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FROM RECOVERY TO SUSTAINABLE GROWTH

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Acronyms and Abbreviations

CDR	Council for Development and Reconstruction
ESIA	Economic and Social Impact Assessment
EdL	Electricité du Liban
EU	European Union
GDP	Gross Domestic Product
IMF	International Monetary Fund
IT	Information Technology
MOF	Ministry of Finance
O&M	Operation and Maintenance
PFM	Public Financial Management
RWA	Regional Water Authorities
SAP	Social Action Plan
TA	Technical Assistance
VAT	Value-Added Tax
WTO	World Trade Organization

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LEBANON ECONOMIC AND SOCIAL IMPACT ASSESSMENT
FROM RECOVERY TO SUSTAINABLE GROWTH

EXECUTIVE SUMMARY

1. ***The hostilities in the summer of 2006 resulted in serious human and physical losses and caused both short- and long-term damage to the Lebanese economy.*** *In addition to the human tragedy of those killed and injured, nearly one million people (one-quarter of the national population) were displaced during the height of the hostilities. The lives and livelihoods of the families who lived in and around the nearly 107,000 housing units which were damaged or destroyed have been severely disrupted. In the key sectors analyzed by the World Bank, the direct damage from the hostilities is estimated at some US$2.4 billion. Indirect damage accounted for another US$700-US$800 million in losses.*

2. ***The substantial social, economic and fiscal implications dealt a severe blow to Lebanon's long-term prospects for recovery.*** *Economy-wide losses from foregone output are estimated at US$2.3 billion in 2006 alone. A projected growth in real GDP of 6 percent in 2006 has been turned into a contraction of nearly the same magnitude. It is estimated that some 30,000 jobs have been lost. Government revenue is expected to decline by US$500 million, while hostility-related spending has increased Government expenditures by approximately US$690 million. As a result, Lebanon's ratio of debt-to-GDP, which had begun declining in the First Half of 2006 on the back of Government reforms and a growing economy, is now likely to reach 190 percent by the end of 2006. Analysis by the World Bank suggests that Lebanon now faces a public finance crisis unless substantial structural, social and fiscal reforms are undertaken. Absent these, the debt-to-GDP ratio is set to continue to climb, reaching new highs of perhaps 230 percent of GDP over the medium-term. This will impede growth and impair the Government's ability to provide essential social and human development services.*

3. ***The human and physical losses and the social and economic damage have undermined the two key ingredients for recovery: confidence in an economic rebound and credibility that the country's institutions can implement the credible economic and social measures necessary to move the country forward and realize its potential.*** *Restoring confidence and credibility requires urgent attention to sector policies and investment programs, modernization of the business environment and efficient expenditure practices. The challenge is daunting and there is no time to waste.*

4. ***The hostilities have also brought into focus the historical neglect of the social sectors, especially the development of effective social safety nets.*** *Lebanon has been hampered by the absence of a coherent social strategy and actionable program. Rather, weak coordination and politically-determined public spending has been the hallmark of social policy in Lebanon with the result that the pattern of spending is inconsistent with the actual needs of the most vulnerable populations. In the absence of appropriate social safety nets, families and businesses are left with the burden of supporting the vulnerable and unemployed. Overall, the impact of social sector programs, including both health and education, is not commensurate with the level of public spending. With additional strain on the system resulting from the hostilities, there is an urgency to initiate social strategies and programs which are inclusive, promote opportunities and provide protection across the population while addressing long-running inefficiencies.*

5. ***The ability of Lebanon's economy to recover and embark on a high and sustainable growth path is constrained by a business environment in need of immediate modernization.*** *The cost of doing business locally is driven up by rigid labor markets, a lack of responsive debt*

and equity markets and risk mitigation instruments, remaining inefficiencies in the tax system and a legal and regulatory framework that is inadequate for a modern services-driven economy. This environment makes it more difficult for Lebanon's private sector to adjust to shocks and to compete in the global economy.

6. ***The Government's current reform agenda includes a number of proposals to expand reform efforts, as well as to introduce effective and efficient sector policies and expenditure programs.*** *The draft program also includes key proposals to improve Lebanon's business environment. This program needs to be agreed, articulated and supported by adequate resources. The speed and strength of this process are critical for avoiding a severe deterioration in public finances and returning the Lebanese economy to a path of growth.*

7. ***A difficult dilemma is presented to the Government by this set of circumstances.*** *The needs of reconstruction represent new challenges and exacerbate the fiscal, macroeconomic and sectoral problems which existed prior to the conflict. While the reform program introduced in early 2006 remains broadly relevant, the hostilities have undercut the platform of strengthening confidence and credibility upon which the Government's program was based. Moreover, the impact of the hostilities has raised the demand for additional public services, while at the same time reducing the revenue available to support public spending. Significant levels of new growth and fiscal effort are now required just to get Lebanon back to the macroeconomic level prevailing in June 2006.*

8. ***A three-pronged strategy is recommended to enable Lebanon to move beyond reconstruction to recovery and sustainable growth.*** *This strategy focuses on the Government's reform program, donor support and the building of public confidence among key measures to be undertaken by the Government:*

First, a coherent reform program must contain the following elements*: (i) structural measures aimed at improving business conditions for the private sector; (ii) fiscal adjustment measures that will yield additional public resources while distributing the burden fairly across society (this could include: improved collections in the electricity sector; additional taxation of the financial sector and other revenue-generating actions; and privatization of some State assets with revenues used to retire debt); (iii) increased attention to the social sectors, including health and education, and the provision of social safety nets to protect the poor and vulnerable; (iv) re-prioritizing of infrastructure policies to sustain a modern services-led economy; and (v) efforts to address shortcomings in public financial management and procurement.*

Second, coordinated donor support, including significant levels of assistance for the Government's reform program in addition to the aid already committed for reconstruction. *Donor assistance should be provided in lockstep with an agreed strategic plan by the Government and supported by appropriate technical assistance to enhance its effectiveness. Higher levels of donor financing in support of structural adjustments should be used to reduce borrowing and help the economy grow out of very high indebtedness. This goes significantly beyond financing for projects and reconstruction associated with post-hostilities reconstruction.*

Third, measures to build credibility and confidence. *This requires broad-based support for the reform agenda based on the public's understanding that its burdens and benefits are shared equally. The main ingredients of a credible Government program are: clear objectives; an actionable implementation plan; a realistic timetable and sequencing; public monitoring of progress and full accountability for delivering results. Building confidence and credibility*

requires burden-sharing arrangements that are seen as equitable and balanced, including broad-based sharing in the costs of fiscal adjustment.

