

## LEBANON NATIONAL INVESTMENT REFORM AGENDA WORKSHOP

Beirut, 19 April 2007

### SUMMARY AND CONCLUSIONS

1. On April 19<sup>th</sup> 2007, the Lebanon National Investment Reform Agenda (NIRA) Workshop took place in Beirut, jointly organised by the Ministry of Finance of Lebanon and the MENA-OECD Investment Programme. The participants included Lebanese representatives from public administration, business sector and civil society, donor community and international organisations, as well as national and OECD experts. The meeting was hosted by the Prime Minister's office at Government Headquarters (Grand Serail) and opened by the Ministers of Finance and Economy and Trade, H.E. Mr. Jihad Azour and H.E. Mr. Sami Haddad respectively.
2. The workshop presented the key elements of Lebanon reform plan and the items on workshop's agenda were selected to reflect the priorities for the Government of Lebanon in the area of investment policy reform. The objective of the meeting was to assess progress in implementation of the National Investment Reform Agenda and to identify issues for further cooperation.
3. Each session featured presentations on the current situation in Lebanon and reform plans in the Government's agenda, followed by commentary and presentations by OECD experts on best international practices. This was followed by an interactive discussion in each session where participants, representing different sectors and organisations, were given a chance to challenge the speakers and recommend further measures for investment climate.

#### *Opening*

4. The workshop started with keynote speeches by the Ministers of Finance, H.E. Mr. Jihad Azour, and the Ministry of Economy and Trade, H.E. Mr. Sami Haddad, who presented Government's key reform plan and first progresses on Paris III agenda.
5. The Minister of Finance H.E. Azour highlighted existing investment opportunities and the interest in Lebanese economy expressed by Arab and international investors in recent occasions, but, at the same time, the need for constant support by the international community to maintain the rate of growth and to keep young entrepreneurs within the country. The Minister gave an overview on current legislative reforms in key areas, such as: reducing administrative barriers to business, streamlining of tax procedures, budget accountability, income tax legislation, and privatisation. He noted also the importance of improving investment climate through enhanced dialogue with the private sector.
6. H.E. Mr. Sami Haddad followed presenting other important areas of reforms addressed to improve competitiveness and to advance liberalisation process, in particular privatisation in key

sectors such as telecommunication, electricity, transportation. The main objectives of the Ministry of Economy remain job creation, cost reduction and quality improvement of public services.

7. Both Ministers welcomed cooperation with the MENA-OECD Investment Programme as a means for Lebanese policy makers and experts to get acquainted with international best practices, and a platform for stronger regional cooperation among MENA countries on investment related issues.

8. Dr. Rainer Geiger, Head of the MENA-OECD Investment Programme, presented the role of the Programme and main activities on both national and regional level as related to the improvement of the investment climate in Lebanon. Dr. Geiger expressed support to the reform plan of the Government, emphasising key areas of cooperation and latest activities related to enhancement of transparency and integrity in reconstruction efforts in a recent workshop organised in Beirut in February 2007. He suggested that implementation of reforms was crucial and that efforts should focus on the areas where parliamentary action was not needed, while preparing ground for future legislation.

### ***Business Perspectives and Opportunities***

9. The Chairman of the newly established Telecommunication Regulatory Authority (TRA), Dr. Kamal Shehadi, gave a presentation on the privatisation process in the telecommunication sector, outlining the existing telecom legislation and the establishment of TRA. The Authority, whose Board has been just appointed in February 2007, has the main purpose of establishing a regulatory environment that enables a competitive telecommunications market, where services can be delivered at affordable prices to the broadest spectrum of Lebanese consumers. This would also be a way to accelerate liberalisation and develop the telecom market. He put the accent in particular on the independent nature of the Authority, in terms of administrative, political and financial aspects, as well as on the high transparency standards to be observed in performing its functions. The main challenge of this privatisation process, as also discussed in the following debate, will be to establish a regulatory framework that enables competition in both mobile and fixed line services, ensuring autonomy of the TRA from the beginning and providing it with sufficient financial means and staff capacity.

