



**ECONOMIC AND SOCIAL
COUNCIL**

Distr.
LIMITED
E/ESCWA/ED/2001/WG.1/7
8 June 2001
ORIGINAL: ENGLISH

ECONOMIC AND SOCIAL COMMISSION FOR WESTERN ASIA

Regional Seminar on FDI National Strategies
and Policies in the ESCWA Region
Beirut, 12-13 June 2001

ECONOMIC AND SOCIAL COMMISSION
FOR WESTERN ASIA

15-06-2001

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THE VIEWS OF THE FOREIGN INVESTORS IN LEBANON*

Compiled by

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Draft for discussion (not to be quoted)

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The Views of the Foreign Investors in Lebanon *

by

Antoine Mansour

Linda Karam

ESCWA

This report is based on a survey conducted in Lebanon in January-February 2001. It accounts on different statements of foreign investors who were interviewed and questioned about their activities in the country. Questionnaires were addressed to fifty enterprises randomly selected, mainly from the services and contracting, tourism, agriculture, and IT sectors. A number of interviews with commercial attaches of Western and Asian embassies in the country was also conducted. This report reveals the views of the foreign investors (the way they pursue their resource, market, and efficiency seeking objectives in Lebanon- their experience, their complains). It does not reflect the views of ESCWA or those of the authors of this document.

Foreign Investment in Lebanon since 1992 As Viewed by Selected Foreign and Local Investors

There are no reliable data with regard to the size and sectoral destination of FDI in Lebanon. The interviews conducted with a number of investment companies confirm the following:

Since 1990 and especially in 1995 and 1996 foreign investment was mainly from the Gulf countries. From 1997 until 1999 Investment came mainly from Lebanese expatriates and Europe. Foreign investors invested in banks, which are considered to be more transparent and profitable. Investors acquired shares in existing banks and/or opened new branches of foreign banks. Since 1998 there is a new form of investment called the "strategic investment" in productive sectors. The best example is Bonjus, which has been bought by Saudi investors; their strategy is to reshape an already existing brand and factory in Lebanon in order to access the Lebanese market as well as to export this product to the regional market.

European and American presence in Lebanon is predominantly in construction and contracting, sales and distribution. In the local market, most western companies have representation offices or agencies that are held by locals, or have franchising agreement such as McDonald's and Burger King. It has been repeatedly said that investors can forecast for three to four years maximum, as there is no potential for long-term investment in Lebanon.

On the other hand, investors from Arab and GCC countries carry out investments in real estate (e.g. hotels, Solidere buildings) and treasury bonds.

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I - A POLICY FRAMEWORK FOR FDI IN LEBANON

Until 1992 Lebanon was still struggling with the outcome of 15 years of war. At that point in time, the government launched a stabilization program, which embraced monetary and fiscal policies combined with a series of structural reforms and consisting of macroeconomic adjustment policy and a rehabilitation project for economic and legal infrastructures.

1- Economic And Political Instability

Foreign investors give preference to locations characterized by stability, predictability, coherent policies, especially when it comes to transnational corporations (TNCs) that pursue integrated international production strategies. They avoid locating activities in countries in which they fear a possible loss of freedom to operate internationally. The uncertain political environment in the country and in the region negatively affects inflows of foreign direct investment.

Regional Political Instability

The high political risks that are due to the regional political instability affect the decision of the foreign investors as to whether to invest in the country, whether to invest on short or long term, and whether to invest directly or to carry out some minor economic activities i.e. opening representation offices or agencies.

Political risks in the region are causing economic instability. The main disadvantage for foreigners (especially investors from the West) in investing in Lebanon is the political instability in the Middle East. As long as there is no peace in the region, some foreign investors agree that there is little added value to invest in Lebanon. Several foreign companies emphasized the fact that the reluctance of foreign investors to invest in Lebanon is due more to the conflict with Israel than to the political debate over Syrian role in Lebanon. We also witnessed cancellation of meetings that were to be held in Beirut; American and European citizens sometimes fear to come to Lebanon at critical moments of tension with neighboring countries.

As for the insurance against political risks, it is said to be available but very expensive; it constitutes a burden on investment projects.

Nevertheless, some believe that wherever there is good business, political instability isn't an obstacle to foreign investment initiatives. For instance, many Lebanese invest in Africa in spite of the risks that accompany their activities. According to some commercial representatives of foreign embassies, there are few cases where investors hesitated to come to Lebanon because of the regional political instability; investors look primarily for profit.