9. ***Given the depth and breadth of the required reforms, the Government needs to identify a manageable program of critical reforms that will generate significant impacts on growth and fiscal and social outcomes.*** *This reform program should also be prioritized and sequenced, and be credibly implementable given the limited institutional capacity and the country's political challenges. The detailed background sectoral analysis presents detailed within-sector prioritized recommendations. However, prioritization across sectors requires evaluations and judgment that is political, and hence, should be carried out by the Government, in consultation with stakeholders. This report's technical analysis provides the material which forms the basis for making the cross-sectoral prioritization.*

10. ***This report sets out an overall framework starting, in Section I, with a discussion of the prevailing macro/fiscal challenges and the complexities added to it by the hostilities.*** *Section II presents the elements of a reform program to promote recovery and sustainable growth. Section III discusses the role of donors in providing financial and technical assistance in support of the Government's program. Section IV reiterates the importance of building consensus around the reform agenda. The report is based on detailed technical analysis of economic, social and infrastructure sectors in terms of the impact of the hostilities and priorities for reform over the next several years.*

I. CHALLENGES OF THE MACRO/FISCAL ENVIRONMENT AND THE IMPACT OF HOSTILITIES

The following section presents an analysis of the prevailing macro/fiscal environment and sets out how the existing challenges have been exacerbated by the hostilities. It briefly summarizes the major physical, social and economic impacts resulting from the hostilities.

I.A. Impact on the Macroeconomy

1. **Lebanon's economy was picking up in 2006, despite long-term concerns.** While economic performance in 2005 was adversely affected by the assassination of Prime Minister Rafic Hariri, growth during 2001-2004 averaged more than 4 percent, and 2006 was shaping up to produce the highest growth rate in a decade. In part, this was due to the stimulus provided by external factors, notably high oil prices, which have favored demand for Lebanon's goods and services and have induced transfers and capital inflows from Gulf countries. Government reforms undertaken in early 2006 also helped create momentum for growth in 2006.

2. **The hostilities, however, put an end to this recovery.** Extensive destruction of physical capital and disruption of trade, tourism markets and supply channels during July-August affected all sectors of the economy. Real GDP for 2006 is now projected to contract by up to 5.5 percent in 2006. Expressed in monetary terms, total foregone output due to the conflict could be as high as US$2.3 billion. Moreover, the loss of investor confidence, the damage to the image of Lebanon as a tourist destination and the emigration of skilled workers will have a long-term impact on the health of the private sector and on the economy as a whole. It is estimated that 30,000 jobs may have been permanently lost. Some 200,000 people may have emigrated during the hostilities. Many of those who left were the young and highly skilled.

Table 1: Leading Economic Indicators

Actual Figures	1997	1998	1999	2000	2001	2002	2003	2004	2005	2006-proj
Gross Domestic Product (US$ billion)	15.6	16.9	17.0	16.8	17.2	18.7	19.8	21.7	22.0	21.8
Real GDP Growth (%)	3.0	3.0	-0.8	1.7	4.5	3.2	4.2	6.3	1.0	-5.5
CPI Inflation (%)	7.8	0.1	0.3	-0.7	-3.1	4.6	3.6	4.7	-0.7	4.0
Gross Debt Over GDP (%)	97.8	109.2	131.4	148.7	164.2	167.7	168.5	165.6	175.4	190.4
Fiscal Balance Over GDP (%)	-24.6	-15.2	-15.6	-24.4	-18.4	-15.2	-13.9	-10.0	-9.2	-15.6
Primary Fiscal Balance Over GDP (%)	-10.1	-2.1	-1.5	-7.8	-1.8	1.2	2.5	2.3	1.5	-2.3
Banks' Deposits Dollarization Rate (%)	63.9	65.5	61.6	66.9	72.5	69.3	66.1	70.0	73.0	74.1

Source: World Bank staff calculations based on Ministry of Finance, Ministry of Economy and Trade, Consultative Research Institute and Banque du Liban data.

3. **The fiscal and debt situation, already precarious prior to the hostilities, has worsened.** Public finances have deteriorated both on the revenue and the expenditure sides. The Government is projecting a decline in revenues by about US$500 million, primarily as a result of a drop in trade, taxes and VAT. Budgetary expenditures are expected to increase by some US$690 million because of higher military spending, early relief expenditures and repair and reconstruction of key public infrastructure. Interest payments could increase by an estimated 22 percent in 2006, reflecting an upward pressure on interest rates. As a result, it is estimated that the 2006 fiscal deficit (before grants) will increase to 15.6 percent of GDP and the primary balance is expected to turn into a deficit of around 2.3 percent. This reverses the progress made over the last several years. Lebanon's ratio of debt-to-GDP, already among the highest in the world prior to

the hostilities, is now estimated to jump from 175 percent to over 190 percent by the end of 2006 (see Table 1). Such a level can choke off growth and impair the Government's ability to provide essential services.

4. **The hostilities have also reversed an improving trend in the debt servicing burden.** Debt restructuring efforts initiated in 2003 following the Paris II Conference were instrumental in reducing Lebanon's debt service from about 16-17 percent of GDP in 2000-2003 to about 10.7 percent of GDP (approximately US$2.3 billion) in 2005. While this trend was on track prior to the hostilities, it has been dramatically reversed with the stock of public debt increasing by 2.3 percent over end-2005 figures to US$39.4 billion in August 2006.

5. **The challenge of debt management in Lebanon is affected by the currency and term composition of the debt stock.** The majority of Lebanon's debt (nearly US$40 billion) is held by private creditors—particularly by domestic commercial banks (see Table 2**).** Half of the debt is denominated in Lebanese Pounds with relatively short maturities (an average of 1.8 years). The other half is denominated in foreign currency with a longer average maturity of 6.7 years. Lebanon's debt is predominantly short-term, nearly a third is scheduled to mature within two years, and nearly two-thirds by the end of 2009.

