common denominator of the association agreements will be the EU. This may lead to a situation in which foreign investors choose to invest in the EU “hub” in order to service all the Arab “spokes.” “Minimizing the so-called “hub and spoke” effect by lowering intraregional trade barriers is a major incentive for creating a single free trade area among Arab countries in the MENA region. The bi-lateral agreements signed by Arab countries may serve by enhancing the effects of the GAFTA and contribute to exploit the considerable room existing for intra-Arab investment.214

Lately, many Arab leaders are calling for economic and political unity, and they argue that their countries will open their borders to other Arab countries in order to tie the social and economic relations among the region and to cooperate to achieve the social, political and economic stability. They emphasize the importance of comprehensive development through regional cooperation and integration; to form an Arab economic bloc operating in a world order based on balance and equality.\textsuperscript{215}

Increased regional interaction, particularly in outwardly oriented development strategies, can enhance economic welfare through specialization and rationalization of consumption and production activities. It can also increase the region’s collective political bargaining power in extra-regional forums, and improve security considerations. These considerations go a long way to explaining the renewed worldwide interest in regional arrangements, in the Americas, Asia, and Europe. Countries in the MENA region face important political, social and economic challenges. Meeting these becomes easier if there is economic growth rather than the economic stagnation still suffered in some countries in the region. Indeed sustained, high economic growth is required if MENA is to address its unemployment problems, find jobs for the large numbers about to enter the labor market, and improve its social indicators. The main key to economic progress for each country is to reform its economy, taking advantage of regional integration in order to face the globalization challenges, and be able to compete in the global market.\textsuperscript{216} Without co-operation and integration among Arab countries, it will be difficult for them to face the new global order.


The policy changes required for successful economic integration are the same as those needed if the countries of the region are to benefit from the more general process of globalization and integration into the world economy. This point is best illustrated by the dynamic Asian economies, where outward-oriented development strategies have been associated with intensified regional economic interaction. There are many indications, geographical, cultural or economic, that suggest there is scope for considerable gains from greater economic interactions within the MENA region. However, the Arab-Israeli conflict and the intra-Arab conflict, joined with inappropriate economic policies, have kept intra-regional economic interactions at a low level in recent decades. Merely to restore these interactions to their natural levels would give an important boost to economic growth within the region.\footnote{Ibid, p. 6.}

The development of the peace process offers a major opportunity for enhanced economic cooperation within the MENA region. As Western Europe found after World War II, such cooperation strengthens not only economic well-being of countries in the region, but also peace. What is needed is a steadfast commitment by countries to structural reforms, including continued multilateral liberalization, along with the removal of impediments to regional economic interaction and a strengthening of the institutional framework.\footnote{Ibid, p. 7.}

2. Position of Lebanon in the GAFTA

The League of Arab States was established on March 25, 1945 by the seven independent Arab states at that time (Egypt, Iraq, Jordan, Lebanon, Saudi Arabia, Syria and Yemen) and was extended progressively until now there are twenty-two member
states.\textsuperscript{219} The main concern of the league was to strengthen the relations and cooperation among the member states, not only to achieve political objectives, but to develop economic, financial, social and cultural ties among the member states. Within the Arab League framework, if the 1950 treaty for Joint Defense and Economic Co-operation stated among its objectives, to develop the economies of the signatories, the 1953 treaty on transit trade was the first to aim at commercial exchange facilitation through setting preferential tariffs for some agricultural and industrial products.\textsuperscript{220}

Lebanon was a signatory to the 1953 "Agreement to Facilitate Trade Exchange and Transit Trade among Arab league states."\textsuperscript{221} Probably, the most important aspect of the 1953 Agreement was the granting of a 25 percent preferential treatment on the existing tariff rate to products emanating from the Arab region. Most Arab countries, however, substantially raised their tariffs in the 1950s and 1960s in efforts to enhance their infant industries, rendering the 25 percent tariff reduction largely inconsequential. Lebanon, however, did not profess any intentions to join the Arab Common Market, an integration scheme that gained some popularity in the 1960s, but which produced no concrete results, since it failed to materialize, and efforts to achieve it were limited to Egypt, Iraq, Jordan, Syria, and later Libya in 1975.\textsuperscript{222}

\textsuperscript{219} For more information on the Arab League, see: http://www.arableagueonline.org/arableague/index_en.jsp
\textsuperscript{220} Abd al-Rahman al-Suhaybani, \textit{Al-Takamul al-Iqtisadi al-Arabi: Mintaqah al-tijarah al'Arabiyyah al-Kubra} (Arab Economic Integration: The Great Arab Free Trade Area), unpublished paper submitted to the 4\textsuperscript{th} meeting of the Arab Business Society, Kuwait, 4-6 May 2000, p.15. Text of Suhaybani's paper provided courtesy of ESCWA.
\textsuperscript{221} For a discussion of the 1953 Agreement see Taher A. Kannan, \textit{Arab Economic Integration Efforts: A Critical Assessment}. Unpublished study prepared for the Economic and Social Committee for Western Asia (ESCWA), Beirut: ESCWA, 1999.
\textsuperscript{222} Abd al-Rahman al-Suhaybani, op. cit.
After several amendments, the 1953 Agreement was finally superseded by the 1981 “Agreement to Facilitate and Develop Trade Exchanges among Arab Countries.”\textsuperscript{223} The 1981 agreement for the facilitation and promotion of intra-Arab trade, signed by all countries except Algeria, Djibouti, and Comoros, called for the gradual lifting of trade barriers among Arab countries with the ultimate aim of creating a customs union among them. Implementing the provision of the 1981 Agreement, however, proved quite problematic, as most Arab countries drew “lists of exclusion”, placing many products outside the trade liberalization schedules. Another deficiency of the 1981 Agreement was its failure to address the issue of non-tariff barriers to trade. Broadly speaking, the impact of these agreements on regional trade has been extremely limited. Intraregional trade among Arab countries expanded little during the last two decades, and its share in total regional trade has remained small. The relative importance of intraregional trade in total Arab trade rose moderately during the ten-year period of 1986-1997, reaching 9 percent of total trade as measured by imports and exports. This compares unfavorably with more successful trading blocs such as the EU, NAFTA (North American Free Trade Agreement),\textsuperscript{224} and the recent Customs Union (MERCOSUR) among four Latin American Countries,\textsuperscript{225} each of which enjoy much higher intraregional trade.\textsuperscript{226} (Table 3.3).

\textsuperscript{223} Ibid.
\textsuperscript{224} North American Free Trade Agreement (NAFTA), pact that calls for the gradual removal of tariffs and other trade barriers on most goods produced and sold in North America. NAFTA became effective in Canada, Mexico, and the United States on January 1, 1994. NAFTA forms the world’s second largest free-trade zone, bringing together 365 million consumers in Canada, Mexico, and the United States in an open market. For more information check the Microsoft Encarta Encyclopedia 2004.
\textsuperscript{225} MERCUSOR, regional trade organization formed in 1991 to establish a common market and a common trade policy toward outside nations. MERCUSOR has four member countries—Argentina, Brazil, Paraguay, and Uruguay. Bolivia and Chile are associate members of MERCUSOR. The organization has its origins in a trade treaty signed by Argentina and Brazil in 1986. In 1990 these countries joined with Uruguay and Paraguay to form a free-trade zone, which allows unrestricted trade between the four
Table 3.3 Intraregional Trade (Percent of Total Trade)

<table>
<thead>
<tr>
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<th></th>
</tr>
</thead>
<tbody>
<tr>
<td>Intra-Arab</td>
<td>6.2</td>
<td>7.3</td>
<td>10.2</td>
<td>8.8</td>
<td>9.0</td>
</tr>
<tr>
<td>Intra-EU</td>
<td>61.0</td>
<td>58.8</td>
<td>65.2</td>
<td>61.9</td>
<td>57.1</td>
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<tr>
<td>Intra-MERCOSUR</td>
<td>10.7</td>
<td>6.7</td>
<td>11.5</td>
<td>19.5</td>
<td>21.0</td>
</tr>
</tbody>
</table>


Nevertheless, the 1981 Agreement served as the basis for a 1995 Egyptian proposal to create a Greater Arab Free Trade Area; a proposal that received the support of Syria and Saudi Arabia.\(^{227}\) A year later, during the June 1996 Cairo Summit of the Arab Heads of State a decision was made to “call on the Economic and Social Council of the Arab League to adopt measures that are necessary to expedite the establishment of the Greater Arab Free Trade Area, in accordance with an action program and a timetable to be agreed upon.”\(^{228}\) The Economic and Social Council established a work group that included government officials and private sector representatives to draw up a plan of action program (barnamej tangizi) for implementing the 1981 Agreement to Facilitate and Develop Trade Exchange among Arab Countries. The Economic and Social Council approved the plan of action in February 1997, paving the way for Arab countries to commence bilateral and multilateral negotiations on the lists of products that would benefit from the 10 percent annual tariff cuts (commencing January 1, 1998) called for in the plan of action.\(^{229}\)

The programme, as agreed on February 1997, was meant to take into account the necessity for the GAFTA to be compatible with the needs of all Arab countries and

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\(^{227}\) Ibid.