10. Dr. Geiger presented international practices in privatisation with regard to key elements and functions to be defined in the process, institutional framework and main entities involved, possible methods used in different countries and main sectors where privatisations were initiated within OECD countries. According to figures, the predominant method of OECD privatisation in the 90s has been public share offering. More recent developments have shown an increasing dominance of emerging economies on the privatisation scene (in particular in Europe and Central Asia), with transactions largely dominated by private equity placements. Empirical evidence shows several positive results as a consequence of privatisations, such as: significant impact on corporate efficiency and performance; positive effects on infrastructure development (when combined with proper policy and regulatory frameworks); good impact on capital market development; positive macro/fiscal effects. On the other hand employment and distributional effects vary according to the context of the country and methods applied. In some countries privatisations that were hastily introduced and ill conceived failed to reach the anticipated results. A key point that determined the success of privatisation in several countries is the introduction of competition policy and an efficient regulatory framework. The main lessons to be learned from OECD experience include an imperative need of political support at the highest level; identification and articulation of policy objectives up-front; transparency and integrity of the process; effective participation by foreign investors; competition and regulatory issues to be addressed prior to sale; establishment of complementary institutions and policies; proper sequencing of sales; judicious use of post-privatisation devices. Finally, Dr. Geiger stressed the importance of corporate governance in SOEs as complementary to privatisation process, presenting the OECD Guidelines on Corporate Governance of SOEs.

### ***Enhancing the business climate through legal reforms***

11. This session provided an opportunity to present in more detail some of the legal reforms contributing to enhance the investment climate in Lebanon, with regard: competition and administrative barriers streamlining; procurement law; financial markets.

12. Mr. Marwan Michael, advisor to the Ministry of Economy and Trade, presented the situation in Lebanon in terms of progress and remaining challenges. The Government intends to ensure that competition prevails through specific legislation and other related laws such as consumer protection, anti-dumping, and e-commerce. Bilateral and multilateral institutions have so far provided technical assistance in drafting a new competition law that will be submitted to the Council of Ministers during 2007. The key challenge will then be enforcement, in particular through establishment of a competent authority –the Competition Council - to be created with a specific mandate to ensure a level playing field and enhance consumer welfare.

13. With regard to the administrative barriers, the Government of Lebanon is undertaking an important project to improve the business environment by simplification of business procedures - in cooperation with the IFC – and streamlining of administrative barriers to investment - in cooperation with FIAS. Reforms in both areas would be addressed to improve business conditions for both local and foreign investors.

14. Mr. Youssef Saad, Senior Procurement Officer at the Office of the Minister of State for Administrative Reform (OMSAR), presented the main objectives of the procurement reform agenda: to protect public expenditure and provide a framework that enables a more efficient use of public funds while enhancing transparency. In particular, with regard to Paris III agenda and the reconstruction process, the Government aims to expedite the completion of the new procurement law and the related implementation tools to be effectively deployed by mid-2007. This law will provide for a more efficient use of public funds while enhancing transparency in accordance with international business standards. A parallel goal in the agenda is the establishment of a regulatory body for maintaining, monitoring and updating the public procurement system. The role of the Court of Accounts as an ex-post agency will be also strengthened to ensure that all budgetary spending is in accordance with budgetary allocations.

15. The main point made by Mr. Saad is that the reform process does not intend to amend existing procurement legislation partially; instead, it aims to completely redraft relevant legislation based on latest innovations and best practices, to foster a new and more effective legislative framework, and at the same time to simplify and unify existing procedures to increase their efficiency. Major challenges in the public procurement reform concern capabilities of the procuring entity; modernization of procurement frameworks on both technical and ethical fronts; striking a balance between market driven competition approaches and the need for specific rules for some sectors (such as defence, health, social services); and optimising the balance between socio-economic prerogatives and integrity prerogatives.

16. A third set of legal reforms focused on financial markets regulations, presented by Mr. Jean Riachi Chairman of Financial Funds Advisors. The need for efficient financial system was emphasised, explaining some of the causes for Lebanon failures in the establishment of efficient equity markets in the past. There is a need for a strong non-banking financial sector in Lebanon, in order to capitalize on skilled human capital and innovative industries and to finance domestic needs through a better risk distribution and provision of equity financing. This makes certain reforms particularly urgent, such as the creation of an independent body to regulate financial markets, a more comprehensive legislation and fiscal reforms on financial services. The current reform addresses some

of these issues, in particular by the creation of a regulatory framework and a regulatory body whose primary functions will consist in rule-making, supervising, authorizing, and enforcing the law. The establishment of this body is one of the key points of strength of the new framework, which aims to attract global and regional investors.

