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LEBANON IN THE GLOBAL CRISIS

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Speech delivered by Minister Mohammad Safadi at

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Mr. Secretary General, Monsieur Cousseran, distinguished guests, ladies and gentlemen, it is a privilege to be present among you at “L’Académie Diplomatique Internationale”. I would like to thank the ADI, the “Chambre de Commerce Franco-arabe” and the “Chambre de Commerce Franco-libanaise” for providing me the opportunity to address you today on “Lebanon and the Middle East in the Global Economy”.

1- Some observations on the world crisis

Before focusing on Lebanon and the Lebanese economy, let me first start by making some observations on the world crisis. These observations are not prompted by the need to talk about Lebanon in the context of the world crisis, but mainly because essential aspects of the crisis correspond to features in the Lebanese and most Middle Eastern economies.

The world crisis, which started as a financial crisis and unfolded in the summer of 2008, has proved to be as severe a shock to the world economy as the 1929 financial crisis, though with a much smaller and limited impact. The containment of the crisis to date owes much to the massive, quick and coordinated response of the authorities of the advanced economies, where the crisis originated in the first place and which have been hardest hit by it.

To have a sense of the severity of the shock, and of the perception by the authorities that it carried great economic danger, it is sufficient to consider the nature of the remedies that have been initiated in the US and most of Europe, in particular two policy measures. First, and above all, there were the sweeping, coordinated and almost unconditional guarantees

that have been extended to the banking and financial sector at large, in addition to practically unrestricted access to liquidity and as needed. This is truly unprecedented, and it presents proof of the authorities' concern then, to say the least, regarding the gravity of the crisis, and the need to contain it quickly and decisively.

Second, the new financial reform legislation that is being currently proposed by President Obama is far-reaching and constitutes an overhaul of the US financial system. The new regulations would limit the domain of operations of banks, and impose strict regulations on the markets of derivatives and other financial instruments. In a sense, the new regulations would take the financial sector back to a situation in the past when the sector was subject to more rules and constraints, which is not necessarily a bad thing.

But the crisis is not fully contained yet. Even the IMF's recent World Economic Outlook (WEO) has characterized the ongoing recovery of the advanced economies as "sluggish". In fact, it projects that the world exports of goods and services in current dollar terms, which fell by 20% in 2009, will not reach their 2008 level before the year 2012. So the recovery is still an unfinished business and many risks remain.

According to some observers, with whom I tend to agree, there is one major structural development in the advanced economies that was instrumental in bringing about the crisis, and that is the ongoing process of financialization. In short, financialization refers to the size of the financial sector with respect to the economy and, since the 1980s, financial institutions in practically all the advanced economies have been expanding much faster than the growth of output or GDP.

To illustrate, and taking the US as a reference, consider the following indicators. In 1970, the debt of the US financial sector represented less than 7% of total private and government debt, and only 10% of GDP. By the end of 2007, these ratios had increased respectively to one third of total debt and 116% of GDP. Moreover, the capitalization of

the US financial sector increased from 5% of the stock market in 1980 to 24% in 2008, and its profits reached 40% of all corporate profits¹.

These are striking numbers. But increasing financialization is more than just an increase in ratios. It involves a fundamental qualitative change that consists in an inversion in fundamental economic relations. Financial intermediaries, as their designation indicates, live off trade and investment and expand, at least in principle, with their expansion. Unfortunately, the situation has been reversed in recent decades. Thus, instead of production driving trade and trade driving finance, the situation has become one of finance driving everything else. This risk of excessive financialization remains, and the remarkable capital losses in the financial sector in the advanced economies may be viewed as a “correction” that has brought the sector to a more appropriate size with the rest of the economy.

2- **Lebanon and the crisis**

What has been the impact of the world crisis on Lebanon and the Middle East? Excepting the Dubai crisis, which seems to be well resolved, growth in the MENA (Middle East and North Africa) countries has fallen in 2009 as everywhere else, but it has maintained positive levels and has been quickly recovering in 2010 toward pre-crisis trends.

In Lebanon, the picture is much better. Average GDP growth in the last three years, 2007-2009, was more than 8% a year, and growth in 2010 has been to date equally strong. The banking sector is still buoyant, attracting an increasing flow of deposits. Its consolidated balance sheet has been steadily increasing since the early 1990s, from 140% of GDP to 330% at end 2009.

Lebanon’s foreign reserves remain at a healthy level, almost by tradition. With the balance of payments in continuous surplus since 2002, the central bank’s foreign reserves

¹ For data details, see Foster, John Bellamy and Magdoff, Fred, *The Great Financial Crisis, Causes and Consequences*, New York: Monthly Review Press, 2009.

stood at end March 2010 at more than \$38 billion, including \$11 billion in gold, which represents about 100% of GDP.

These are very good numbers that are clouded, however, by the debt overhang. Our government debt currently stands at the relatively high level of about 148% of GDP, although it has been falling in recent years from its highest level of 180% of GDP that it reached at end 2006. Moreover, with more than 85% of budget revenues allocated to expenditures on interest and the salaries bill alone, and that ratio increasing to 100% of budget revenues if we add the transfers to Electricité Du Liban, it then becomes clear that little is left in the budget for capital or development expenditures.

In practice, not only the government's fiscal policy but its overall economic policy is critically constrained by these debt considerations. There is a reform plan that has been adopted by the Lebanese authorities in the context of the Paris 3-Conference. It is mostly based on the privatization of several public enterprises, including telecommunications and Electricité Du Liban, plus some tax increases. The problem is that the reform plan, as acknowledged by those who drafted it, is not sufficient to bring a significant reduction in the government debt and to put it on a sustainable downward path. In other words, we still need to develop a more effective and credible plan to resolve the government debt issue.