\(^{228}\) Decision No. 1997 (23 June 1997) of the Arab League of States. Quoted in Abd al-Rahman al-Suhaybani, p. 15.

\(^{229}\) Ibid.
with international norms. It stressed the importance of including an action plan and a schedule for implementation, in order to avoid past errors. The plan is for the GAFTA to be fully implemented after a ten-year transition period starting on January 1, 1998. The GAFTA implementation will be managed by the council of ministers of the member states and a permanent executive and follow-up committee, a commercial negotiations committee, an Arab rules-of-origin committee and a technical secretariat. These committees include both government experts and representatives of the Arab Chambers of commerce. The GAFTA program consists of progressive, linear, and automatic tariff reductions over ten-years at a rate of 10 percent per annum. Thus, tariffs will be totally eliminated by the year 2007, and the member countries agree to bind the national tariff schedules, which were applied on December 31, 1997. As for the countries that did not ratify, the bound tariffs are those apply at the time they notify the Arab League of the ratification and endorsement of the program. Tariff-like charges and additional taxes are covered by the program and are treated like normal tariffs.

The Lebanese government responded to the adoption of the action program by entering into negotiations with several Arab countries (including Syria) to draw up lists of products that would be subjected to the 10 percent annual tariff cuts, or in certain cases to sharper cuts, or even admitted duty-free. I will be dealing here with two important agreements between Lebanon-Egypt and Lebanon-Jordan, in addition to the negotiations concerning free trade area with the GCC. As for the Lebanese-Syrian agreement I will be

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232 Check Appendix 1 for a list of all the agreements that Lebanon signed with several countries including the Arab countries. Most of the agreements that Lebanon signed with the Arab countries are Fee Trade Agreements.
dealing with it under a separate title. All these agreements were signed as a pursuit of GAFTA.

a. The Trade Agreement with Egypt

On September 10, 1998, the Lebanese Prime Minister, Rafiq al-Hariri, and his Egyptian counterpart, Kamal al-Janzouri, concluded in Cairo three agreements relating to the unification of standards, cooperation in the field of marine transport and the establishment of a free trade zone.233 The action program sought reciprocity by completely lifting duties on two specific lists of agricultural products (one list for Lebanese exports and the second list for Egyptian exports) provided that these products are admitted during periods of low production in the other country.234 As for industrial products, they were divided into three categories: First, products (mainly processed foods) that would be subjected to 25 percent annual tariff reductions starting with the beginning of the year 1999; second, products that would be subjected to lower annual cuts in tariffs; third, products that Egypt would agree not to export to Lebanon or would export only upon the issuance of import licenses from Lebanon.235

A little more than a year prior to the agreement, in March 1997, Lebanon and Egypt had come to blows over trade when the Lebanese Minister of Agriculture (at that time), Shawqi Fakhuri, restricted imports of Egyptian potatoes. Fakhuri justified his decision by saying that he had to respond to a protest from local potato farmers at the flooding of the Lebanese market with cheaper Egyptian potato. The Egyptian

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234 Each country would draw its own agricultural calendar, identifying the months during which imports of particular agricultural commodities (such as potatoes) would not be allowed in order to protect local growers.
235 In return for this concession, Lebanon agreed not to export any textile items to Egypt until after January 1, 2002. For the complete agreement check: http://www.economy.gov.lb/ MOETEN/MOET-bilateral.html
government responded by denying entry of 27 containers of Lebanese apples, and temporarily recalled its ambassador from Beirut. Consequently, Lebanese Prime Minister, Hariri, rushed to Cairo, and held urgent talks with President Mubarak and his Prime Minister al-Janzuri, which led to the diffusion of the crisis. In August 1997, al-Janzuri visited Beirut to further repair the damage and gain more access to the Lebanese markets.\textsuperscript{236}

As for the trade balance with Egypt, it is heavily tilted in Egypt's favor. In 1999, Lebanese imports from Egypt amounted to US$ 58 million, while exports to Egypt amounted to only US$ 15 million; this gives an import/export ratio of a little more than 25 percent, which while low is more than double the overall export/import ratio for Lebanon.\textsuperscript{237} It is highly unlikely that implementing the provisions of the executive program would help redress the trade imbalance between Lebanon and Egypt; on the contrary it is likely to make it worse.

However, from the vantage point of fostering the creation of the GAFTA there is a strong argument in favor of Lebanon freeing its trade with each of Egypt, Jordan, and Syria. Based on the analysis of trade intensities within the Arab region, Ali Bolbol concludes that: “all four countries—Egypt, Jordan, Lebanon and Syria—would represent the best natural trading partners and the most viable formal trading arrangement. But since they constitute the middle ground between the AMU [Arab Maghreb union] and the


\textsuperscript{237} Sami Baroudi, \textit{Lebanon’s Foreign trade Relations in the Post-civil war Era: Scenarios for Integration (1990-present)}, op. cit, p. 14.
GCC [Gulf Cooperation Council], they most probably hold the key for a successful Arab FTA."\textsuperscript{238}

Lebanese officials, led by President Lahoud and Prime Minister Hariri, seem to highly embrace the view that Lebanon must play a central role in bringing GAFTA into existence. During a June 2001 visit to Cairo, Hariri told his Egyptian hosts that: “inter-Arab trade should operate as smoothly as between provinces of the same country.”\textsuperscript{239} In a similar vein, Lahoud observed that: “Arab countries need to create an Arab Common Market that eliminates all barriers and economic constraints and facilitate the implementation of new strategies to revitalize our economies and enable us to enter the international market from a position of strength.” He went on to conclude: “I see no alternative to open borders and economic integration based on mutual trust.”\textsuperscript{240}

\textbf{b. The Trade Relations with Jordan}

Trade relations between Jordan and Lebanon are organized according to a commercial agreement signed on November 1, 1992.\textsuperscript{241} This agreement contains a list of tariff reductions and exemptions, definition of rules of origin, and negotiations on a free trade zone.\textsuperscript{242} Jordanian-Lebanese talks started on August 23, 1999 in Amman between delegations from the Ministries of Agriculture in the two states, during which discussions centered on evaluating the exchange of agricultural products and means of developing agricultural ties. The secretary general of the Jordanian Ministry of Agriculture, Mazin

\textsuperscript{242} For the whole agreement, see: \url{http://www.economy.gov.lb/MOETEN/texts/updates/resume%20-%20include/Jordan.htm}
al-Khawasenah noted, in a statement, the special relations between Jordan and Lebanon.\textsuperscript{243}

However, a commercial crisis took place later in November between Lebanon and Jordan, but it ended when the Jordanian authorities allowed the entrance of 30 trucks carrying Lebanese potatoes, which were stopped at the Jordanian land borders for three days. This permission came after the agreement of the Lebanese government to implement the agricultural program signed between the two sides, as of the first of September and lasting until October 25\textsuperscript{th}. When the Lebanese Minister of Agriculture refused to ratify the renewal of the agreement on exchanging agricultural products between Lebanon and Jordan and when Lebanon worked to modify the agreement, the Jordanian authorities stopped their implementation according to the agreement and prevented the entrance of all Lebanese agricultural products. The Jordanian-Lebanese agricultural agreement dictates that the agreement should be renewed annually in July every year with the effective date being the end of August. The agreement also includes the exchange of agricultural products between the two states without customs duties, according to which Jordan can allow Lebanese fruits and potatoes in, while Lebanon can import Jordanian tomatoes and other vegetables.\textsuperscript{244}