17. Finally, Prof. Frederic Jenny, Chair of OECD Competition Committee, gave an overview on competition law and competition policy, drawing on lessons from developing and transition economies. He pointed at the complementarities of different policies to promote a market oriented economy, in particular in the domains of competition, privatisation, liberalization, and deregulation. According to best practices in developed and developing countries, careful coordination of these policy areas is required. In Lebanon, the weakness of competition is mainly related to the existence of different barriers to entry that generate a highly concentrated market. Other problems are the outdated commercial laws, administrative obstacles to business and corruption. Prof. Jenny highlighted how Lebanon would benefit from a liberalisation of its markets through the reduction of anti-competitive practices. The impact would be particularly strong on investment opportunities, but also very favourable to wage earners. Domestic liberalisation would allow reduction in the cost of several key domestic industries - to the benefit of others, and would render the economy overall more productive through allocation gains. The establishment of an efficient competition authority is another key point for the reformers, who have to pay particular attention to the design of its structure and core functions. A crucial point is the relationship between the future Competition Council and sectoral regulators; this is particularly relevant for Lebanon at this stage of reforms, with regard to privatisation and telecom regulation.

18. Discussion focused on conditions to ensure success in both privatisation and competition enhancement, as two related processes. As main conclusions of this session, it has been underlined that: competition law is a necessary tool for economic development; competition law must be part of a wider pro-competitive agenda; the institutional design of the competition authority must be adapted to the local specificities of the country; the role of the competition authority in regulatory reform and privatisation is crucial; the relationship between the competition authority and the sectoral regulators must be made clear in the law so as to avoid gaps or duplications.

### ***Toward a modern tax framework***

19. This session focused on the economic program of the Lebanese Government on the improvement of the fiscal system, discussing its effectiveness in comparison with fiscal reforms taking place in other countries in the region (Egypt) as well as in OECD ones.

20. Mr. Hajji Chehade, Director of the Revenue Directorate in the Ministry of Finance, gave an overview of the fiscal reforms adopted over past years to encourage both local and foreign investors, the corporate tax regime, and the measures addressed to strengthen control by the Ministry. The modernisation of the tax system is a core issue in the current economic reform agenda; key priorities are: enhancement of transparency in the revenue directorate; increase of revenues as a share of GDP; simplification of procedures for tax payers; fight against fiscal evasion; improvement of competences in the staff in tax administration; development of an awareness campaign. Two main steps will be: 1) the adoption of the Tax Procedure Code (envisaged by 2007) to implement administrative reforms and streamline tax procedures; 2) the introduction of the Global Income Tax (2008) as a comprehensive income tax, to enhance revenues, improve compliance and restore existing related tax laws.

21. A post-implementation assessment of fiscal reform in the region was presented by Mr. Ashraf Al Arabi, Deputy Minister of Finance of Egypt for tax policy. He discussed the Egyptian income tax reform, introduced in 2004 to increase tax revenues, make administration more transparent

and efficient, improve economic performance. The ex-post assessment demonstrated that both public and private sector have benefited: business climate improved, tax administration improved efficiency, and finally revenues rose as a consequence of tax base expansion. Lebanon could learn some lessons looking at the main challenges encountered by Egyptian colleagues in the implementation, in particular in improving integrity in the tax system, facilitating contacts with taxpayers, training tax officers and implementing more sophisticated concepts included in the new law –such as transfer pricing rules.

22. Finally, Mr. Alan Carter, UK Delegate from OECD Working Party on Tax Policy Analysis and Tax Statistics, provided some experiences in OECD Countries concerning Corporate Tax Reform, pointing out its importance in terms of effects on behaviour rather than as share of revenue, as corporate tax affects the level and composition of investment – which affects also growth and influences the pattern of foreign direct investment. The trend in OECD countries shows that tax policies have changed over recent years. Main problems faced by OECD concerned the preferential treatment of debt as compared to equity, which can lead to distortions of financing decisions and create opportunities for abusive tax planning. Statutory corporate tax rates have been falling across the OECD but revenues have been relatively stable. Countries have moved away from full imputation and reduced shareholder relief, but overall tax rates on dividends have generally fallen. Some countries are introducing more fundamental corporate tax reforms.