One of the negative impacts of the regional political instability is the country's image vis-a-vis foreign investors. It is clear that the Lebanese government has made some efforts during the past few years trying to acquire an international reputation by rebuilding and modernizing its infrastructure services and improving the investment

climate through a focused investment promotion agency but foreign investors continue to perceive Lebanon as an insecure place.

Unexpected Changes in Economic Policies

Frequent and unexpected changes in economic policies in Lebanon have negative impact on foreign investors' locational choice. The two successive changes of the Cabinet in 1998 and 2000 led to a lack of continuity in government policy. All Solidere projects stopped two years ago under Hoss mandate. Some believe that in the beginning of the nineties investors were waiting for Solidere to start "booming" their activities. Foreigners (mainly Kuwaitis and Saudis) were looking for opportunities in Lebanon and were eager to start their investments in the country. But it has been a year and a half that there has been a freeze in the economic activities and foreign investors abandoned their project. They have run out of the country for the main reason that the schedule of Solidere master plan has been postponed with the government shift, while the permits that were given before were suspended. Interests on payments were not even stopped in parallel!

It has been demonstrated that the reshuffling of the Cabinet has negatively affected the enforcement of contracts signed with the government. The political instability in the country removes confidence of foreign investors and causes sometimes disproportions in treatment.

52% of the interviewees believe that the unexpected changes in economic policies in Lebanon are a major difficulty they had to face in operating in the country.

a- The changes in the government mandate leads to the disrespect of signed contract

The confidence of foreign investors is breached by disrespect of signed contracts, which occurred with the changes in the Cabinet. Authorizations, even though foreseen in the contract, were suspended. This experience led some foreign companies to bear additional costs on their project estimated at up to a million dollar, and to terminate all their activities and leave.

It is quite significant to note that many court litigations have opposed the Lebanese government to several foreign companies with whom it had contractual arrangements. A French telecom company argues that potential foreign investors are following up the proceedings of the legal action in order to evaluate the accountability of the Lebanese government: the outcome of their case is critical to Lebanon's international creditworthiness.

b- Frequent changes in economic policies shows foreign investors that there is no accountability and no reliability in investing in the country

Economic instability has reduced trust and confidence of foreign investors in Lebanon. A representative of a foreign company indicated that they had high hopes when they first came to Lebanon five years ago. But the company faces today severe economic recession, and a drop in the purchasing power in the country. A large

Kuwaiti investment project (a complex for cinemas) in downtown Beirut has been postponed; Kuwaiti investors changed their mind because of the instability and the uncertainty of Solidere plan.

Economic instability is reflected in the constantly changing tax regulations, which negatively affects businesses. Companies cannot predict their expected forecast in a reliable manner, and have difficulties in finalizing a proper business plan. The unpredictability of the regulatory system is risking the viability of the business.

"We can't have any reliable forecast; economical changes are very frequent. Consequently, we risk doing wrong analyses all the time: this is an instable climate for investment" said one of the investors.

c- The internal political instability shows some cases of disproportion in treatments

Foreign investors are affected negatively by changes that occurred in various government administrations in the country. A foreign fast food restaurant (Kuwaiti investor) was encouraged by one of the municipalities to open a branch in Beirut and was offered facilities and incentives. The change that occurred, however, in the staff of the municipality was accompanied by a change in the procedures, which became more complex; high amount of fees was imposed on the restaurant in order to get the requested and pending authorization, while other restaurants in the same area didn't face the same constraints.

2- Treatment of Foreign Investors-The Rule of Law

Rules Regarding FDI Entry and Operations-

Foreign and Lebanese investors are treated alike and foreign investors abide to the same rules and regulations. They are not required to obtain a priori authorization to invest. According to the wording of the Lebanese Prime Minister, preferential treatments to nationals are in place only for the local industry².

Only 10 % of the interviewee believes that there are restrictions on activities that are confined to nationals only

The existing legislation does not discriminate against foreigner investors in Lebanon and reserves equal treatment for both. The commercial law regulating the conduct of business in Lebanon, whether under the umbrella of Lebanese companies or as branches of foreign entities or as an individual, provides for facilities rarely found in other countries of the region. The common example is the absence of limitation as to the extent of foreign participation in the capital of joint stock or limited liability

² "الحريري: الدعم الدولي للبنان وفق الخطة المرسومة": المستقبل ١٣ أيار ٢٠٠١ ص ٩

companies, except for (i) the limitations of foreigners' appropriation of land and real estate, a law that has been amended lately³; (ii) in commercial representation; and (iii) regarding the management of the companies, notably the obligation of having Lebanese nationals on the boards especially in the joint stocks companies and in commercial banks.