On September 13, 1999, King Abdullah of Jordan started a two-day state visit to Lebanon with a call for stronger Jordanian-Lebanese relations and for joint efforts to establish the long-aspired Arab Common Market. King Abdullah, on the first visit to Lebanon by a Hashemite monarch in more than 30 years, said at a meeting with Lebanese

Prime Minister Salim al-Hoss 245 “Jordan hopes that practical steps will be taken for the achievement of that goal gradually so as to arrive at what is aspired for and what is needed in order to fulfill the idea of pan-Arab economic integration and translate it into facts on the ground.” Economically Lebanon and Jordan have agreed to set up a free trade zone, and the two sides are expected to discuss an agricultural calendar to better organize seasonal trade so that only the surplus of products in one country would be sent to the other. 246

This visit by the King Abdullah was followed by a visit of his Prime Minister Ali Abul Ragheb who signed on October 31, 2002, with the Lebanese Prime Minister Rafiq al-Hariri a protocol which states to form a higher committee presided by the two countries’ prime ministers. The statement said that the committee would discuss its first meeting in the second half of 2003 in Amman. Hariri and Abu al-Ragheb held a close door meeting lasted before they had attended a meeting for a Jordanian-Lebanese ministerial committee during which some 11 agreements and protocols were signed. These agreements sought to establish a free trade area, encouraging the investment and canceling double taxation as well as maintaining scientific cooperation in the industrial fields and cooperation in the area of the media and establishing joint chambers of economy. And all this will be in favor of the creation of the Greater Arab Free Trade Area as both premiers said.247

c. Free Trade Area with the GCC

In a new step toward the GAFTA, Prime Minister Rafiq al-Hariri announced from Doha the decision to launch a free trade zone between Lebanon and the Gulf Cooperation Council. This declaration came during an official visit by Hariri to Qatar where he met with the Qatari Emir and the prime minister. The decision was made during a meeting of GCC officials with Lebanese Prime Minister Rafiq al-Hariri.248

Hariri said, “This era requires consultation by all Arabs in the interest of the Arab nation; the Arab nation was to achieve stability and economic progress.” He also praised the Free Trade Agreement, which is to be concluded later this year between Lebanon and the GCC. This is the first time an Arab state from outside the GCC will conclude such an agreement with the GCC bloc. Hariri added that the accord would “bring Lebanon closer to the GCC countries” and that both sides wanted this agreement because it was in their mutual interests to have it. He stressed that the Free trade Agreement with the GCC states would significantly improve trade between the two sides.249

Lebanese Minister of Economy and Trade, Marwan Hamade, welcomed this decision to launch the free trade zone with the GCC. Hamade said “this agreement is the first of its kind between the GCC and another Arab state.” He added that the Gulf States represent “a significant economic and strategic extension to Lebanon’s productive and financial sectors.”250

249 Ibid.
The six-member Gulf Cooperation Council (GCC) has signed, in March 2004, a draft agreement with Lebanon to set up a free-trade zone as part of a drive to reach trade pacts with major exporting blocs. Riyadh-based GCC officials said Youssef bin Tarad al-Sadoun signed a deal with Fadi Makki\textsuperscript{251}, who led a Lebanese negotiating team. “Preparations will be made soon for a signing ceremony. The meeting comes in the framework of distinguished relations linking the GCC to Lebanon,” officials said.\textsuperscript{252}

With the presence of the Lebanese Prime Minister Rafiq al-Hariri, foreign ministers of Lebanon and Kuwait, Jean Obeid and Sheikh Mohammed al-Sabah,\textsuperscript{253} Lebanon and the six-member Gulf Cooperation Council (GCC) inked on May 11, 2004 a free-trade agreement that removes all trade barriers between the two parties, a move that was highly criticized by local industrialists. The agreement, the first of its kind in the region, will see the immediate lifting of customs barriers on goods in both directions.\textsuperscript{254}

In an attempt to allay the fears of industrialists, Economy and Trade Minister Marwan Hamade said, “contrary to the argument of some people, the cost of production in the GCC states is almost like Lebanon, and government is willing to deal with all the grievances of the industrialists.” Asked about the subsidies on production in the GCC states, Hamade said all subsidies in the Arab states will be removed at the beginning of 2005 in accordance with the Arab free-trade agreement. However, most of the industries in the GCC states are subsidized by the government, which gives producers an edge over Lebanon. The cost of transport is very high for the Lebanese producers and shipping

\textsuperscript{251} General Director of the Ministry of Economy and Trade.
\textsuperscript{253} The representative of Kuwait signed in the name of the GCC because Kuwait is the president of this GCC session.
goods from Lebanon to the GCC costs 70 percent more than shipping from the GCC to this country and the cost of transport is very high for the Lebanese producers.255

B. Basic Controversies in Trade and Economic Relations with Syria

Throughout many centuries of Middle Eastern history, the inclusion of Lebanon within the borders of Syria was standard political discourse and policy. The notions of *bilad ash-Sham*, Greater Syria, and Fertile Crescent unity all expressed, each in its own way, the ambition of Damascus to dominate its geographic surroundings.256

Since the start of the 1975 Civil War, Syrian involvement in Lebanon has been substantial, if inconsistent; and its interference in the Lebanese issues was increasing day after day. The majority of the Lebanese consider that Syria occupies Lebanon; and this occupation of Lebanon constitutes the natural manifestation of power by the strong against the weak. Syrian occupation and power-impose on Lebanon takes place by dominating its thought, manipulating its identity, engineering its politics, and enforcing trade agreements on it; as the majority of the Lebanese think.257 I will try in this part to show the facts and basis for the Lebanese-Syrian relations.

1. Basic Facts about the Lebanese-Syrian Relation

One of the most controversial and internally divisive aspects of Lebanon’s foreign economic relations is the economic relationship with Syria. The argument over trade and other economic ties with Syria cannot be separated from the broader political argument over Syria’s military presence and political influence in Lebanon. Local supporters of

Syrian influence in Lebanon view the economic relationship as working for the advantage of both, while opponents perceiving Syrian hegemony view the economic relationship as unbalanced (in favor of Syria), and highly unfavorable to the interests of Lebanon. Statistical records reveal that Syria is not Lebanon’s leading trade partner. Between 1993 and 2003, Syria ranked between 3 and number 6 in terms of Lebanese Exports to (see table 3.4); and between number 5 and 11 with respect to Lebanese imports, while imports from Syria were valued at US$ 207 million, representing 3.2 percent of imports in 2002 (see table 3.5).\(^\text{258}\)

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Exports to Syria only cover 8.5 percent of imports from it. The trade between Lebanon and Syria is imbalanced, and this is for three main reasons: “1) the higher costs of factors in Lebanon, particularly labor, fuel, electricity and land; 2) administrative obstacles to the flow of imports on the Syrian side of the border; and 3) the payment system in Syria, where importers are required to deposit the entire value of their imports at a Syrian bank at an exchange rate for the Syrian pound that is higher than the black-market rate.”\(^{259}\)

Official statistics, however, undoubtedly understate the size of trade between Lebanon and Syria. Lebanese families go to Damascus and Aleppo for shopping; taking advantage of the lower prices on textiles, household items, and food products. As those individuals do not pay customs upon re-entering Lebanon, their imports are not outlined in the official statistics. Furthermore, Syrian workers in Lebanon buy most of their food in Syria and do some trading on the side. Syrian vendors pulling carts loaded with Syrian products, that never cleared customs, are a common sight all over Lebanon.\(^{260}\) There are sharp disagreements in Lebanon over the size of Syrian exports to and the number of Syrian workers in Lebanon and both issues are highly politicized. Lebanon’s Labor Ministry estimates there were about 54,000 foreign workers registered in 2000. Conservative Christian groups that are the main opposition to Syrian influence speak of a million or more workers of Syrian origin in a country of about four million. The truth, analysts say, lies somewhere in the middle and shows that even for Lebanese who chafe at a relationship that Syria describes as “one people in two countries,” their economic interests are separate from their patriotic sensibilities. “This is not a one-way love affair;

\(^{259}\) Sami Baroudi, *Lebanon’s Foreign trade Relations in the Post-civil war Era: Scenarios for Integration (1990-present)*, op. cit, p. 8.