Table 2: **Lebanon's Public Debt Structure**

	$US bln		**Shares (%)**	
	2005	**Aug-06**	**2005**	**Aug-06**
Total Debt Stock (end Period)	**38.5**	**39.4**	**Within total debt**	
a) Local Currency Debt:	***19.3***	***18.9***	***50.2%***	***48.0%***
of which:			*Within total local currency debt*	
Central Bank	7.7	6.3	40.0%	33.5%
Commercial Bank	9.4	9.8	48.7%	52.0%
Public Sector	1.6	2.1	8.3%	11.0%
Individuals or Private Institutions	0.6	0.7	3.1%	3.5%
			Within total debt	
b) Foreign Currency Debt:	***19.2***	***20.5***	***49.8%***	***52.0%***
of which:			*Within FEX debt*	
Central Bank	1.6	1.7	8.3%	8.3%
Commercial Banks	9.3	10.7	48.4%	52.0%
Foreign Governments	0.5	0.5	2.6%	2.4%
International Development Agencies	1.3	1.3	6.8%	6.3%
Paris II Loans	0.6	0.6	3.1%	3.0%
Others*	5.9	5.7	30.7%	28.0%

**Includes non-resident banks, non-banking institutions, individuals, special TBs for expropriation in foreign currency and non-classified private sources.*

Source: Central Bank, Association of Banks in Lebanon, World Bank Staff Calculations.

6. **In the face of a high and rising public debt, a comprehensive package of measures is needed to significantly change Lebanon's macroeconomic prospects.** The key components of such a package are: (i) *growth-inducing structural reforms*, geared mostly to improving the climate for private investment (see Section II.A); (ii) *fiscal adjustment*, strong enough to generate

a sizable primary surplus while spreading the burden fairly across society; this could take the form of additional contributions from the financial sector (see Section II.B); and (iii) *debt reduction efforts*, to induce a quicker transition to sustainable debt ratios; such efforts could consist of using the proceeds from the privatization effort or using new aid from international donors who have already committed funds for reconstruction (see Section III).

7. **Alternative scenarios help illustrate the need for such a comprehensive policy package**. Starting from a predicted debt-to-GDP ratio of 190 percent at the end of 2006, a *low case scenario of limited economic and fiscal reforms* is found to result in a rising debt ratio, reaching 229 percent of GDP at the end of 2011. The low case reform scenario envisions: (i) limited structural reforms so that GDP grows at only 3 percent on average per annum, and (ii) weak fiscal effort with a gradual return of the primary surplus to its pre-conflict level of 2 percent of GDP by 2011. A different scenario, built on a *stronger structural reform and fiscal adjustment effort*, would result in a more positive outcome. The stronger structural reforms would, by themselves, raise GDP growth levels to 5 percent annually which would, in turn, reduce the debt-to-GDP ratio by 26.5 percentage points to reach 203 percent by the end of 2011. On top of this, the stronger *fiscal adjustment effort* (assumed to raise the primary surplus by an additional 4 percentage points to reach 6 percent by end-2011) would reduce the debt-to-GDP ratio by an additional 22.3 percentage points. Together, these two components would result in a debt-to-GDP ratio of 181 percent by the end of 2011. But, this is not a satisfactory situation either. There remains a need for further reductions in the debt ratio. This could be achieved by accelerating privatization of selected State assets and using the proceeds to retire debt. Or, it could be achieved by using the proceeds of additional external assistance. A donor grant contribution of 2 percent of GDP (over and above existing pledges for reconstruction) would bring the debt-to-GDP ratio down to 171 percent by end of 2011.

8. **Fiscal adjustment efforts may be aided by the fact that the impact of the conflict on banks has not been severe.** Although there was an initial decline in bank deposits (with a drop in deposit of 3 percent for residents and 14 percent for non-residents during July-August), some 50 percent of this decline was reversed by end-September. Banks estimate that the losses from direct damage amounted to less then 2 percent of their commercial portfolio and less than 1 percent of their housing portfolio. Thus, the profit position of Lebanese banks has not been affected very severely, and they may be in a position to share in the burden of generating additional public revenues.

I.B. Impact on Key Sectors

9. **The hostilities in the summer of 2006 inflicted serious physical damage, primarily in the South, the southern suburbs of Beirut and parts of the Beka'a Valley.** These areas sustained most of the casualties and injuries, substantial loss of physical assets, disruption of social services and the loss of livelihoods. The education system sustained significant physical destruction with approximately 15 percent of the country's public schools damaged or destroyed, in addition to similar losses among private schools. Sixteen hospitals and 65 outpatient facilities sustained some level of damage. During the height of the hostilities, nearly one million people (one-quarter of the national population) were displaced. Overall, direct damage of assets is estimated at US$2.4 billion. A summary of estimated losses associated with the hostilities is shown in Table 3 below.

10. **Even outside the most heavily affected areas, physical damage and loss of infrastructural assets is impacting a large portion of the Lebanese population.** In particular, damage to the road network is widespread (with 140 bridges destroyed or damaged) including

along the heavily traveled coastal highway. Damage to water and wastewater networks interrupted the supply of safe drinking water and sanitation services. Environmental damage is widespread and may be long-lasting. The need to clear and dispose of a huge amount of debris and rubble caused by the destruction of residential areas and infrastructure has significant implications for both the physical environment and waste disposal. The bombing of the Jiyeh petroleum storage tanks resulted in the country's largest oil spill affecting 150 km of the Lebanese coastline as far north as the Syrian border, with particularly severe consequences in the areas around Beirut, Tabarja, the historic town of Byblos and the Palm Islands Nature Reserve off the coast of Tripoli. The Government has estimated the cost of fuel oil clean-up at up to US$200 million. The economic cost of the direct and indirect impacts of the spill and the disposal of rubble along the coast is expected to be much higher once losses in tourism receipts, earnings from fishing and potential health costs are considered.

Table 3: Estimated Cost of the Direct and Indirect Impact of the Hostilities in Selected Sectors

	Direct Impact (in US$ million)	Indirect Impact (in US$ million)	Total Impact Cost (in US$ million)
I. Infrastructure Sectors			
Housing	1,800	100	1,900
Energy	84	5 - 8	89 – 92
Water	65		65
Transport	135	95	230
Municipal	80		80
Agriculture and Irrigation	212	470 - 475	682 – 687
II. Social Sectors			
Education	44	43	87
Health	12	16 - 78	28 – 90
Pensions	4	13 - 26	17 – 30
TOTAL	**2,436**	**742 - 825**	**3,178 – 3,256**
Labor	Direct job losses,120,000. An estimated 200,000 left the country during the hostilities.	Persisting employment losses, 30,000. 3 percent increase in pre-conflict unemployment.	

Source: World Bank estimates.

Note: This table collates the estimates provided in the detailed sectoral analysis, and draws heavily on"War Damage Assessment and Restoration Program – Preliminary Damage Assessment Report", by Khatib and Alami.