23. An important point discussed is the impact of taxes on FDI, and, in particular, the effects of certain tax incentives, which complicate the tax code with sectoral special measures, encourage tax planning, raise governance and corruption issues and encourage round tripping of domestic investment. Lessons in tax policy design suggest the need to: collect evidence about taxpayer behaviour before introducing any tax incentive; evaluate tax incentives from the outset; be aware that some policies do not work and be prepared to abolish these. Finally, tax incentives often go hand in hand with enhanced avoidance opportunities; this raises the need to develop capacity for spotting and countering these.

### ***Improving the entrepreneurial finance: venture capital and SMEs access to credit***

24. Access to credit has been identified as an issue of urgency to revitalise the private sector. Scarce financing has been acknowledged as a major problem for Lebanese enterprises, in particular SMEs. However different programmes have been set up by the Government to support financing facilities and ease constraints.

25. The IFC representative, Mrs. Julia Brickell, highlighted the role of private sector in the economy as creator of employment, growth and revenue. To play this role adequately, access to finance is a crucial issue; Lebanon has recorded impressive progress in this area (according to WB Doing Business survey), standing out in the region for its financing facilities. On the other hand the cost of credit is still very high, and small enterprises still face many challenges in accessing credit information. IFC pledged between 250-275 millions USD to support private sector development. Its programme is focused on extension of credit lines to banks and financial intermediaries lending to SMEs. Other initiatives are undertaken to increase awareness on corporate governance issues among SMEs, to improve credit information through a credit bureau, and to ensure effectiveness of all programmes by continuous monitoring.

26. The session continued with a presentation of the key programs developed by the Government to help SMEs and allow them to increase financing of their business activities, leading to increased domestic investment, output, and employment. Mr. Wissam Fahed, from the Ministry of Finance, explained Lebanese Government's interest subsidy program, which is aiming at mitigating

the crowding out effect induced by public sector borrowing. Interest rate subsidies are financed by the Lebanese Treasury and administered by the Central Bank of Lebanon and apply to specific sectors: tourism, industrial, agricultural, handicrafts, and technology.

27. He also gave an overview of the programmes introduced specifically for SME support, e.g. EIB financing to rehabilitate the service and industrial sectors; socio-economic development projects managed by the Council for Development and Reconstruction, aiming at poverty reduction and at absorbing the social implications of structural adjustment processes as well as providing sustainable job and income opportunities (as the Economic and Social Fund for Development –in cooperation with the EU- and the Community Development Project – with the WB). Following Paris III, further actions have been taken by the Government to assist enterprises in securing funds to repair damaged equipment, by accessing long-term funding at reasonable cost. Support to the private sector represented 17% of the total Paris III pledges. Moreover, support has been offered by international institutions through long term financing at below market rates (including soft loans from EIB, IFC, AFD, OPIC and Arab Fund). Another important initiative concerns equity funds, as the war weakened the balance sheets of several companies and debt to equity ratios became very high; private equity operations are being supported by the EIB, in cooperation with Lebanese banking sector and specialized institutions.

28. A parallel key programme to assist SMEs is run by Kafalat, mentioned by different speakers and represented by the Chairman, Mr. Abu Habib. Kafalat is a financial company created by the Government to assist SMEs to access commercial bank funding at a reasonable cost, by providing loan guarantees that benefit from interest rate subsidies. These loans benefit from exemption from the reserve requirement by the Central Bank of Lebanon; this significantly reduces the cost of capital. The sectors covered by Kafalat are: agriculture, tourism, traditional crafts, and high technology. The plan is to extend these facilities to other sectors and to larger firms. To this end, Kafalat entered into a partnership with the European Union and the Ministry of Economy and Trade of Lebanon to increase the amount and the size of the loan guarantees and to introduce new guarantee types.

29. Finally, the role of private equity and the problem of equity gap has been addressed, as this remains a big challenge for Lebanon and the region. Mr. Paul Chucrallah from Byblos Venture Bank explained the role of private equity investments as a form of corporate financing that can be compared to many others including bank debts. To tackle the equity gap issue is the purpose of Byblos Venture, a private equity company being set up to serve Lebanese and regional SMEs in need of equity capital to grow, with the goal of rising between 20-50 Millions USD. Byblos Ventures will be active in Lebanon and the region (Syria, Jordan and Egypt), although most of its exposure is expected to remain Lebanese. The venture is sponsored by Byblos Bank and supported by the EIB through a technical assistance programme.