\(^{260}\) Ibid.
it goes both ways,” said one analyst—who preferred not to be named—of the preponderance of agricultural and construction workers from Syria, which has a GDP roughly equivalent to Lebanon's but a population about four times bigger. “My conviction is that there are 300,000 to 350,000 Syrian workers, some who come for seasonal labor, some who remain for building projects, and a small number in the service sector, hotels and personal services.”

The role of Syria in ending the Lebanese War (knowing that Syria participated and played a very important role in the war with party against the other) and its continued military presence in the postwar era provided it with substantial leverage over the postwar political elite in Lebanon, which itself was in part a Syrian creation. Syrian domination over Lebanon since 1990 provided the framework and the driving force for the conclusion of a nexus of agreements, memorandums of understanding and protocols that sought to regulate military, political and economic relations between the two sides. Syria sought to codify its unequal and multifaceted relationship with Lebanon, through a series of rules, procedures and institutions, where it is the main beneficiary from this relation. It must be stated that most members of the Lebanese political elite, and a significant portion of the economic elite (benefiting from Syria by achieving political posts and economic profit), embraced (at least in public) the unequal relationship with Syria, defending it against local and external critics.

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262 Sami Baroudi, *Lebanon’s Foreign trade Relations in the Post-civil war Era: Scenarios for Integration (1990-present)*, op. cit, p. 9.
2. Trade Agreements with Syria

Following the Ta'if agreement and the ousting of General Aoun\textsuperscript{263} from power by an alliance of the Syrian army, the various leftist militias, and those elements of the Lebanese army not loyal to the Lebanese Government of General Aoun, the Syrians sought a way to legalize their presence in Lebanon. As a result the Brotherhood Treaty was signed in Damascus on May 22, 1991 rapidly followed by a number of other military and security treaties. The government, being Syrian installed and controlled, did not resist these treaties in any way.\textsuperscript{264} Article 1 of the Brotherhood Treaty states: “The two states will work to achieve the highest level of cooperation and coordination in all political, economic, security, cultural, scientific and other fields in a manner that will realize the interests of the two fraternal countries…” While article 2 says “the two states will work to achieve cooperation and coordination in the economic, agricultural, industrial and commercial fields as well as in the fields of transportation, communications; customs the establishment of joint profits and coordination of

\textsuperscript{263} At the end of President Gemayel's term on September 23 1988, he appointed Army Commander General Michel Aoun as interim Prime Minister. In January 1989, the Arab League appointed a six-member committee on Lebanon, led by the Kuwaiti foreign minister. In May, the Arab League assigned a higher committee to work toward a solution for Lebanon. The new committee was composed of Saudi King Fahd, Algerian President Bendjedid, and Moroccan King al-Hasan. In July 1989, the committee reported that its efforts had reached a "dead end". After further discussions, a meeting was arranged for Lebanese parliamentarians in Ta'if, Saudi Arabia. After a month of intense discussions, the deputies informally agreed on what is known as the Ta'if agreement. Upon their return to Lebanon in November, where the deputies approved the Ta'if agreement on November 4, and elected Rene Moawad, President on November 5, 1989. General Aoun did not accept the approval of the Ta'if agreement or the election of President Moawad. He issued a decree in early November dissolving the parliament. President Moawad was assassinated on November 22, 1989. On November 24 Elias Hraoui was elected. President Hraoui named Salim al-Hoss as Prime Minister. In October 1990, a joint Lebanese-Syrian military operation against General Aoun forced him to capitulate and take refuge in the French embassy.

development plans.” The Brotherhood Treaty also set up six joint bodies to institutionalize cooperation and coordination between the two sides.\footnote{Ibid. For the complete treaty see Appendix 2.}

On the heels of the Brotherhood Treaty came 22 agreements, 26 protocols and 11 memorandums of understanding; of those were 12 agreements, 18 protocols and 7 memorandums that dwelled on economic matters. Undoubtedly, the most important economic agreements concerned the liberalization of the cross-border movement of goods and people—the first of which date back to 1993. The “Agreement on Economic and Social Cooperation” was signed in Beirut on September 16, 1993. It called for freeing the cross border movement of individuals, goods and capital, and for coordination policies in agriculture, industry and services with the aim of achieving a common market.\footnote{For a summary of the agreement, see: Lebanese Republic, Ministry of Economy and Trade, \textit{Itifak Ta’awon wa Tanseek Iqtisadi wa Iljima’i’i’ Baina al-Jumhuriyah al-Lubnaniah wa al-Jumhuriyah al-Souriyah} (Agreement on Economic and Social Cooperation between Lebanon and Syria), September 16, 1993. Online. Internet. March 10, 2004. Available: [http://www.economy.gov.lb/MOFTEN/MOFT-bilateral.html]} Under the 1993 agreement, tariff and other barriers to trade were to be lifted gradually, while restrictions on cross-border labor movement were to be immediately removed.\footnote{One has to keep in mind that Lebanese labor force do not go to work in Syria due to the difference in wages which are very low in Syria, and the living expenses which are higher in Lebanon, in addition to the complicated laws and regulations in Syria which makes Lebanese labor force afraid from working there. This make the agreement unbalanced like the previous Brotherhood Agreement (since Syria will benefit much more). Both the Syrians and Lebanese know the impossibility for Lebanese workers to work in Syria, this thing clears the high probability that the agreements were enforced on Lebanon without being able to negotiate.} The 1993 agreement reversed the order of priorities found in other integration schemes, such as the EU and the NAFTA, when it placed the complete freeing movement of labor before totally liberalizing trade.\footnote{Sami Baroudi, \textit{Lebanon’s Foreign trade Relations in the Post-civil war Era: Scenarios for Integration (1990-present)}, op. cit, p. 10.}

While implementing the labor aspects of the 1993 agreement was immediate, executing its trade component had to wait until the beginning of 1999. In early 1998,
Prime Minister Hariri and his Syrian counterpart, Mahmoud al-Ze’bi, signed an agreement to phase out tariffs on industrial products over a four-year period, commencing at the beginning of 1999. The first 25 percent cut took effect on January 1st, 1999. On October 11, 1999 (under the Hoss Government) an agreement was reached on a schedule to remove all tariffs on agricultural products by November 2004. An initial 50 percent tariff cut was to enter into effect the day following the signing of the agreement, with further 10 percent reductions every subsequent year. But given the great ease with which products are illegally imported across the border in Lebanon’s direction, the maintenance of some tariffs till 2004 does not offer Lebanese farmers much protection.

Moreover, Syria's Prime Minister Mohammad Naji Otari received in Damascus on January 14, 2004, his Lebanese counterpart, Rafiq Hariri. Talks during the meeting dealt with the fraternal relations linking the two states, means of enhancing and developing them and with agenda of meetings of the Joint Syrian-Lebanese Social Economic Higher Committee. In a statement to the press, Hariri said that there is a dire need for activating the agreements signed between the two states, and increasing the economic exchange for achievement of the economic integration in the face of the world major economic blocks. For his part, Otari pointed out that this visit aims at boosting the bilateral relations and realizing integration in domains of economy, trade, agriculture, industry transport, energy, gas, electricity, dams of water and many other domains.

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269 Ibid.
Both Premiers discussed also some issues of Arab concern and the latest developments in the region particularly on the Iraqi and the Palestinian arenas, in addition to the importance of enhancing joint Arab action in the face of the standing challenges and dangers targeting the Arab Nation. Later, both premiers signed the joint minutes of the said meetings in the presence of the two delegations. Other agreements in the fields of customs, transport, trade, water and energy were also signed. The official delegation accompanying Hariri included, Ministers of Economy and Trade, Finance, Energy and Water, Public Works, Communications, Industry, Agriculture and of Tourism.\(^{272}\)

No doubt, the Lebanese economy has become closely integrated with the Syrian one, although official trade statistics do not fully reveal this fact. This is partly due to smuggling and partly because integration has proceeded in other ways, mainly through the presence of the large number of Syrian workers in Lebanon. One indicator of this close integration was the speed with which Syrian authorities cut custom duties on raw material imports in response to an earlier and similar decision by the Lebanese government.\(^{273}\)

The November 2000 decision by the Hariri government to eliminate duties on raw material imports for industry (and to lower duties on other imports) caused considerable nervousness and unease within official and business circles in Syria due to the fear that it would give Lebanese industrialists a competitive edge over their Syrian counterparts.\(^{274}\)

While this close level of integration might have been inevitable given the global trend

\(^{272}\) Ibid. See also: “Agenda of the Joint Syrian-Lebanese Social Economic Higher Committee Meeting in Damascus, January 14, 2004,” Al-Mustaqbal, op. cit.