11. **Housing, a sector with relatively few problems prior to the hostilities, is the most costly reconstruction challenge.** Initial calculations by consultants working for the Government estimate that some 107,000 housing units will have to be rebuilt or repaired at a cost of around US$1.8 billion. The destruction of housing also has had a huge impact on the lives of the people who lived in the affected neighborhoods. People have not only lost their largest financial asset, but also their personal possessions. Working and personal lives, schooling and neighborhood and family support networks have been severely disrupted. The destruction also represents a

reduction in the capital stock available to the Lebanese economy, equivalent to a one-time loss of about 10 percent of GDP. Moreover, there is an annual loss of some US$100 million a year which represents the foregone flow of services from homes (i.e., the loss of a place for living or renting) for as long as it takes to rebuild. The construction sector may also slow as investors delay or postpone planned investment in response to the general economic downturn. On the other hand, a robust effort to replace the lost housing stock could have a beneficial impact on the construction sector in this period when excess capacity could allow expansion without increasing costs.

12. **In the social sectors, the hostilities not only caused new crises from the loss of life and injuries and damage and destruction of the services infrastructure, but exacerbated existing weaknesses**. Historically, the social sectors have been neglected, and social insurance and social safety nets have been underdeveloped. The direct and indirect employment losses arising from the hostilities are likely to increase poverty and vulnerability, especially in the areas affected by the hostilities. Regional inequalities are also likely to worsen. Because the hostilities caused an economic slowdown and rise in unemployment, it will be difficult to raise additional financing through either employee/employer contributions to Social Security or from general revenues. Therefore, the already sizable operating deficit in the social security system is likely to increase. Likewise, an already unsustainable level of debt to the private hospital sector of US$580 million will hamper the ability to provide care for the uninsured population precisely at the time that it is most needed.

II. STRATEGY FOR REFORM

This section provides suggestions for the Government's program organized into five categories of reform: (i) structural reforms aimed at restoring stability and investor confidence in order to provide an impetus for private sector-led growth; (ii) fiscal adjustments to reduce the debt burden; (iii) increased attention to the social sectors, including health and education, in addition to the provision of social safety nets to protect the poor and most vulnerable; (iv) policies and re-prioritizing and re-sequencing of infrastructure investments; and (v) robust and transparent implementation of the overall program, including serious efforts to address public financial management and procurement.

II. A. Structural Reforms for Growth – Five Critical Steps

13. **At present, the first priority is to restore stability and investor confidence in order to provide an impetus for private sector-led growth.** Quick action by the Government, supported by substantial aid from the international community and NGOs to restore essential infrastructure, including initial repairs to the airport, ports and major roadways, and reconnecting power and water supplies have been successful. The reopening of schools and businesses has brought an important level of stability and normalcy to Lebanon following the large-scale displacement of the population during the hostilities. To maintain this momentum, and to promote a positive image of Lebanon to the world (and especially to the domestic and foreign investors who left during the hostilities), it is important that the Government make clear that Lebanon is "open for business" and help restore investor confidence.

14. **Second, actions are also needed to help businesses, including farms, recover.** Although physical damage was not inconsequential, the greatest losses were caused by the loss of commerce (particularly as it came during the peak summer season), from the interruption of the care of crops and loss of trade and markets. Therefore, action is necessary to help businesses adjust to these shocks, particularly cash-flow problems, by giving support for rescheduling

existing debt and providing new finance for working capital, introducing measures to allow tax obligations to be met flexibly and helping to restore trade links. The Government has already started implementation of programs in this direction.

15. **Third, reducing impediments to business (from lack of modern telecommunications, to corruption, to administrative and other barriers to entry and exit), needs sustained attention.** Reforms in labor and social security, licensing and other barriers to entry and exit of firms, and more transparent private sector involvement in the provision of services will help to put the Lebanese economy on a long-term growth trajectory. A large percentage of businesses identify corruption as a part of the costs of doing business in Lebanon. The Government's current reform agenda includes a significant number of legal and regulatory reform proposals to improve the business environment. The speed and strength of this process will be important factors in determining how quickly the economy can recover from the impact of the hostilities and return to a positive growth scenario.

16. **To improve the business environment, the Government needs to continue and strengthen its promotion of its legislative and regulatory reform agenda to address the following issues:**

- **Burdensome and discretionary business entry, licensing procedures and relatively weak protection of property rights, tax compliance and monopoly powers all combine to discourage innovation and new job creation. Together, these barriers also reduce Lebanon's competitive position.** The Government's existing reform strategy includes a significant reform of competition policy and the abolition of exclusive import agencies in order to reduce the obstacles to entry, and in particular, to reduce monopoly power in the economy. However, as has been shown by experience in other countries, the existence of laws and regulatory authorities have little impact without high-level political commitment and persistent implementation.
- **Bankruptcy reform needs to be tackled in order to help the economy adjust more quickly to the shock of the hostilities.** Lebanon's poorly functioning bankruptcy procedures make the exit or rehabilitation of struggling firms extremely difficult, and therefore, will slow the pace of recovery. Even in cases of *force majeure*, restrictions are imposed on business owners, and there is no viable route to corporate rehabilitation such as provided under Chapter 11 bankruptcy regulations. If the alternative is the loss of most of the value of existing assets and the possibility of fines and jail time, business owners will avoid exiting, even when their businesses are no longer viable.
- **Lebanon's rigid labor and social security regulations are an additional impediment to the hiring and firing of employees in the formal sector.** Outdated regulations and systems depress employment and make Lebanese businesses less competitive. Analysis conducted by the World Bank prior to the hostilities indicated that in absence of these restrictions, formal sector firms would, on average, employ 15 percent more workers. Unfortunately, public strictures introduced in the aftermath of the hostilities that prohibit firms from laying off workers, or reducing compensation, or that require punitive payments from those that do so, have further increased rigidities in the system. These regulations are also more likely to hinder employment, rather than increase it, by forcing firms (which are facing sharply reduced revenues) into insolvency, and by lowering incentives to expand formal employment, even as demand recovers. Strengthening social safety nets to provide support to the unemployed would remove this burden from businesses. In the short-term, donor assistance can be sought to provide support while the Government develops appropriate systems for long-term sustainability. The Government could simultaneously

introduce more flexible labor rules which would help firms adjust more quickly and create new employment opportunities. Reforming social security and the pension provision would go further in lessening the rigidities of the labor market, while providing protection to the vulnerable elderly. (See Section II.C.)

- **Lebanon's growth and recovery will be enhanced by the immediate modernization of its internet and telecommunications structure.** It needs a regulatory system that provides competitive incentives to locate a new information technology-based industry.

