مصرف لبنان
BANQUE DU LIBAN

A Roadmap for Resilient and Sustainable Economic Diversification in Lebanon

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I. Introduction

Thank you for granting me the opportunity to share with you my vision about a strategic subject matter that highlights the prospects of the Lebanese economy at such critical circumstances.

Just like humans, the lives of nations are tainted with uncertainties and hardly predictable improbabilities that may render extreme impact on their destinies. Similarly, like humans, nations tend to seek simplistic explanations and solutions for such phenomena. However, these solutions often lie within the nations' preemptive abilities and skills to shatter the risks and exploit the malign wreckages of adverse events or to capitalize on the opportunities of benign occasions.

As such, the main mindset for actualizing this survival instinct is to diversify the nation's capacities and wealth on a wide scope so as to minimize losses and maximize gains on the economic front. From this perspective, I will highlight the concept of economic diversification, discuss its remedial effects on the Lebanese detrimental economic outlook, and then present Banque Du Liban's initiatives serving economic diversification.

II. Economic Diversification: Diversifying the Risks, Capitalizing on Opportunities

The pervasive effects triggered by global economic crises ushers in a new paradigm that applies the principles of risk management to economic development. Hence, the best indicator of countries' successful development is no longer sheer GDP growth but rather risk-adjusted, sustainable growth. Central to this risk-management paradigm is the need for greater economic diversification, which not only reduces the impact of externalities but fosters more robust, resilient growth over the long term.[i]

Economic development critically involves diversification and structural transformation, that is, the continued, dynamic reallocation of resources from less productive to more productive sectors and activities. Practices of economic diversification need to look beyond trade, which reflects diversification in the external sector, towards capturing domestic sector diversification and the underlying dynamic process of structural transformation of production across sectors. Trade diversification, which is necessarily interlinked with domestic diversification, can be achieved along several dimensions. First, it may occur across either products or trading partners. Second, product diversification may engage the introduction of new product lines (extensive margin), or a more balanced mix of existing exports (intensive margin). Finally, structural transformation significantly involves changes not only in the type, but also in the quality of products.[ii]

According to World Bank observations, diversification and product quality measures are associated with faster subsequent output growth. Moreover, evidence shows that countries with more diversified production structures tend to have lower volatility of output, consumption, and investment, in addition to greater macroeconomic stability and higher income per capita and development.[iii] Such correlations between diversification and growth, as opposed to the classical school that over-emphasizes specialization, can be witnessed in several experiences of world economies. For instance, the result of an empirical study points to the fact that Nigeria could utilize her largely untapped trade potentials for sustained gains through conscious efforts at diversifying the economy towards large-scale industrialization of the non-oil sector of the economy, emphasizing deepening technology in trade and investment, and sustaining the recent improvements in the agricultural sub-sector.[iv] Other examples of frontier countries that have submerged into diversification and structural transformation are Vietnam, a country that has achieved middle-income status, Tanzania, Angola, and Malaysia, an emerging market whose income per capita has grown 20-fold over the past 40 years.[v]

As for the patterns of quality upgrading, initiating policies that focus on creating a domestic environment broadly conducive to quality upgrading and sustained resource reallocation enhances the use of more physical - and human - capital intensive production techniques, thus helping to build on existing comparative advantages and boost countries' productivity and export revenues.[vi]

Despite the fact that there is no one-size-fits-all recipe, cross-country empirical evidence emphasizes a range of general policy and reform measures that have proven effective in promoting diversification and structural transformation in low-income countries. These include conducting institutional regulatory reform, launching workforce development initiatives, improving infrastructure and trade networks, investing in human capital, encouraging financial deepening, reducing barriers to entry for new products, launching schemes for innovation, and developing industrialization. In this spirit, a new diversification toolkit developed by IMF provides easy access to product-level data on export diversification and product quality, enabling country authorities and mission teams to conduct more detailed, country-specific policy analysis.[vii]

Institutional regulatory reform necessitates basic measures such as the establishment of a central economic policymaking entity (CEPE) to monitor and guide the national economy. Furthermore, workforce development initiatives assure that diversification is a human as well as an economic challenge, whereby policymakers need to consider the human capital as the pivotal resource in this equation, requiring large-scale shifts in education policy and labor force development.[viii]