\(^{274}\) Ministerial decree 3477, lowering duties on practically all imports and eliminating them on raw materials that enter into industrial use, was adopted by the cabinet on October 29, 2000, and signed by President Lahoud the same day. For the text of the decree see Assafir, October 30, 2000, p. 3; see also Annahar, October 30, 2000, pp. 2-3. In subsequent modification to the decree a list of industrial components was also exempted from all custom duties. See Assafir, April 25, 2001, p. 6.
towards the formation of regional economic blocs and Syria’s economic, political and security interests in Lebanon, the majority of Lebanese view the relationship with Syria as seriously flawed, imposed rather than freely negotiated, and more beneficial for Syria than to Lebanon.\textsuperscript{275} Regardless of their exactness, the dominance of these attitudes does not promise for a good future of economic partnership between Lebanon and Syria, if the Syrian hegemony over Lebanon is to continue.\textsuperscript{276}

C. Local Responses to Trade Liberalization Schemes with the Arab Region

The implementation of trade liberalization, even if a stage on a regional basis, was bound to raise objections from sectors that felt threatened by cheaper imports. The strongest opposition to trade liberalization agreement negotiated with the MENA region came from the farming community. This cannot be surprising since Lebanese agriculture sector is underdeveloped and uncompetitive (even by regional standards). Farmers’ groups, especially the Agricultural Coordination Committee (ACC), was against the trade agreements signed with Egypt, Jordan and Syria, even they called for amending these agreements and even for suspending Lebanon’s membership in the 1981 Agreement to Facilitate and Develop Trade Exchange among Arab Countries that provided the basis for GAFTA.\textsuperscript{277} The Agricultural Coordination Committee noted, in a statement issued on

\textsuperscript{275} Sami Baroudi, Lebanon’s Foreign trade Relations in the Post-civil war Era: Scenarios for Integration (1990-present), op. cit, p. 11.

\textsuperscript{276} The majority of the Lebanese view these agreements with Syria as influenced by the Syrians, and they look toward the Syrian interference in Lebanon as an occupation. In addition to the Syrian workers, where the majority of the Lebanese want them to go out from Lebanon due to their great number and the low salaries they take, knowing that they do not pay taxes or any similar thing for the Ministry of Immigration or the Ministry of Work as other workers from other countries do.

\textsuperscript{277} Al-Mustaqbal, 6 July 2001, p. 9. Another group that spoke strongly in favor of revising the trade agreements with the Arab countries, especially Syria, was the Assembly of Southern Farmers, headed by Waddah Fakhri. In a statement issued on October 18, 2000, the Assembly called for revising the agricultural sections of trade agreements with Arab countries, and for ending smuggling from Syria through placing Lebanese army checkpoints on the Syrian border to assist the custom authorities in preventing smuggling. An Nahar, October 19, 2000, p. 6. In an earlier statement, Fakhri blamed the Lebanese government for entering into trade agreements with Syria that were detrimental to the interests of Lebanese
July 18, 2001, that “freedom of trade between Lebanon and Syria or between Lebanon and other Arab countries...harms Lebanon’s interests, because our higher production costs...result in unfair competition, leading to heavy losses for farmers and the bankruptcy of agricultural firms.”

The Lebanese farmers used several strategies, similar to those resorted to by European farmers or even farmers everywhere, such as demonstrating; blocking roads especially in Baalbeck-Hermel and Akkar, and throwing crates of vegetables and fruits on the roads. In January 2001, farmers’ protests in the Hermel region (to the North of Lebanon) turned violent when farmers cut the Hermel-Tripoli road with burning tires and even attacked trucks loaded with agricultural products (mainly coming from Jordan and Syria), prompting the Lebanese security forces to intervene. However, this rapid reaction of the security forces was probably triggered by the anti-Syrian tone that the protest took.

One should not exaggerate the success of the agriculturalist lobby in mobilizing farmers, or broad sections of public opinion, behind its demands for revising the trade agreements with Arab countries. The number of protesters represented a small fraction of the farmers’ population. While Lebanese governments have proven quite unwilling to renege on their commitments to free agricultural trade (particularly with Egypt, Jordan, and Syria), they did introduce a few concrete measures in an attempt to reverse the deterioration in agricultural conditions. Maintaining the commitments to freeing

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279 These are some agricultural regions in Lebanon, where a lot of farmers live.
280 Tripoli is the second largest and main city in Lebanon after the capital Beirut.
agricultural trade with the MENA region, government efforts have focused on trying to boost agricultural exports, through addressing the high costs of production and transportation problems. In 2001, the budget of the Ministry of Agriculture was raised to better equip it to deal with the agricultural problems. Farmers were provided with access to subsidized loans, although the number of beneficiaries remains quite small. But the most ambitious plan to boost the agricultural sector in Lebanon has been developed by the Investment Development Authority of Lebanon (IDAL). The government launched through IDAL, on August 14, 2001, the Export Plus program on the decree number 6041/2001. The main objectives of the program are: Increase the quantities of the Lebanese agricultural exports to traditional markets; tap new export markets; supervise the quality of agricultural exports and ensure compliance with international standards; and transfer technology and know-how to farmers and exporters. Export Plus program entails the allocation of up to 50 billion Lebanese pounds (around US$ 33 million) for assisting exporters in quality control, packaging, labeling, and transporting vegetables and fruits to Arab markets.

The program succeeded in achieving some of its objectives: Exports of fruits & vegetables increased by more than 15% during the first year of implementation and 20% the second year; exporters managed to tap new markets (France, UK, Belgium, Romania, India...); transfer of know-how to farmers and exporters about required international standards and quality control measures; and significant improvement in terms of quality

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282 The Investment Development Authority of Lebanon (IDAL), based in central Beirut, was established on December 1st, 1994 by Decree of the Council of ministers in order to “initiate, supervise, direct and facilitate investment projects in Lebanon.” According to documentation provided by the authority, “to ensure its effectiveness, IDAL was set up to liaise at the ministerial level and report directly to the Prime Minister. These measures provide the investor speedy access to information and decision-making in implementing projects. For more information about IDAL see: http://www.idal.com.lb
283 Ibid.
of the exported agricultural products according to the norms set by the Lebanese Ministry of Agriculture and the international standards with respect to criteria such as: Grading (size and color); marking; product classification; and packing.285

The most controversial aspect of Export Plus entails providing cash payments for exporters on each ton they export to help defray transportation costs. The provision of cash payments for Lebanese exporters will most probably provide importing countries with a strong legal basis to impose countervailing duties on Lebanese exports. As regards trade in agricultural products with the MENA region, the government’s thinking seems to be clear and straightforward. All tariff and non-tariff barriers will eventually be lifted; while imports will be restricted only during periods of high production that are defined by properly advertised agricultural calendars. In the meantime, the government, within the constraints imposed by its limited resources, is working very hard to improve its competitiveness and enhance its exports.286

As for the individual industrialists, they criticized several aspects from the trade liberalization agreements with Syria and other Arab countries. On the other hand, the Association of Lebanese Industrialists (ALI)287—the main body representing Lebanese industrialists—was not too critical to the agreements since it shared al-Hariri’s optimism about the likely effects of freeing trade on Lebanese exports to the Arab countries. Nevertheless, ALI did criticize the Lebanese authorities on few occasions for the attitude

286 Ibid.
287 The Association of Lebanese Industrialists (ALI) founded in 1943, is a Lebanese economic organization-grouping industrialists from all Lebanese region in a concerted and balanced effort at promoting and developing industry in Lebanon. The association seeks to create and maintain an atmosphere that is favorable to industrial growth and development. Considering the fact that industry in Lebanon, except for cigarette manufacturing, is purely private, the Association's role becomes even more marked. For more information, see: http://www.ali.org.lb
they handled trade negotiations with the Arab countries. In a statement issued on September 15, 2000, ALI blamed the government for not taking into consideration the views of concerned economic sectors before concluding trade liberalization agreements, calling on it to insist on full reciprocity in trade concessions in the future, and more importantly not to conclude any new agreements with any country until agreement is reached on product specifications.  