17. **Fourth, the facilitation of trade can give a significant boost to growth in a relatively short time frame and without the need for large-scale investment.** Trade is equivalent to 55 percent of Lebanon's GDP, and even minor improvements in the cost of trading can have significant benefits for the economy. Building on existing reform efforts, there are additional short- and medium-term reforms that the Government can implement, including streamlining the organizational structure of the administration of border control, and integrating border control and customs functions under a single institutional umbrella. Steps to decrease excessive bureaucracy and opportunities for informal payments also need action. These existing challenges have been made worse by the increased security environment surrounding the movement of goods following the hostilities, and by the adoption of UN Security Council Resolution 1701. Donors can provide considerable assistance, both in terms of expertise and financing in support of efficient trade logistics, keeping in mind that procedures and technology must be introduced in a way that is focused on facilitating trade within a secure environment, rather than emphasizing security considerations at the expense of trade. Regional partners can also provide a significant boost to Lebanon's growth by correcting their own deficient procedures which discriminate against the transit of goods entering through Lebanese ports, as well as by facilitating the importation of Lebanese goods.

18. **Fifth, increasing competition can make a noticeable impact on the business environment, as well as improve the fiscal outlook.** Privatization can be part of a medium-term fiscal adjustment program. For example, the telecommunications sector, currently operated as a Government-run monopoly, acts as a serious drag on modernizing the economy with poor services in mobile phone and internet services and prices two-five times higher than regional norms, and has impeded the development of Information Technology (IT) and the creative services sectors, as well as e-commerce, where Lebanon should have considerable strength. Also, problems related to the energy provider, Electricité du Liban (EdL), are not only a fiscal problem, but also an impediment to growth.

II. B. Fiscal Adjustment and Reforms – Priority Measures

19. **Fiscal adjustment is essential to reduce the unsustainable level of debt and debt-servicing**. The measures identified below aim at increasing the primary surplus through both the expenditure and revenue sides. Some are designed to share the burden of adjustment equitably, while some are also likely to have a beneficial impact on efficiency and growth.

- **First, improving the management of the electricity sector.** EdL's total deficit for 2006 is likely to be close to US$1 billion, over a fifth of total Government revenues. The sector needs better management in order to reduce costs and improve revenue collection over time. A key component of reforming the sector is a program of public and private investments, with increased competition, to reduce illegal connections, convert the production system from oil to gas and expand capacity to eliminate the need for generators. The removal of price distortions would free some funds for

additional investment and consumption, while greater quality of service delivery would reduce output losses;

- **Second, reforming the public sector pension system.** Generous public sector pensions are a major contingent liability for Lebanon. Reforms in this area can restore the financial viability of public pension schemes and raise the productivity of the public labor force without increasing real Government spending. Such reforms will also improve equity over the medium-run;
- **Third, generating additional revenues.** Revenues could be raised through such measures as increasing the Value-Added Tax (VAT) rate from its current level of 10 percent;
- **Fourth, burden sharing.** It is recommended that revenue generating measures include measures that make for better burden sharing across socio-economic groups. Examples of the latter type of measures include supplementary taxation of the financial system (focused on transactions, assets or income).

20. **Additional measures are also needed to reduce the stock of debt directly.** Debt reduction can be obtained through asset swaps such as privatization. Privatization will need to be an element of both the medium-term fiscal adjustment program and the growth agenda, with telecommunications being a sector where there is likely to be significant investor interest. Foreign assistance could also be used to reduce debt. If linked to a program of structural and fiscal reforms, this would smooth the burden of fiscal adjustment, while facilitating the implementation of key reforms. Given the high reliance on short-term loans, a large proportion of which is due to mature over the next two years, channeling the additional financing to retire a portion of the short-term debt should be a priority.

21. **It is recommended that the Government complement the above measures with improvements in expenditure and debt management**. The recent progress in these areas can be consolidated with a focus on key expenditure management issues concerning procurement and auditing processes, current and capital budgeting, and in key debt management issues concerning governance, risk management, coordination of monetary and fiscal policies and cash management as part of a sustained program for fiscal consolidation and debt reduction.

22. **The long-term impact of recovery-related spending on the precarious fiscal situation should also be taken into account.** Promises which cannot be met within a reasonable fiscal envelope, particularly if heavily dependent on uncertain donor financing, should be avoided. The starting point for all programs which assist those affected should be to require some level of co-financing or burden-sharing between the Government and beneficiary. For example, the cost of rebuilding damaged or destroyed houses should be shared by the households and the Government. Otherwise, there is a significant risk that claims will be open-ended and grow to unmanageable levels. In addition to this key principle, rules need to objectively proscribe eligible losses, and implementation arrangements must be beyond reproach. These objectives are best achieved through independent oversight of programs.

II. C. Priorities for the Social Sectors

23. **Increasing the focus on the social sectors, both because of their relative neglect in the past, and because of the additional strains on the population caused by the hostilities, needs to be a top priority.** Beyond the immediate needs of dealing with the aftermath of the hostilities, there are a number of long-standing issues which impact negatively on social

development. These include a lack of coherent policy development and implementation capacity, a pattern of public spending inconsistent with the regional share of deprived populations because of the influence of confessional politics on social spending and the absence of appropriate social safety nets which have left families and businesses with the burden of supporting the vulnerable and the unemployed. Overall, the impact of Lebanon's social sector programs, including both health and education, has not been commensurate with the level of public spending.

24. **The Government has been cognizant of the shortcomings of the system and was gearing up to address social issues in a comprehensive manner prior to the hostilities.** Up to now, coherent policy development and implementation have been hampered by the absence of a social policy framework, along with weak coordination and governance and lack of reliable data (for poverty, and also for the outcomes of interventions, including *ex-post* evaluations). The development of the Social Action Plan (SAP) in May/June 2006 and individual sector strategies, along with the creation of an Inter-Ministerial Committee for Social Policy, are important steps in addressing these problems. The SAP proposals remain valid for addressing many of Lebanon's social issues, but they need now to be augmented to accommodate the direct and indirect impacts of the hostilities, including restoration of the education and health system, expansion of its formal social safety nets to reach out to those in need and increasing coverage of social insurance programs. The recovery program is an opportunity to redefine the role of Government in social spending, moving away from political to more equitable targeting.