However, foreign investors' critical concerns are: legal protection guaranties; resolution of dispute with the government; profit repatriation; protection against expropriation and nationalization.

a- Legal Protection Guarantee

Legally, there is no real protection and no fixed standards of treatment to foreign companies. Foreign investors are operating in Lebanon at very high risks. Investors need stronger legal basis for their operations; the "rule of law" should be the predominant rule. Lebanon's effort to accede to the WTO will have a positive impact on the implementation of fixed and stable legal infrastructure. Therefore, standards are needed for production, notably in the technology sector. While it is necessary to import technology and since 'brain' is the main comparative advantage of Lebanon, legal safeguards are proportionally vital to the country's economic growth. Thus, Intellectual Property Rights (IPRs) need to be protected by a legal framework, and laws should be also enforced. Their enforcement in Lebanon is doubtful.

Another advantage of the rule of law is that it reduces corruption. The "rule of law" replaces the "laissez-faire" rules (this used to work maybe 50 years ago, but not anymore). Practically the prime minister is the one who has the utmost discretion of decision. This situation has been criticized and is described as inconsistent with the features of the market economy.

b- The Judicial System

It has been said that political influence is sometimes exerted in the judicial system, which results in discriminatory treatment against foreign companies and in favour of locals. Foreign investors are suspicious about the independence of the system. Thus, a number of foreigners have often recourse to foreign arbitration overseas since they do not trust the judicial system in the country.

A US investor of Lebanese origin said "from my personal experience, I think that the current legal system in Lebanon does not provide enough protection for investors, and this issue should be subject to thorough revision (...). The legal system in court is very time consuming"

4

³ Hariri who said in his speech in the seventh annual Arab Investment and Capital Markets Conference in Beirut: "My advice to Arab investors who bought properties under the names of Lebanese partners is to change the deeds under their own names". "PM Urges Investors to Get in the Game", The Daily Star, Friday 11, 20001. Pages 1&7.

⁴ Magnet for Investors", Lebanon Opportunities, March 2001, page 37.

36% consider that the judiciary system and enforcement of contracts has been a difficulty for them in operating in the country
18 % rate this difficulty as one of the three major difficulties faced by the company

c- Profit Repatriation and Money Transfer-

The Lebanese economy is a market economy characterized by a liberal economic regime, a robust private sector, free exchange regime, flexible business laws, absence of control on capital movements, and full convertibility of the Lebanese pounds. The free transfer of capital into and from Lebanon and the favorable foreign exchange law have always represented a major attraction to companies and businessmen.

d- The Banking System

Secrecy in the banking system in Lebanon strongly attracts foreign investors. But a major complain is that personal loans are very hard to obtain. Banks are extremely conservative in lending. Some companies faced problems in raising the needed funds from banks.

"It took us two years to raise the investment money in Lebanon while it took us only one month to do the same fund raising in Cyprus. In addition interests rates are very high. The return on investment is also low, as compared to other countries"

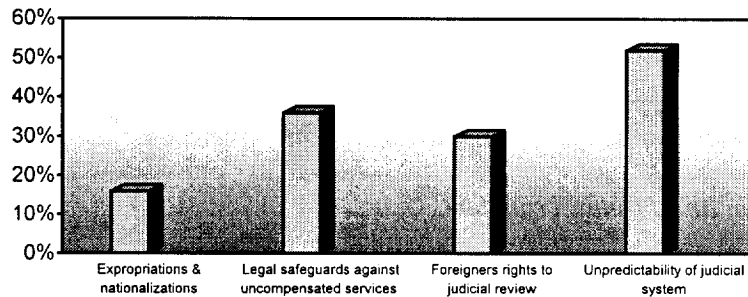
Only 4% of the interviewee had difficulties in foreign exchange procedures
(The least to be considered as a difficulty)
Only 10% had difficulties in capital and profit repatriation

e- Protection Against Expropriation and Nationalization-

It is clear that foreign companies don't face problem or risks in this regard. In contrast to many developing countries, Lebanon has a long tradition of free trade and liberal investment policies. The involvement of the public sector has generally been limited to basic social services and infrastructure. Basic economic property rights have been respected even during the war. "With private property guaranteed and protected by the Lebanese constitution, the risk of government nationalization is practically non-existent"⁵.