30. Participants agreed that raising money from international investors for a private equity project requires above all certain standards in transparency and ethics. In economies dominated by family firms, as in Lebanon, the mere presence of an institutional investor can lead founding families to modify their behaviour and to put management and audit systems in place, thereby reducing the share of intuition and increasing the share of rigorous analysis. Formally and informally, the private equity investor can contribute with know-how, time and networks, and can also help in finding suppliers, clients and partners.

31. Another key recommendation coming out from discussion in this session concerned the need of improvement of information on access to loan facilities, enhancing communication about the benefits of partnerships to encourage the shift to private equity investment.

32. Finally, the delegate from EU Commission, Mrs. Tina Mede, introduced the EU-Mediterranean Charter for Enterprises and the benefits that its implementation can bring to Lebanon, in particular with regard to SME Policies. With regard to monitoring and measurement of progresses in enterprise policies developed by the Government, the SME Policy Index was presented, as a tool created by OECD for Western Balkans that can be also applied in the MENA region, and in particular in Lebanon. This project would be jointly conducted by EU and OECD, in cooperation with national coordinators and partners in the Lebanese public and private sectors.

### **Conclusions and Recommendations**

33. The workshop concluded with some final recommendations presented by H.E. Minister Azour and Mr. Rainer Geiger. The involvement of Lebanon in the MENA-OECD Investment Programme will continue in a number of areas relevant for Lebanon's economic reform plan, such as: regulatory framework; competition policy; transparency and anti-corruption; taxation and financial services – according to the outcomes of the NIRA workshop. In particular:

- a) Regulatory framework - Privatisation and Competition reforms: An important step has been taken by setting up an independent regulatory authority for telecommunications. However the budget and the means of action of the agency still need to be defined and no decision has been taken on privatisation of the fixed line operator.
  - *It was concluded that assistance in the regulatory reform process should be provided, by helping to build capacity for the new competition authority – to be established according the new competition law, currently in the drafting stage. OECD can offer technical assistance with regard to the establishment of the competition authority and its relationship with sectoral regulatory authorities (i.e. the newly created Telecommunication Regulatory Authority). Capacity building programmes could be developed for staff in both authorities, as well as for judges.*
- b) Transparency, integrity and public procurement: progress has been achieved in pushing forward legal reforms, but further work is required. In particular, with concern to public procurement, the modernisation of Lebanese legislation should be backed by measures to ensure its implementation.
  - *The recommendations derived from the earlier OECD-LTA Workshop on Transparency in Reconstruction, held in Beirut in February 2007, should be followed and applied, by establishing a multi-stakeholder group to oversee the reconstructions process and activating capacity building programmes for public procurement, addressed to train procurement officers.*
- c) Tax system and fiscal policies: the Ministry of Finance, with the help of the IMF, is working on fiscal reforms focusing on the improvement of tax procedures and the budgetary process. On the other hand there is need to refine the strategy for tax policy, assessing the overall tax burden, the impact of taxation and the optimal mix of different taxes.
  - *An assessment of tax incentives and on their economic impact should be undertaken, taking advantage of OECD expertise. Another area of action could be to provide support for negotiation of international tax agreements, offering training programme on this subject to Lebanese tax officials.*
- d) Enterprise financing: Lebanese financial institutions, with the help of international donors, are developing measures to increase SME access to finance. However the unavailability of equity and venture capital for innovative enterprises remains a challenge.

- *OECD proposed a specific project aimed at the creation of a regional Institute for Entrepreneurial Finance in Lebanon, with the following functions: research, analysis of the regulatory framework, development of innovative financial instruments to bridge the equity gap as well as training and advice for entrepreneurs and financial institutions. The centre would be based in Beirut and serve as a centre of excellence for the region.*

The above recommendations and action steps will be followed-up by the MENA-OECD Investment Programme and conducted in cooperation with the Lebanese Government, the private sector and civil society. The final purpose is to establish a platform for co-operation among local, OECD and other international experts as well as other MENA countries and to develop good practices that will help to strengthen Lebanon as a major economic player in the region.