25. **In the health sector, public spending can be realigned in order to reach a larger share of the population, particularly the most vulnerable.** Health spending is relatively high on a per capita basis, but the monies have been directed at overbuilding of hospitals and provision of expensive services and drugs, while neglecting primary health care services, including immunization programs, family medicine and basic screening services. Addressing these deficiencies through increased levels of funding, however, is not an option given the sizeable debt already accrued to the largely private hospital system and the worsening fiscal situation. In this case, reforms should focus on measures to revitalize primary care services, strengthen the essential public health functions of Government agencies and enhance the capacity of the Ministry of Public Health to ensure the most effective use of public resources. These measures will significantly improve the overall public health system and narrow the equity gap in health indicators between the poor and non-poor in Lebanon.

26. **In education, improved outcomes depend on correcting long-standing policy issues, so as to produce a level of efficiency gains sufficient to ensure a more equitable distribution across a larger sector of the population, including universal access to basic education.** These improvements include: (i) addressing the oversupply and misallocation of teaching and administrative staff; (ii) completion of the school mapping project to redistribute and consolidate schools; (iii) reconsidering civil service education subsidies (within an overall review of the compensation system of civil servants) that support cash transfers mainly to private sector schools at the expense of programs that could be directed to the most needy students; (iv) eliminating fees at the basic education level and replacing them with the provision of block grants to public schools; and (v) at the post-basic education level, consider provision of conditional cash transfers as a means of reducing the drop-out rate among poorer students. Improving the management of programs and education financing through accelerated implementation of the core elements of the Education Development Program within the Ministry of Education is also required.

27. **An effective unemployment insurance scheme and labor law reform and enforcement will not only reduce uncertainty for workers and employers, but also create an environment more conducive to growth in the economy and the creation of jobs.** Similarly,

integrating the current pension scheme for civil servants, the military, and the end-of-service indemnity program for private workers into a fully-funded defined contribution scheme will expand income protection in old age, as well as help reduce the burden on the Government of unfunded pension liabilities. At the same time, the introduction of a non-contributory social pension scheme could provide a minimal level of protection to keep the vulnerable elderly from falling into deep poverty. Such programs, if well designed, would have the additional benefit of providing a sense of equity and social cohesion within Lebanon's highly confessional political system.

28. **Necessary improvements in social service delivery will be difficult unless improvements are made to correct existing implementation weaknesses.** Limited resources and expanded demands dictate that programs, across the board, be better focused. Social safety net programs need to be targeted to the most vulnerable, and health and education expenditures can have better overall outcomes at the same level of spending if more appropriately spread across regions and aimed at ensuring that essential levels of services are universally available. The introduction of modern targeting techniques will help the Government deliver services where the greatest need exists. This requires, however, that ministerial capacity be strengthened in order to collect and analyze data for objective household targeting and to design, administer and monitor social programs.

29. **Overall, it is best if Government policy in programs in the social sectors focuses on measures that reach the beneficiaries directly, compared to alternatives which may take more time to implement or increase costs of delivery and lead to higher overheads and more leakages.** Moving away from a diversity of funding mechanisms and in-kind contributions towards a more transparent financing scheme will also help service delivery and better budgeting. Including sunset clauses in emergency programs introduces a time-bound limit on Government expenditures. At the same time, evaluation of programs during implementation can provide useful feedback in terms of a program's extension, amendment or closure at the end of the prescribed period. Targeting mechanisms, including means-testing, categorical or geographic targeting, should be as transparent and scientifically-based as possible, taking into account limited capacity.

30. **Although detailed data on social conditions in Lebanon are lacking, the potential for large-scale assistance to have unintended or negative consequences indicate a need for careful analysis of the social conditions for development, as well as the social services to be provided, with attention to both the content and targeting of assistance.** Reforms will impact groups differently and need to be implemented in an equitable way that shares the burden and makes use of various delivery mechanisms, including municipalities and NGOs. Soliciting feedback from extended beneficiaries is a proven means of monitoring how well programs are meeting the needs of citizens.

II. D. Priorities for Infrastructure Sectors

31. **In terms of infrastructure, while Lebanon has had commendable success in early rehabilitation and replacement of destroyed assets, the imperatives of promoting growth and managing the fiscal situation dictate a re-examination of existing sectoral priorities**. In particular, this will require concentrated action in reform of the electricity sector, along with water, transport, agriculture and irrigation and municipal infrastructure so as to provide essential services and the infrastructure for growth, while being mindful of the considerable fiscal constraints facing the country. While each sector has specific issues and priorities, there are a

number of common themes which run across nearly all infrastructure sectors assessed by the Bank and which can be used for reorientation of the reform agenda.

32. **First, because of a program of significant investment in infrastructure in the 1990s, there has been a tendency to over-emphasize construction without the requisite attention to the Operation and Maintenance (O&M) of facilities nor to the means of financing them.** Better planning for O&M, already part of the Government's strategy, is even more essential now since new demands on Government financing dictate that increased value be obtained from the existing infrastructure. In transport, for example, the capital investment program for roads needs to be reappraised and priority focused on establishing a road administration that can effectively prepare maintenance programs and manage road assets using modern road asset management systems and techniques. Similar arguments exist for agriculture and irrigation where plans for large-scale upstream investments and the continuation of wasteful subsidies can be redirected toward providing core services.

33. **Second, in nearly every sector, improving the efficiency of Government operations and the delivery of services is a core requirement to meet reform plans.** Once infrastructure is in place, efficient functioning of ministry staff and programs is required to ensure the proper operations and management of assets. In water, for example, this implies building and strengthening the overall management and efficiency of Regional Water Authorities (RWAs) so that they are capable of fulfilling their responsibilities for planning and maintaining the physical network and for securing their financial position. Strengthening the fiscal and financial capacity of municipalities and empowering local authorities in service delivery is long overdue. Similar needs exist for strengthening Government operations across other infrastructure sectors.

34. **Third, public sector financing can be better focused through the establishment of more efficient administrative units and consolidating the plethora of small programs and subsidies which limit and dissipate the overall impact of Government spending.** As in the social sectors, the impact of Government spending on infrastructure is often muted by poor administration and programs that are so widely scattered as to have little noticeable impact. As a result, public spending in key sectors, although not necessarily inadequate, produces insufficient results. More value could be obtained by concentrating on improving and expanding extension services, research, program coordination and statistical analysis. Programs should be consolidated to focus on those investments which are most likely to support the real economy.

35. **Fourth, an increased role for the private sector in a number of key infrastructure sectors, including water, electricity and telecommunications will serve both to reduce the fiscal burden on the Government and will also improve service delivery.** In water, for example, this would entail rolling out private participation schemes in the North and Beka'a Valley and putting in place an appropriate legal and regulatory framework for increased private sector participation in the sector as a whole. In electricity, while unbundling and privatization are difficult in today's environment of high fuel prices and large subsidies, initial steps can be taken, such as outsourcing the distribution function through service contracts to improve billing and collection. Public/private partnerships can also be started for creating additional generation capacity in the electricity sector. The introduction of competition in the telecommunications sector will improve performance and lower costs.