⁵ "Investment Strategy And Institutional Strengthening", March 1998. Foreign Investment Advisory Service, International Finance Corporation and The World Bank, p.5.

**Risk Factors Endangering FDI Business
as viewed by Foreign Investors in Lebanon**

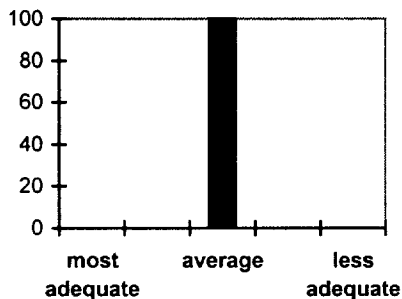


3- Fiscal System or Policy

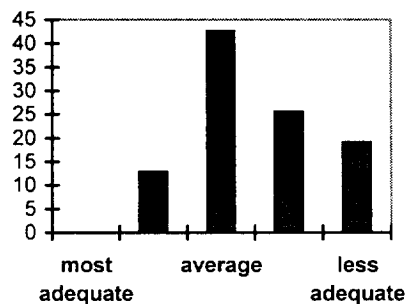
Instable for some, unclear for others

Monetary and fiscal policies determine the interest rates and thus the cost of capital in a host country; they directly affect one of the determinants of the investment decision. Fiscal policies also determine general tax levels, including corporate and personal tax rates and thereby influence inward FDI. The Lebanese fiscal and taxation laws have always been tailored to meet local and international investors' interests. But in spite of the latest reduction of customs tariff rate, instability in that respect, which witnessed many successive amendments since 1994 is creating a source of worry to all investors making them reluctant to invest in Lebanon. The stability of the regulations and laws enable in fact an investor to make reliable forecasts, and thus make important decisions, notably on the location of their investment. The suggestion of the Minister of Finance to impose taxes on the annual turnover of the companies instead of the taxes on the profits led many foreign parties to declare their intentions to withdraw from Lebanon and to move to another country, like Dubai or Cyprus.

**Clarity and Transarency of the Tax System in Lebanon
as viewed by Foreign Investors**



**Stability of the Tax System in Lebanon
as viewed by Foreign Investors**



4- Privatization Policy

The wave of privatization in the developing countries since the late 1980s has fed the explosive growth in FDI inflows. Foreign investors involvement in privatization presents a major opportunity to attract productive capital to the economy in developing countries. Privatization enhances the country's development prospects and has a positive long-term impact on the availability of productive capital from abroad. However, its contribution to increase FDI inflows largely depends on how privatization programs are managed.

The Lebanese government has set a program to privatize state-owned enterprises in order to reduce the country's mounting budget deficit and public debt and to encourage foreign investment. This program is expected to improve the economy growth and stimulate trade; privatization should also reduce the threat of political interference and consequently economic instability in the country. Electricity and telecom being the main focus of the privatization plan, foreign investors in Lebanon are eager to take part in the privatization in these sectors.

II- ECONOMIC DETERMINANTS

1- Market Size

Foreign firms, including TNCs, need to grow and/or to stay competitive by gaining access to new markets at home and abroad and/or increasing existing market shares. From a host country's perspective, the relevant economic determinants for attracting market-seeking FDI include market size, in relation to the size and income of its population, and market growth⁶. Lebanon definitely has a small domestic size market and the purchasing power of the Lebanese citizens is limited. It doesn't open up for large investments to cater the needs of the local market (~3 million people in Lebanon, while in Egypt ~50 million). Moreover, Lebanon has very few natural resources, and sourcing of raw material and other inputs by foreign companies is very limited. One way to attract foreign investors is to increase exports⁷, through the conclusion of Trade Agreements with other countries and through the accession to the WTO.

2- Geographical Location and Access to Regional Market

With the progress in the liberalization of international trade and technological advances in telecommunications and transportation, foreign investors are pursuing increasingly regional and global strategies and integrating their production structures on a regional or global basis. If the local market is not the primary consideration in this case, access to the regional market is particularly important.

⁶ UNCTAD, World Investment Report 1998: Trends And Determinants, p.107.