On the whole, industrialists were quite reluctant openly to defy the government in its efforts to join GAFTA, or to question close trade with Syria. To a certain extent, this more positive approach of industrialists can be explained in terms of good personal relations between leading industrialists (especially the ALI’s president and members of its board of directors) and Prime Minister Hariri and his economic team. Moreover, the government appears to be successful in co-opting the industrial lobby by taking measures as: a) freezing the minimum wage since 1996 and ending the automatic cost-of-living wage increments;  

b) reducing the industrialists’ mandatory contributions to the National Social Security Fund (NSSF);  
c) providing industrialists with access to concessionary loans subsidized by the government; and d) completely eliminating all custom duties on raw material imports for industrial use in late 2000. Finally, industrialists have shown greater confidence than farmers in their ability to develop exports to Lebanon’s traditional markets in the Gulf and to open new markets.

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290 In March 2001, the Hariri Government lowered mandatory contributions by employers to the NSSF from around 38.4 percent of an employee’s salary to 23.5 percent. See The Daily Star, March 23, 2001, p.7; and Assafir, March 13, 2001, p.8.
Conclusion

The objective of this study was to see the effect of trade liberalization on the developing countries including the Arab world and to answer the questions raised in the introduction. The case study in this research was Lebanon's participation in the GAFTA as a response to globalization. As we have seen in this study, globalization offers some advantages and gains for developing countries, but the challenges are extremely high. Globalization has created unprecedented growth in global markets and opportunities for individuals to prosper. Yet, over a billion people live in extreme poverty on less than one dollar a day. Their poverty is partially determined by constraints that limit their ability to enter and compete in national, regional, and global markets.  

Since the MENA region is comprised of developing countries, they must work hard to face the challenges of globalization and trade liberalization in order to be able to survive, otherwise they will remain suffering under its negative effects. In addition to the challenges brought by globalization, the MENA countries suffer from many problems found in their own systems. Some of these problems are: High population growth and the low productivity, where the rate of population growth is one of the highest in the world (2.5 percent annual increase over the last twenty years); political and institutional corruption which is hindering the development in most of the MENA countries; the large ineffective public sector which causes several problems to development such as affecting negatively the business and investment climate and increase the cost of doing business for both domestic and foreign investors; the underdeveloped and inefficient financial

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market; and the high trade restrictiveness. These problems are causing severe problems for the MENA countries’ economies. These problems must be solved and effective government steps must be taken, otherwise the MENA economies are unlikely to be able to compete not only with the developed countries but even with the Asian economies in low skill manufacturing exports.

The MENA countries must change the role of the state from the direct actor in the economy to a regulator in the competitive free markets. They must reduce the role of the public enterprises in the export sector and barriers to imports through privatization, and encouragement of private investments.

The MENA countries must also upgrade and develop their infra structure. Technological transfer in the form of knowledge or physical capital undoubtedly plays a crucial role in helping MENA countries to adapt and compete in the global market. The challenge will be to do all this without unduly straining public finances or external positions. To this end, private sector participation can be very helpful. This brings us to the third policy that must be adopted by the MENA countries which is privatization. Implementing the privatization plan could help reduce the financial burden of the governments, cut the wage bill of the public sector, and render several public-sector institutions more efficient. Moreover, the income generated from privatization could be used to withdraw existing public-sector debt and lower the debt-service bill that is threatening to become a burden on the budgets of several Arab countries including Lebanon.

One of the most important strategies is political and institutional reform. Empirical studies prove that democracy, civil society organizations, institutions’ qualities
and governance are weak in the MENA region while levels of corruption are strong, and this has negative effects on prospects for growth and development. A deepening of political reforms is widely viewed as a prerequisite for firmly rooting badly needed economic reforms. The rulers and members of governments and their assistants enjoy the wealth of the countries in the MENA region. This is unlike the case of China, where despite its violations of human rights and undemocratic rule, it was able to benefit from trade liberalization due in part to levels of political corruption lower than those found in Arab countries. The democratization of the Arab world cannot await the solution of the issue of the Middle East, and the reform in the Arab world cannot depend on the regional political settlement, as the Prince of Qatar, Sheikh Hamad ben Khalifa Al-Thani said. He added that the external calls to reform the Arab regimes must be a source of reassurance, rather than concern because they show the importance of this region and its role in the future. He stressed that the reform would lead to stability, economic development and wealth because participation enhances the responsibility of the citizen, which in its turn strengthens the regimes and gives them a more efficient political role, especially in the process of reaching a just and global solution for the issue of the Middle East. Reform also will lead to a more efficient economic role since the governments will be responsible in the eyes of their citizens.292

Fiscal reform is inevitable if development is to take place in the region. The Arab countries must develop their tax systems. A poorly administered tax system is another channel through which the public sector can impose significant costs on the economy. Moreover, financial markets mainly the banking sector must be developed.

In addition, the peace process with Israel will support growth in the MENA countries, by allowing reductions in spending on military development that are extremely high in some Arab countries. By doing so, the money spent on the military will go for other sectors. The peace process also will increase the investments in the region and encourage development.

One more necessary thing for development is the enforcement of the Arab Free Trade Area and the regional bloc. In this era of globalization and regional blocs, the Arab countries must work harder to make their bloc more effective on the international level, because a country cannot survive alone in this system.

Lebanon, as we have seen in this paper is facing several problems and must work harder in order to be able to resolve them. Over the past few years, through its structural reform plan, the Lebanese government has undertaken serious efforts to modernize and develop the economy and offer the most suitable climate to foreigners and nationals desiring to invest in the country. Although due to limited success, the reform strategy is facing serious political, economic, and social problems.

Lebanon has signed several agreements in favor of trade liberalization. Lebanon signed an association agreement with the EU. It soon will become a full member of the WTO after being an observer since January 30, 1999. Also, Lebanon has signed several agreements with Arab countries in favor of the Great Arab Free Trade Area. These steps are in addition to the large number of bilateral trade agreements with a lot of countries. Given its characteristics and endowments (as mentioned in chapter two), Lebanon occupies an intermediate place in the ranking of comparative advantage and is

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being squeezed from above and below. On the one hand, the more advanced developing countries (East Asian Countries) have gone upscale in their production structure towards more skilled and capital intensive activities. On the other hand, large and unskilled labor-abundant countries are integrating fast into the world economy, putting strong pressures on low-skill intensive manufactures. The Central European countries are geographically closer to one of Lebanon’s main trading partner, the EU.  

This raises the question of how will Lebanon fare in a more competitive environment and what trade strategy should it follow to boost its exports. The answer may partly lie in exploiting the unfulfilled potential of intra-industry trade with Arab countries as a first step towards globalization since they do not have a highly advanced industrial base. Intra-industry trade (IIT), or trade in similar goods which a country undertakes, is indicative of the level of industrial advancement and of the implied potential to compete with industrialized economies in a more open trade setting.  

Arab countries trade more among each other in similar goods than with the EU or the world at large. This means that Arab countries (including Lebanon) have more similar levels of industry specialization, and that they compete more effectively in the intra-regional setting than specifically with the EU. Protection against Lebanese exports is much higher within the region than with developed countries. Given the small share of Lebanese exports destined for the EU (and other developed countries) and the low EU tariffs currently applied to Lebanese products, it seems that Lebanon would benefit only marginally from the elimination of the EU tariffs under the Euro-Med agreement. On the

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295 In the trade literature, the amount of intra-industry trade is often taken as a measure of the diversity, degree of specialization, and degree of technical sophistication of its industrial sector. Ibid.
other hand, regional countries import comparatively more Lebanese products, and they
subject Lebanese exports to much higher protection than those of industrial countries.
For this reason, Lebanese exports could greatly benefit from reciprocal trade liberalization with these countries.\textsuperscript{296} And this is what the Lebanese government is trying
to do through the trade agreements signed with several Arab countries such as Syria,
Jordan, Egypt and the GCC, and playing an important role in achieving the Arab Free
Trade Area.