36. **Finally, in terms of reconstruction, rebuilding assets and designing and implementing compensation programs should be consistent with medium- and long-term sectoral goals.** In agriculture, for example, programs which narrowly focus on replacing what was lost would have better outcomes if they were, instead, oriented toward restoring rural

livelihoods. The proposed fund for the redistribution of free livestock and farming equipment, for example, will serve to reinforce existing inefficiencies and inequities, and will not address the worst impact of the hostilities nor contribute to putting the rural economy back on a growth track. Rather, a similar level of financing could be provided to enhance working capital and access to credit for farmers who could use it to cover losses from this year's lost harvest and prepare for the next season. Programs such as these can provide immediate relief to those who have suffered losses, but in a way that gives a boost to growth into the future. In water, the pace of reforms needs to be maintained or quickened to ensure operational and managerial efficiency, even as work to repair the damage from the conflict is ongoing.

37. **Reconstruction efforts should also work within the institutional and legal environmental framework which the Government has put in place**. Lessons learned from the reconstruction after the Civil War have shown that long-term environmental impacts from hasty reconstruction can offset benefits if proper mitigating measures are not implemented in a timely manner. Hence, the reconstruction process should not be conducted at the expense of the environment, but should be consistent with a proper environmental protection strategy.

II. E. Improving Public Financial Management and Procurement

38. **Although the Government has been introducing reforms to its Public Financial Management (PFM) system for several years, this effort should be continued to strengthen the transparency and monitoring of the budget cycle.** Despite improvements in various components of budgeting, accounting, audit and internal control systems, overall budget preparation remains insufficiently linked to the Government's macroeconomic objectives. The absence of a modern budget law has stalled significant reforms, and the annual budgeting process is marred by variability and uncertainty.

39. **Transparency is compromised because large portions of public investments are off-budget and expenditure ceilings voted by Parliament are not binding because of the ability to carry over budget appropriations indefinitely.** Nineteen percent of public spending is outside of the regular budget, including the foreign-financed portion of the public investments executed by the Council of Development and Reconstruction (CDR) and ministries. The budget law also does not cover the activities of publicly-owned autonomous agencies such as EdL (before 2005), although EdL's deficit is covered by Government revenue. The Government has been making improvement in this area, for example by including EdL in the budget as of 2005. Unifying the entire budget is required if the Government is to effectively control public revenues and expenditures, maintain its social safety nets and improve its financial relations with public utilities.

40. **It is recommended that the Government and Parliament improve the overall control environment for budget execution and verification**. The Court of Accounts does not meet the criteria for independence as defined by international practice nor does it conduct audits in a way that would enable the expression of the auditor's opinion on the fairness of the Government's annual financial statements. The legislative base for internal control--the 1963 Law on Public Accounting--is extremely weak, since it predates the evolution in modern internal controls for Governments which has developed over the last 20 years. There were attempts by the Government to improve the control environment by amending the accounting law, but these amendments were not passed by Parliament.

41. **Improvements in PFM to correct the problems outlined above include:**

- **Improving transparency in the budgeting process by consolidating currently off-budget items.** This will require more than an accounting entry, but reforming the method of budget preparation and reporting.
- **To ensure that budget ceilings are respected, the Government could, in the short-term, limit the budget carry-over to a maximum of five years.** In the longer term, implementation of a multi-year budgeting process would help accommodate capital investments, which extend over several years.
- **Attempts to introduce modern internal control standards and reform of the Court of Accounts need to be made again through introduction of changes in the Public Accounting Law.**

42. **The Government suffers from parallel weaknesses in the area of procurement with a legal framework that is over 40 years old and has little connection to the way procurement is currently conducted.** The CDR has, since its establishment as a legally and financially autonomous public agency in 1977, operated under its own procurement regulations and has grown to virtually monopolize the construction of public sector capital investments and procurement. While CDR has shown itself competent in executing large projects and expediting donor-funded procurement, its operations are ambiguous in the context of a functioning and effective public administration. Moreover, the concentration of nearly all project management in the public sector in a single agency has been accompanied by a vacuum of capacity to manage and implement projects in line ministries. This situation has contributed to the serious disconnect between capital investment and development objectives and O&M budgets which, as discussed above, is a serious problem across all sectors.

43. **As with financial management, procurement reform needs to be addressed with urgency and commitment.** As a first step, simplified procurement procedures are worthwhile, but must be anchored in a legal instrument which can be used by implementing agencies throughout the Government for national competitive bidding and shopping. This effort should also produce standard bidding documents and training so that they are used in a proper and transparent manner. Further transparency can be imbedded in the system through better dissemination of information and introducing a means for registering and resolving complaints. Finally, a mechanism for dealing with problems after contract signature is a necessary part of procurement reform. Physical progress on reconstruction projects could be monitored at the Prime Ministerial level so that there is a sufficient level of authority over all implementing agencies. In the medium-term, the law and decrees for establishing a regulatory body for maintaining, monitoring and updating the public procurement system are necessary.

III. DONOR/GOVERNMENT PARTNERSHIP

The international community reacted quickly and generously to support Lebanon in the wake of the hostilities with humanitarian assistance and support for reconstruction. The challenge now is to put in place a partnership between the Government and donors which provides sufficient and long-term assistance in support of a credible and monitorable reform program set within a sustainable medium-term financing framework.

44. **The Government presented its urgent humanitarian and reconstruction needs to the international community on August 31, 2006 at the Stockholm Conference, and was met by**

some US$900 million in pledges of support, nearly all of which were in the form of grants. Grants from Arab countries, pledged or received by November 21, 2006 reached US$1,470 million, most of which were outside the Stockholm Conference process. The majority of infrastructure reconstruction is underway, although replacing the housing stock will be a multi-year endeavor. Initial repairs to the airport, port, power, water, irrigation and road networks have been widely successful and, in many cases, financed by international donors and by the private sector. Humanitarian needs for food, water, urgent health care and temporary accommodation for displaced persons have been largely met.