⁷ During the seventh annual Arab Investment and Capital Markets Conference in Beirut on May 10, 2001, Finance Minister Fouad Seniora underlined the need to speed up the establishment of a common market said the "the Arabs were unable to create an effective common market so far, which prompts some of these states to enter the international markets individually and at higher costs". Daily Star, Friday 11 May, 2001. p.7.

Lebanon therefore should benefit from its traditional advantage of its geographical location to access regional market, especially if it aims to promote export-oriented activities: Lebanon is generally described as where the “East meets West”⁸. This could make Lebanon a regional business center. Lebanon is at four hours from Europe, this is an advantage for Lebanon compared to the UAE. This is felt notably in the fashion market. If this access is limited notably by tariff or non-tariff barriers, Lebanon would lose its comparative advantage.

In case Lebanon, Syria and Jordan open up their market and a free zone is established in the Levant area, it would be promising for Lebanon. Lebanon might be hub for investment and many foreign companies revealed in fact their intent to establish their regional office in Lebanon.

**Only 18% believe that sourcing of raw material and other inputs might be an interest of the foreign partner to invest in the country.
None of them believe that it is the first reason to invest in Lebanon.
Most of them believe that it is ranked as one of the least important reasons of interest to invest in Lebanon**

“There is a need for a free zone, Lebanon needs to be a free trade center in the Middle East. Because the Lebanese market is a small market, the investment in it would be interesting only if Lebanon serves as a transit center for the region (Middle East, North Africa).”

However, it is important to note that the relative importance of the geographical location is changing, as transnational corporations, within the context of globalization and liberalization of the world economy, increasingly pursue new strategies to enhance their competitiveness. New technologies in telecommunication and transportation have made it possible for TNCs to coordinate and manage their assets across borders and to service markets anywhere in the world.

**60% of the interviewee considers that one of the major reasons to invest is the *access to the regional market*
57% view it as the first reason to invest in the country.**

3- Labour, Costs and Laws

In Lebanon, unskilled and semi-skilled foreign labour (particularly from Syria) is available at low costs. In addition, local labour is relatively expensive when

⁸ “Lebanon, Investment Strategy and Institutional Strengthening”, March 1998. Foreign Investment Advisory Service joint service of the International Finance Corporation and The World Bank, p.5.

compared to non-GCC countries. Social security costs are higher than in any other country in the region.

**28% of the interviewees consider labour costs as high.
18% viewed this as one of the three major most important difficulties**

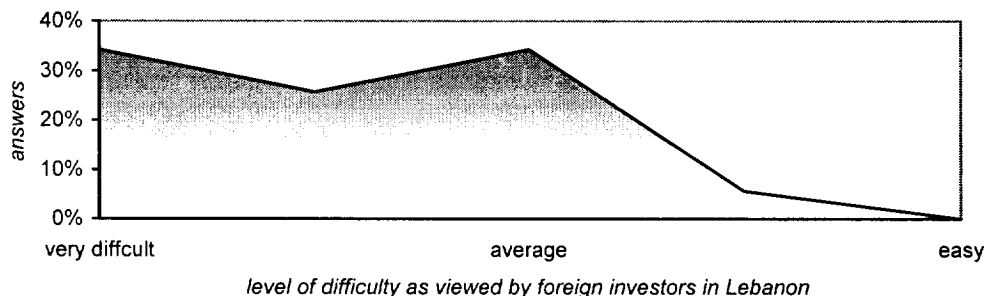
The social security regulations, which provide cover for both local and foreign employees and professionals, play a substantial role in providing a certain level of security to foreign parties. But the social security system suffers from heavy rates of participation, which reached, before the last amendments 38.5 percent of the salary. 28 percent of the interviewed foreign companies in Lebanon had complains about labour costs. 18 viewed it as the foremost difficulty in operating in the country. However, in April 2001 a recent amendment of the law reduced the rate to 23.5 percent.

Some foreign companies had bad experiences with labour laws when it comes to abusive dismissing as the indemnities are very high. Some foreign companies sometimes complain that the High Counsel of Arbitration always rules in favor of the employee. The judicial system isn't always very clear for foreigners.