Industrialization and innovation have been the most prominent forms undertaken by developing countries in their process of diversification. Having 80% of developing country exports as primary commodities in the 1960's, today, almost 80% of these exports are industrial products. In this context, the first policy message is the need to implement the right economy-wide "horizontal" basics for macroeconomic management, complimented by human capital and institutional, or governance, capital. Secondly, "vertical" policies that favor traded sectors can include focused infrastructure investments, tax and tariff relief, special zones, programs or regulations that bring down labor costs, or other measures. The common features among these industry-oriented experiences are: accelerating development and sustaining economic and social stability; increasing the level and range of exports; drawing on a stable, strong, and credible technocracy; enhancing constituencies rooted in non-oil tradeable sectors.[ix] As for innovation, it does not just mean 'invention' or 'R&D', but rather the capacity to absorb, implement, and exploit innovation effectively within industrial sectors, aiming at building competitive strength and generating added value for the economy.[x]

III. Remedial Diversification for a Detrimental Lebanese Economic Outlook

With the escalation of the detriments of the Arab transitional era, specifically the Syrian war, and the overruling impotence at the Lebanese political scene, the stressful uncertainties at the Lebanese macroeconomic, socio-economic, and political stages have reached critical levels. GDP growth in Lebanon is estimated to lag at 2% during 2016, a rate that is relatively healthy with respect to the region's turbulences; moreover, inflation has sharply decelerated to around 0% with the economy operating below potential, coupled with a balance-of-payment deficit of three billion US Dollars amid widening fiscal deficit, in addition to soaring unemployment rates that touch the boundaries of 20%, reaching 18% among women and 34% among youth, ironically increasing with educational level.[xi]

Amid this challenging environment, robust economic diversification schemes prove to be indispensable for resisting current and prospective strains and evading their respective risks.

From the trade-export enrichment perspective, it is noted that Lebanon's diversification rating according to the Export Diversification Index is quite promising, recording 2.09 and ranking 33 among 187 countries. Similarly, the Overall Export Quality Index rates Lebanon at 0.911, ranking 54 out of 177 countries.[xii]

This positive diversification position covers nine major industrial sectors that contribute to 21.3% of GDP[xiii], a contribution that has been following an opposite trend of the ascending role of the industrial sector in the MENA region. The food product and beverages sector ranks top at 26% of total industrial output, followed by non-metalic mineral products (12%), fabricated metal products (11%), electrical machinery (11%), chemicals (8%), furniture and manufactured goods (7%), paper products (6%), rubber and plastic products (5%), printed and recorded media (4%), and machinery and equipment (3%).[xiv] The agricultural sector contributes to 7.2% of GDP[xv] and 4.3% of total exports, having vegetables accounting for 51% of agricultural exports.[xvi] As for the services sector, it contributes to 71.5% of GDP[xvii], led by tourism and financial services, with traditionally distinguished education, health, and real-estate sectors.

This overview suggests the potential development of specialized and diversified high-quality and state-of-the-art product-mix in such sectors as agro-industrial industries, construction, logistics, machinery manufacturing, chemicals, skilled handicraft industries, art-fashion-jewelry products, information communication and technology, green and renewable energy industries, and waste recycling services. These sectors are estimated to produce around 50% of GDP and employs around 50% of the labor force. In addition, certain sophisticated services and industries that are promising contributors, such as cultural-educational services, health-research services, financial technology services, and potential petroleum products.[xviii]

In order to achieve such product-mix trade-export enrichment, the Lebanese economy should seize from being captured by the service-economy syndrome and focus on more diversified schemes. In fact even services should be directed towards synergistically serving other industrial, agricultural, and knowledge sectors. Hence, following domestic diversification and structural transformation approaches should be considered so as to capitalize on Lebanon's comparative advantages:

First, initializing industrial policies that focus on developing highly sophisticated exports, taking advantage of the increasing share of industrial exports as a percentage of total exports that rose from 37% in 2000 to 57% in 2007, in addition to the increase in export sophistication of 36% between 2000 and 2008.[xix] In this context, the advanced Australian services sector is a good example for developing enabling services and intermediary business services.[xx] This approach can espouse the establishment of industrial zones as the ones established in Beqa', business complexes, and special economic regions such as the one planned to establish in northern Lebanon.

Second, industrializing the real sector through developing a strategic orientation towards industrialization and curbing rentier economy to be able to reap the benefits of temporary booms in industry and absorb the innovation within industrial sectors.[xxi] This is especially important for evading the "resource curse" phenomenon that might arise with the prospective Lebanese petroleum industry.