45. **The challenge now, in many ways, is more difficult since it requires a commitment on the part of both donors and the Government to sustained financing over the medium-term.** As set out in Section I, fiscal sustainability requires not just Government reform and a growing economy, but significant debt reduction. Donor aid would be extremely helpful and needs to go over and above the financing for reconstruction, without exacerbating the country's debt burden. This requires donor aid on grant or concessional terms for budget support in addition to project financing. Given the macroeconomic situation, priority will be on higher levels of assistance, particularly in the early years, to smooth the burden of fiscal adjustment over time. Simulations show that grant assistance at 10 percent of GDP (about US$2.34 billion) disbursed over 2007-2008 under a "reform scenario" could reduce the debt-to-GDP ratio to 166.4 percent by 2011, while similar assistance at 20 percent of GDP (about US$4.69 billion), could reduce debt-to-GDP ratio to 151.5 percent by 2011. Delivery of such levels of external support, however, cannot be expected unless it is grounded by a credible reform strategy set within a monitorable action plan and a sustainable medium-term financing framework.

46. **It is proposed that a new partnership between the Government and donors be forged that will establish a mechanism that will both help the Government efficiently implement its policies and programs at the same time that it provides assurance to donors that progress, against which higher levels of financing can be disbursed, is being made.** Such a mechanism could be supported through a special purpose, multi-donor trust fund which could monitor key provisions of the reform.

47. **Within such a construct, the creation of a donor-financed Technical Assistance (TA) fund could serve three key purposes**:

- **First, it would provide a means of helping plan and put in place policies and programs across sectors as set out in the Government's strategic reform agenda.**
- **Second, it would provide a means by which the Government can synchronize its reform efforts with the flow of donor aid that is necessary to finance the reforms, and, as appropriate, mitigate their impact.**
- **Third, it would provide a reporting facility of use to both the Government and donors in terms of monitoring the progress of reform activities and their impact and outcomes.** This would help the Government better manage a challenging recovery process and give the Government the tools necessary for sharing the results with stakeholders and the public more widely. It also would provide a method by which the Government could report to donors on progress, and thereby, help ensure that the donors have adequate assurance of the continued benefits of large-scale assistance, leading to continued support for increased levels of disbursements against pledges. While it would be expected that the Technical Assistance (TA) fund would cover key provisions of the reform agenda, elements of the reform which were

outside of this TA framework would necessarily be absent from the reporting mechanism.

48. **Direct beneficiaries of Technical Assistance could include not only key Government ministries, but also other stakeholders and service providers involved in the reconstruction and reform process**. Across nearly all the sectors, Government plans include widening involvement in policy development, planning and implementation through the establishment of cross-ministerial committees, user groups and private sector and stakeholder representation. Technical Assistance may subsequently be required to help quasi-governmental agencies, local government, academic institutions, civil society groups and other service providers as appropriate.

49. **Substantive improvements in PFM are essential for the success of the Government reform plans over the medium-term.** Introducing these changes, while managing significant increases in external financing, will be challenging. While the existing PFM reform program is a Government priority (see Section II), an interim solution in the area of donor finance monitoring and reporting can be simultaneously introduced. The Ministry of Finance (MOF) is establishing a monitoring and reporting system which will enable the Ministry to act as a central location within the Government for information on the overall flow of donor assistance. It will also provide for the development of an agreed set of transparent procedures for financial management and procurement which will be followed by other Government ministries and agencies in executing donor financed reconstruction activities.

50. **As appropriate mechanisms are put in place to mobilize, manage and monitor significant increases in donor financing and ensure that these funds are effectively used, donors then need to support the Government's leadership of the recovery program.** Financing should be provided in lockstep with the agreed program and should avoid investments in infrastructure or social programs that are not within an agreed framework. Donor financing that is not well coordinated can often be counterproductive, both in terms of improving the transparency of the overall budgeting system, and in terms of creating programs and infrastructure that the Government is unable to operate and maintain once donor financing has ended. This is particularly true in Lebanon's case where the prevailing fiscal situation requires stringent controls on spending. Poorly coordinated donor financing can also inadvertently undercut efforts at building consensus around a unified strategy.

51. **Finally, donors can also provide support for Lebanon's economic recovery by adjusting their own policies in support of Lebanese export growth.** Exports will be an important source of growth and can be supported by providing better access of Lebanese goods to markets both within and outside the region. As discussed in Section II, regional trading partners can help by improving the movement of trade across their borders both for imports and transit trade. Donor countries could boost Lebanon's trade by facilitating Lebanon's re-entry into the World Trade Organization (WTO) and ensuring that Lebanese trade receives the full benefit of current trade agreements, including free entry of goods into the European Union (EU) and improved access to United States markets.

IV. BUILDING CONSENSUS AROUND A REFORM STRATEGY

Open debate and meaningful and broad-based support can build and strengthen the credibility and success of the reform process.

52. **Lebanon brings considerable strengths to the difficult challenges it faces – with an entrepreneurial people, a cadre of highly educated professionals, an influential and affluent international Lebanese community willing to invest in the economy, and one of the most open and diverse societies in the region.** Lebanon's own efforts to recover from repeated shocks, including the Civil War, the assassination of Prime Minister Hariri and the hostilities in the summer of 2006, have been met with an upsurge of goodwill from the international community to help reconstruction and set Lebanon on a path of sustained growth.

53. **But the short-term recovery, and a credible strategy for medium- and long-term sustainable growth outlined above will be extremely difficult, particularly in the context of Lebanon's fiscal situation.** It will require very substantial trade-offs among worthy objectives, and a disciplined medium-term financing framework if the strategy is to avoid worsening the fiscal situation and undermining growth and social spending. The dilemma presented to the Government by this set of circumstances is a difficult one. While the reforms discussed in this report provide some guidance on focus and priorities, it is the prerogative and responsibility of the Government to develop a coherent, actionable strategy which can be supported by donors.

54. **How the costs of adjustment are shared across Lebanese society, and among the donor community, requires a clear, pre-emptive strategy.** To be politically viable, and to minimize the impact of reforms on the needs of the poor and those most affected by the conflict, the burden of reform needs to be apportioned in a way that is seen as equitable and balanced. This applies, in particular, to the fiscal adjustment effort that is now needed. Measures to curtail spending and raise revenues are more easily accommodated if implemented in ways that are perceived to be fair and equitable, and that place the higher burden on those most able to bear such a burden.

55. **The reform program is also an opportunity to redefine the role of the Government, particularly in social spending, and to move away from political towards more equitable targeting.** The goal would be a credible, well-articulated vision for a more regionally balanced social policy. Interventions, whether short-term or not, should be visible and appreciated by those they aim to benefit. This does not mean merely a communications campaign or a public relations exercise, but rather a Government that is seen to be reaching out to its citizens.