Among the main characteristics of the Lebanese economy, beside being
developing, small and open, is the fact that its exports, at least of goods, are very poor
when compared not only to exports of the small industrial countries, but also to exports of
the Arab non-oil producing countries of similar size. However the government is
exerciting good effort to solve these problems and improve its trade competitiveness (as
discussed in preceding chapters). The Lebanese economy needs to grow at high rates for
many successive years. Because of the small size of the domestic market, such a
sustained rapid growth cannot take place without large export-oriented investments. In
an attempt to improve the Lebanese exporting capability through trade agreements, the
Lebanese government has been acting in several directions: It is working hard to be a full
member in the WTO, which is expected soon. Lebanon signed the Association
agreement with the EU, and signed several agreements with Arab countries and non-Arab
countries. In order for Lebanon to take full advantage of those agreements, the Lebanese
economy needs to be restructured with the aim to decrease its production costs and
improve its competitiveness.

\textsuperscript{296} Ibid, p. 216.
Moreover, Lebanon must work hard to reduce its debt problem. It must go forward with the privatization plan that will serve in the reduction of the debt and increase investments. Political problems must be solved among the government members; otherwise these problems will never be solved. There must be a solution for the unemployment and the competition from foreign labor especially the Syrian workers. In addition to that, there must be a review of the Syrian-Lebanese relations especially the agreements which were imposed on Lebanon. There must be a solution also for the Palestinian refugees' camps, which are not under the Lebanese authority and they are unsecured. This is affecting the economy negatively especially tourism. Failure to highlight and solve real problems or temporarily forgetting them does not mean they do not exist. On the contrary, they ferment and become increasingly difficult to reform, change or solve.

Last but not least, a well-managed response to globalization would require a stable macroeconomic environment with low inflation, low budget deficit, political stability, security, and independence. Otherwise, Lebanon and the Arab countries will not be able to compete on the global level, and will be marginalized by the forces of globalization.
<table>
<thead>
<tr>
<th>Country</th>
<th>Signed</th>
<th>Remarks (ratified)</th>
<th>Highlights</th>
</tr>
</thead>
<tbody>
<tr>
<td>Armenia</td>
<td>May 95</td>
<td>Nov. 98</td>
<td>MFN* treatment (custom duties, transit)</td>
</tr>
<tr>
<td>Australia</td>
<td>March 97</td>
<td>Jan. 98 (Pending legislative procedures)</td>
<td>MFN (custom duties, etc.), technical cooperation, protection of intellectual property rights</td>
</tr>
<tr>
<td>Azerbaijan</td>
<td>Feb. 98</td>
<td>March 99</td>
<td>MFN treatment (custom duties, transit), economic cooperation (construction, tourism, transport, oil, etc.)</td>
</tr>
<tr>
<td>Bahrain</td>
<td>-</td>
<td>Not ratified</td>
<td>Free Trade Agreement, economic cooperation</td>
</tr>
<tr>
<td>Bulgaria</td>
<td>-</td>
<td>Not ratified</td>
<td>Framework agreement</td>
</tr>
<tr>
<td>Belarus</td>
<td>June 01</td>
<td>Dec. 2001</td>
<td>Framework agreement</td>
</tr>
<tr>
<td>Cameroon</td>
<td>Oct 62</td>
<td>Feb 64</td>
<td>Framework agreement (listing of traded products and MFN for maritime transport)</td>
</tr>
<tr>
<td>Chile</td>
<td>Nov. 97</td>
<td>Feb. 99</td>
<td>MFN treatment, technical cooperation</td>
</tr>
<tr>
<td>China</td>
<td>Nov 72</td>
<td>Aug 74</td>
<td>Framework (encourages trade)</td>
</tr>
<tr>
<td>China</td>
<td>June 96</td>
<td>April 2001</td>
<td>MFN (custom duties, trade procedures)</td>
</tr>
<tr>
<td>Croatia</td>
<td>Dec. 2002</td>
<td>Not ratified</td>
<td>MFN, Framework agreement</td>
</tr>
<tr>
<td>Cuba</td>
<td>March 98</td>
<td>Feb. 99</td>
<td>MFN treatment, encourages trade, technical cooperation</td>
</tr>
<tr>
<td>Czech Rep.</td>
<td>Oct. 94</td>
<td>May 95</td>
<td>MFN treatment incl. sea transport, using port facilities</td>
</tr>
<tr>
<td>Country</td>
<td>Date 1</td>
<td>Date 2</td>
<td>Description</td>
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<tr>
<td>Egypt</td>
<td>Sept 98</td>
<td>Feb. 99</td>
<td>Free trade zone Agreement</td>
</tr>
<tr>
<td>Gabon</td>
<td>Feb. 01</td>
<td>Not ratified</td>
<td>Framework agreement (encourages trade, transit)</td>
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<tr>
<td>Greece</td>
<td>July 97</td>
<td>Nov. 98</td>
<td>Economic cooperation (industry, transportation, maritime transport, tourism, technical training, etc.)</td>
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<tr>
<td>Indonesia</td>
<td>Aug. 99</td>
<td>Aug. 2001</td>
<td>Cultural, technological, and economic cooperation</td>
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<tr>
<td>Iran</td>
<td>Oct. 97</td>
<td>Nov. 98</td>
<td>Framework agreement</td>
</tr>
<tr>
<td>Iraq</td>
<td>April 2002</td>
<td>June 2002</td>
<td>Free Trade Agreement</td>
</tr>
<tr>
<td>Iraq</td>
<td>Dec. 99</td>
<td>May 2000</td>
<td>Encourages economic, trade, technical cooperation, and the exchange of expertise</td>
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<tr>
<td>Iraq</td>
<td>April 67</td>
<td>June 67</td>
<td>List of tariff reductions and exemptions, MFN (maritime), allow free zones,</td>
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<tr>
<td>Jordan</td>
<td>Oct. 92</td>
<td>Jan. 93</td>
<td>List of tariff reductions and exemptions, definition of rules of origin, negotiations on free trade zone</td>
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<tr>
<td>Jordan</td>
<td>2002</td>
<td>Not ratified</td>
<td>Establish free trade area</td>
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<tr>
<td>Kuwait</td>
<td>Jan. 96</td>
<td>July 96</td>
<td>1996 is a framework agreement followed by 1998: List of custom exemptions, definition of rules of origin, tariff reduction and exemptions, free trade zone agreement</td>
</tr>
<tr>
<td>Malaysia</td>
<td>May 95</td>
<td>July 96</td>
<td>Encourages trade, transit facilities, and MFN treatment</td>
</tr>
<tr>
<td>Morocco</td>
<td>March 72</td>
<td>March 73</td>
<td>Encourages cooperation in agriculture, industry, and the establishment of joint ventures</td>
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<tr>
<td>Nigeria</td>
<td>March 68</td>
<td>Jan 69</td>
<td>Framework (encourages trade in listed products)</td>
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<tr>
<td>Pakistan</td>
<td>Jan. 01</td>
<td>Aug. 2001</td>
<td>Framework agreement (encourages trade)</td>
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<tr>
<td>Poland</td>
<td>May 93</td>
<td>April 94</td>
<td>MFN treatment in sea transport and in using port facilities, selective tax and custom exemption for re-export</td>
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<tr>
<td>Country</td>
<td>Date 1</td>
<td>Date 2</td>
<td>Framework Agreement</td>
</tr>
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<tr>
<td>Qatar</td>
<td>Aug. 00</td>
<td>April 2001</td>
<td>MFN treatment in sea transport and in using port facilities, selective tax and custom exemption for re-export</td>
</tr>
<tr>
<td>Romania</td>
<td>Oct. 94</td>
<td>Dec. 95</td>
<td>MFN in custom tariffs, operations, and transport. (Restrictive) use of free zone, tariff exemption for certain products</td>
</tr>
<tr>
<td>Russia</td>
<td>March 95</td>
<td>July 96</td>
<td>Encourages transit trade, tourism, capital movement, MFN (transport), cooperation in custom regulations, and includes a list of tariff exemptions (mainly agriculture, animal)</td>
</tr>
<tr>
<td>Saudi Arabia</td>
<td>Nov. 71</td>
<td>Dec 71</td>
<td>Framework agreement (includes a listing of traded products)</td>
</tr>
<tr>
<td>Senegal</td>
<td>June 63</td>
<td>Feb 64</td>
<td>Framework agreement (MFN in maritime, encourages economic and trade cooperation)</td>
</tr>
<tr>
<td>Slovakia</td>
<td>April 01</td>
<td>Aug. 2002</td>
<td>25 % annual tariff reduction on industrial products, Free trade zone agreement. Economic, social, agricultural cooperation and movement of goods and people.</td>
</tr>
<tr>
<td>Syria</td>
<td>Aug. 98</td>
<td>1998 Feb 94 (4 agreements)</td>
<td>Encourages economic cooperation and joint ventures, includes a tariff reduction on listed products</td>
</tr>
<tr>
<td>Sudan</td>
<td>April 69</td>
<td>Feb 71</td>
<td>Framework agreement (includes a listing of products)</td>
</tr>
<tr>
<td>Tunisia</td>
<td>April 72</td>
<td>-</td>
<td>Encourages trade; economic, industrial and scientific cooperation</td>
</tr>
<tr>
<td>Turkey</td>
<td>Oct. 91</td>
<td>April 92</td>
<td>MFN for export &amp; import tariffs and procedures, technical and investment cooperation</td>
</tr>
<tr>
<td>Ukraine</td>
<td>March 96</td>
<td>Feb 97</td>
<td>Free trade zone agreement (lists tariff exemptions and reductions, facilitate transport). Encourages trade and economic cooperation</td>
</tr>
<tr>
<td>UAE</td>
<td>April 2000</td>
<td>Aug. 2001</td>
<td>Encourages economic cooperation and the exchange of experience</td>
</tr>
<tr>
<td>Yemen</td>
<td>Nov. 99</td>
<td>May 2000</td>
<td>Framework agreement (encourages trade)</td>
</tr>
</tbody>
</table>