Third, creating the essentials of knowledge economy, technology deepening, and lifelong learning through enhancing learning societies-communities-smart cities and establishing a national innovation system that comprises the government, industry, education and research providers, and funders, aiming at developing indigenous knowledge away from the 'buy rather than make' approach to innovations.[xxii]

Fourth, bridging the gap between productive economy and education through a two-sided approach that should be tackled by both the economic forces and the education sector. This gap is evidently reflected in the fact that 41% of the labor force is employed in jobs incompatible with their specializations.[xxiii] Hence, it is crucial to radically develop in parallel the academic curricula, specifically vocational education and training, and the capabilities of the market forces and labor market towards knowledge economy and industrial-agricultural-technical production.

Fifth, upgrading the legislative and regulatory business environment, particularly concerning the rights of financiers, the bankruptcy law, tax regulations, credit collateral values, the law for fair competition, the law for electronic financial transactions, the law for corporate governance, and the implementation of efficient trade processes especially for SME's, knowing that Lebanon ranks 147 out of 189 countries in the World Bank's "trading across border".[xxiv]

Sixth, developing the financial and capital markets in order to enhance the culture of contribution through equity financing versus debt financing, thus facilitating domestic diversification among SME's. This includes establishing an SME-dedicated stock exchange and enhancing crowdfunding. It is noted that the Lebanese stock market is mainly composed of the banking sector (78.3%), followed by real-estate (18.7%), while industry and trade compose only around 3%.[xxv]

Seventh, investing efficiently in infrastructure projects, especially those associated with information and communication technology, in addition to diminishing the cost of production and offering incentive plans for industrial, agricultural, and entrepreneurial projects.

Eighth, capitalizing on the Lebanese Diaspora transnational communities as agents of development and not merely as seasonal remittance transferors. Low-cost financing opportunities offered by a Diaspora bond[xxvi], along with the concept of offshore outsourcing and offshore subsidiaries, may be a dynamic and effective enabler for diversification, thus transforming the crisis of brain drain into a development catalyst.[xxvii]

Ninth, adopting a financial education national strategy that fosters financial literacy in the financial ecosystem through disseminating basic economic and financial information among businesses and citizens in order to provide guidance for investment opportunities, financing needs, risk management, and feasibility studies. In the same vein, establishing credit registers and bureaus serves diversification endeavors.

Tenth, augmenting good governance practices in public and private institutional environments so as to curb corruption and obstructive bureaucratic practices that tend to hinder diversification and structural transformation.

Eleventh, preparing a suitable platform constituting a hub that embraces logistics and construction services for entering the reconstruction phase in post-war Syria, particularly in northern Lebanon.

IV. Banque Du Liban's Initiatives Serving Diversification

Banque Du Liban's unconventional monetary policy has encompassed many initiatives that serve the end of economic diversification. Briefly, these initiatives can be addressed as follows:

First, the provision of stimulus packages through exemptions in the required reserve ratio and soft loans extended to Lebanese banks, mounting to six billion US Dollars in four years, in support to housing, education, renewable energy projects, innovative projects, research and development ventures, entrepreneurship, and other productive sectors of the economy.

Second, creating knowledge economy through encouraging Lebanese banks to invest in the equity capital of startups, incubators, accelerators, and other companies working in the knowledge economy. This innovative scheme made available around $600 million to support creativity and innovation.

Third, reinforcing capital markets as a source of financing, with its two channels: equity financing and debt financing, while assuring that capital markets enhance or, at least, do not threaten financial stability.

Fourth, rallying a broadly based financial literacy program, aiming at heightening consumer empowerment through increasing the financial literacy of the population.

Fifth, implementing corporate governance practices in the financial and banking sectors in order to optimize the performance, prudence, and transparency of these sectors and protect the interests of their stakeholders.

V. Conclusion

Any genuine comprehensive economic diversification is not simple to conceive or implement; however, compelling evidence shows that it will yield substantial gains in the form of sustainable, durable, long-term economic development. Despite the fact that developing countries have a limited margin in which they can implement these measures amid such an overly complex global economic system, they may have an opportunity that more economically advanced nations do not: the chance to get diversification right as their economies grow, rather than attempting to retrofit diversification measures on a mature economy.[xxviii]

The old Chinese saying concludes it best: "When the winds of change blow, some people build walls and others build windmills."

Thank you

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