3- Fundamental problems in the Lebanese economy

I would like to contend, however, that the Lebanese economy suffers from more fundamental problems than debt, which have existed practically since independence, and that these problems continue to severely constrain the capacity of the economy to produce sustained high growth and good employment opportunities instead of relying on emigration for good jobs and incomes. I would also like to contend that we can identify a couple of well-specified projects that can take the Lebanese economy out of its predicament and put it on a new and higher growth path.

There are two fundamental problems that the Lebanese economy has continuously suffered from. First, economic growth has tended to be generated by only a few activities

and in a relatively small area. Indeed, much of the economic boom in Lebanon is driven by two activities, real estate and tourism, and is concentrated in the center of the country, more specifically Beirut and part of Mount Lebanon. In other words, most of the people and areas of Lebanon are little touched by economic growth and its benefits. The result is prosperity for the few, and a stark economic and social contrast between the center and the rest of the country.

The second problem is economically even more fundamental and has to do with the productivity of the economy, specifically of labor, which is relatively modest. Thus, the average productivity of labor (measured as GDP at constant prices divided by employment) currently is about 20-25% lower than it was in 1974. In this regard, and as a confirmation of that observation, a recent study by the World Bank has indicated that, if we take TFP (total factor productivity) in Brazil in 2007 to be 100, then TFP in Lebanon would be only 38².

We have to admit that, though Lebanon's economic productivity may be higher than in some countries in the region, it is definitely not at a level that makes it the competitive and modern economy that it aims to become.

There are several economic, and political, problems that one can mention to explain the long presence of these problems in the Lebanese economy. I would like to cite only two: the education system and the structure of economic activity. And, by the way, I believe these problems are also fundamental, with varying degrees, throughout the Middle East.

The education system, especially in government schools and at the primary and complementary levels, is inadequate and antiquated. Its standards and effectiveness have in fact fallen compared to what it was prior to 1975. As for the structure of economic activity, it is one where agriculture and manufacturing are unproductive and with falling shares relative to GDP. In Lebanon, the share of both agriculture and manufacturing has fallen to, respectively, only 6% and 8% of GDP. If these shares are also small in the

² See The World Bank, *From Privilege to Competition: Unlocking Private-Led Growth in the Middle East and North Africa*, Washington, D.C.: The World Bank, 2009, p.65.

advanced economies, they reflect the high productivity of labor and production processes in those economies whereas, in Lebanon and developing economies in general, they are the reflection of poor productivity.

This pattern of unproductive merchandise production, in agriculture and manufacturing, is common throughout the MENA countries. The problem arises when we witness these underdeveloped basic sectors that sit underneath a relatively developed financial sector and a satisfactory financial situation in the economy, as is the case in most of the MENA countries. In fact, this is the situation that I was referring to in my introductory remarks when noting a similarity of patterns between the global crisis and MENA economies, namely a financial expansion that is out of synch with the development of basic sectors of the economy.

4- Two projects for a new Lebanese economy

Lebanon has not really integrated in the new global productive economy, and it suffers from long-enduring structural problems. But my claim is that Lebanon can become a modern productive economy, and that its economic development can itself provide the right context for political reform.

I have in mind two specific projects, and I have already proposed one to the Council of Ministers and received initial approval.

The projects in question are respectively in the domains of human and physical infrastructure. The first one consists of reforming the education system in public, i.e. government, schools with the objective of significantly improving the standards and quality of education. Studies have shown that such a project is not costly (a few hundred million dollars at most) but requires dedication and perseverance over a number of years. The benefits of the implementation of such a project affect all economic activities and sectors by making labor and the economy more productive, and by taking the economy's growth potential to a higher level.

More important, however, is the fact that the implementation of such a project would strengthen the link between citizens and the state by providing all future generations with the opportunity of obtaining a good education at little cost. Such a development would send a signal to all that, henceforth, citizens can benefit from a much more equal-opportunity field for jobs and incomes, which would reduce the need to have recourse to religious or religious-community schools. That is also political reform.

The second project consists of the construction of a modern high-speed railway system along the coastline of Lebanon, to be linked through a few highways to major cities in the mountains, thus creating a modern national transportation network that would facilitate and speed the transportation of merchandise and people throughout the country. It is difficult to over-estimate the economic and social benefits of such a project, which would induce people to live outside the already-choking Greater Beirut, stimulate a wave of new investments and the creation of new businesses and jobs. Clearly, a totally new economic context would be created through the implementation of this project.

In this regard, the private sector in Lebanon can and should play a critical role. Instead of just waiting for the government to build the necessary human and physical infrastructure, it has to be an active partner in that process. The Lebanese private sector, banks in particular, can make the second project in particular a reality in the context of the so-called PPP (Public Private Partnership). This would in fact significantly promote the long-term interests of all in the private sector.

These two social and economic projects are foremost political projects in that they tend to strengthen the bond between Lebanese citizens and the “state”, the “state” as a truly public and non-religious entity that serves the public interest. By stimulating national development and reinforcing the condition of citizenship through the implementation of a couple of national socio-economic projects, genuine political reform may become less forbidding and Lebanon could gradually, but effectively, emerge as a strong and modern democracy.

If you go back only five years, since 2005, think of all the severe shocks that Lebanon has been regularly subjected to, in terms of assassinations of many prominent political figures, a destructive Israeli war, various episodes of domestic political strife and instability, political sit-ins, etc. And yet, we have managed at the same time to conduct our presidential, legislative and municipal elections, and to produce the best period of growth since the end of the war in 1990. So one should not under-estimate the capacity of Lebanon to rise again, like a phoenix. But even a phoenix needs a push or incentive to rise again.

Thank you.