*MFN: Most Favored Nation
Appendix II: Lebanon-Syria Treaty of Brotherhood, Cooperation, and Coordination, May 22, 1991

The Lebanese Republic and the Syrian Arab Republic on the basis of the distinguished brotherly relations between them which serve their strength from the roots of kinship history common affiliation common destiny and joint strategic interests; out of their belief that the achievement of the broadest cooperation and coordination between them will serve their strategic interests and provide the means for ensuring their development and progress and for defending their pan-Arab and national security be a source of prosperity and stability enable them to face all regional and international developments and meet the aspirations of peoples of the two countries; and in implementation of the Lebanese national accord which was ratified by the Lebanese Chamber of Deputies on 5 November 1989 have agreed on the following:

Article 1. The two states will work to achieve the highest level of cooperation and coordination in all political economic security cultural scientific and other fields in a manner that will realize the interests of the two fraternal countries within the framework of respect for their individual sovereignty and independence and will enable the two countries to use their political economic and security resources to provide prosperity and stability ensure their pan-Arab and national security and expand and strengthen their common interests as an affirmation of the brotherly relations and guarantee of their common destiny.

Article 2. The two states will work to achieve cooperation and coordination in the economic agricultural industrial and commercial fields as well as in the fields of transportation communications customs the establishment of joint profits and coordination of development plans.

Article 3. The connection between the security of the two countries requires that Lebanon not become a threat to Syria's security and vice versa under any circumstances. Therefore Lebanon will not allow itself to become a transit point or base for any force state or organization that seeks to undermine its security or that of Syria. Syria which cherishes Lebanon's security independence and unity and the agreement among its people will not allow any action that threatens Lebanon's security independence and sovereignty.

Article 4. After the political reforms are approved in a constitutional manner as stipulated in the Lebanese national accord and after the deadlines specified in this accord have expired the Syrian and Lebanese Governments will decide on the redeployment of the Syrian forces in the al-Biqā' area and the entrance to western al-Biqā' in Dahr as-Baydar up to the Haammanah-al-Mudayrī-'Any Dara line and if necessary in other points to be specified by a joint Lebanese-Syrian military committee. The two governments will conclude an agreement specifying the size and duration of the Syrian forces’ presence in these areas and the relationship of these forces with the authorities of the Lebanese state.
Article 5. The two states' Arab and international foreign policy shall be based on the following principles:

1. Lebanon and Syria are Arab states which are committed to the Arab League Charter the Arab defense pact and joint economic cooperation and all agreements ratified within the framework of the Arab League. They are members of the United Nations and are committed to its Charter. They are also members of the Non-aligned Movement.

2. The two countries share a common destiny and common interests.

3. Each country supports the other in issues related to its security and national interests in accordance of the contents of this treaty. Therefore the governments of the two countries shall coordinate their Arab and international policies cooperate to the fullest extent possible in Arab and international institutions and organizations and coordinate their stands on regional and international issues.

Article 6. The following bodies shall be formed to achieve the goals of this treaty. Other bodies can be established by a decision from the Supreme Council.

1. The Supreme Council:

A. The supreme council will consist of the presidents of the two contracting countries and a number of other members from both countries.

B. The supreme council will meet at least once a year and more often when necessary at a venue to be agreed upon.

C. The supreme council charts the general policy for coordination and cooperation between the two states in the political economic security military and other fields. It also supervises the implementation of this policy and adopts the plans and decisions that are made by the executive body the foreign affairs committee the economic and social affairs committee the defense and security affairs committee or any committee that is established in the future provided that the constitutional provisions of the two countries are respected.

D. The supreme council's decisions are binding and effective within the framework of the constitutional laws and rules of the two countries except for those decisions which require the approval of the executive or legislative authorities in the two countries under their constitutional provisions.

E. The supreme council defines the subjects on which the committees concerned have the right to make decisions. Once they are issued these decisions assume an executive nature within the framework of the constitutional laws and rules of the two countries except for those decisions which require the approval of the executive or legislative authorities in the two countries under their constitutional provisions.
2. The Executive Body:

The executive body will consist of the prime ministers of the two countries and a number of ministers concerned with the relations between them. This body will assume the following tasks:

A. To follow up on the implementation of the decisions and to submit reports to the supreme council on the phases of implementation.

B. To coordinate the recommendations and decisions of the specialized committees and to submit the proposals to the supreme council.

C. To hold meetings with the specialized committees whenever the need arises.

D. The executive body will meet at least once every six months and more often when necessary at a venue to be agreed upon.

3. The Foreign Affairs Committee:

A. The foreign affairs committee will consist of the two countries' foreign ministers.

B. The foreign affairs committee will meet at least once every two months and more often when necessary in the two countries' capitals on a rotating basis.

C. The foreign affairs committee will seek to coordinate the foreign policy of the two countries with regard to their relations with all countries. The committee will work to coordinate their activities and stands at Arab and international organizations. The relevant plans will be drawn up and submitted to the supreme council.

4. The Economic and Social Affairs Committee:

A. The economic and social affairs committee will consist of the ministers concerned in the two countries in economic and social sectors.

B. The economic and social affairs committee will meet in the two countries' capitals on a rotating basis at least once every two months and more often when necessary.

C. The economic and social affairs committee will be responsible for working to attain economic and social coordination between the two countries and for drawing up the recommendations that will lead to such coordination.

D. The recommendations adopted by the economic and social affairs committee will take effect after they have been endorsed by the supreme council in accordance with the constitutional provisions of the two countries.

5. The Defense and Security Affairs Committee:
A. The defense and security affairs committee will consist of the two countries' ministers of defense and interior.

B. The defense and security affairs committee will be responsible for studying the adequate measures needed to safeguard the two countries' security and for suggesting joint measures to confront any aggression or threat endangering their national security or any unrest that may disturb their internal security.

C. All plans recommendations and measures prepared by the defense and security affairs committee will be submitted to the supreme council for endorsement after taking into consideration the constitutional rules of the two countries.

6. The General Secretariat:

A. A general secretariat will be created to follow up on the implementation of the provisions of this treaty.

B. The general secretariat will be headed by a secretary general who will be appointed by the supreme council.

C. The headquarters specialization basis and budget of the general secretariat will be determined by the supreme council.

Closing Provisions:

A. Special agreements shall be concluded between the two countries in the fields covered by this treaty such as the economic security defense and other fields in accordance with the constitutional rules in each of the two countries and shall complement this treaty.

B. This treaty shall take effect after being ratified by the authorities of the two countries in accordance with their constitutional provisions.

C. Each of the two countries will abrogate any law or regulation which is not in line with this treaty. Such abrogation will be done in a way that does not violate any constitutional provision in either country.

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148


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