"We had so many conflicts with the local workers. One employee was dismissed two months before our work ended and he was paid in full of all his due (salary, notice, leave, etc.). He didn't agree and obtained from the court an order to freeze all the payments of the companies, (involving millions of dollars) and he claimed an indemnity of \$23000 knowing that his salary was of \$600 per month. The sum he claimed was much more than what he earned during his contract with us. Later on, our lawyer cleared the point in the court, which ruled in our favor. But the court action was very slow and our bank account was blocked for two months. Unfortunately, for all the damage that we have faced we could not sue the judge because it is not foreseen in the local law that the judge is responsible for his mistake"

As for the work permits for foreign staff, the survey revealed that the companies face difficulties to get work permits for their foreign staff (see graph below).

Difficulties in Getting Work Permits for Foreign Staff



Moreover, work permits are considered expensive. The manager of one of the companies interviewed prefers to stay in Lebanon with a tourist visa, rather than to go through the complex procedures. The difficulty is somehow linked to the complexity of administrative procedures that are exposed afterwards in this document. It is difficult to get work permits because of red tape. The ministry of labour restricts the employment of foreign labour in certain professions. Foreign investors need to follow a certain procedure before hiring employees. A vacancy announcement should be inserted in a local paper and priority is given to local candidates. Foreigners who might consider this as discrimination in favor of locals because they sometimes prefer to hire specialized workers found available only abroad do not appreciate this.

4- Human Resources

Inflow of FDI depends indeed on many factors, crucial among them being the availability of skilled labour. Lebanese people have a high educational level and linguistic abilities, which makes foreigners comfortable in their communication with locals. Moreover, Lebanese people have a “worldview” because of their educational background and their wide experience outside the country. This constitutes an “intangible created asset” to attract FDI. The quality of the services provided in Lebanon is highly valued and respected, notably regarding lawyers, auditors, architects, engineers, and in computer and software industry. Foreigners consider lawyers and auditors highly competent professional and able to provide qualified assistance, both locally and internationally. However, the emigration of intellectuals in Lebanon is worrying.

“In Lebanon there is no financial advantage compared to other countries. We (Saudis) gamble on the potential of the country” in terms of individuals skills. Lebanese individuals are capable and educated, but they should understand that the country is now different than before, it needs adjustment especially in government bureaucracy and corruption”.

“The only advantage is the human resources, which is unfortunately migrating in view of the economic and political down flow. This is like a snow ball that will continue unless something comes up and shakes the market.”

Possessing created assets is central for firms' competitiveness in globalizing economy. Compared to natural resources, these types of resources can be created by host countries and influenced by governments.

In their quest for competitiveness, TNCs assign a particularly important role to obtaining access to created or strategic assets: the principal wealth-creating assets and a key source of competitiveness for firms (Dunning, 1993a, pp. 60-61; 1998c, p.47; Mytelka, 1987, and Stewart, 1997).

Created assets can be tangible like the stock of financial and physical assets such as the communication infrastructure or marketing networks, or intangible. The list of intangible assets is long but they have a common denominator: knowledge. They include skills, attitudes (e.g. attitude learning capabilities), competencies (e.g. to organize the income-generating assets productively), relationships (such as interpersonal relationships forged by individuals or contacts with governments) as well as the stocks of information, trademarks, goodwill and brainpower. These assets can be embodied in both individuals and firms and they can sometimes be enhanced by clusters of firms and economic activities.

The importance of created intangible assets in production and other economic activities has increased considerably. A large proportion of the costs of many final goods and services, ranging from such created assets as R&D, design, advertising, distribution and legal work. Less than 10 percent of the various created assets. Moreover, international competition increasingly takes place through new products and processes and these are often knowledge-based. At the same time, markets for knowledge based resources and assets are becoming more open and enterprise embodying these assets can be bought and sold. The acquiring created assets and enhancing corporate competitiveness.

Source: UNCTAD, *World Investment Report 1998: Trends and Determinants*, p. 114.

For example, a Belgium company has preferred to invest in Lebanon rather than in Syria. Despite the fact that labour cost is cheaper in Syria, the company faced problems in finding in Syria the skills required to operate high tech and sophisticated machines. The company is established now in Lebanon where it is said to have trust in local partners who have better communication skills and where skilled labour in the field of technology is available. This company is presently exporting 100% of its products to Europe.

Many foreign companies in Lebanon have a successful experience with their local partner. Many local partners are in fact Lebanese expatriates who encouraged investment in Lebanon and formed partnerships with foreign investors; they moved their office to Lebanon, and some of them even moved their office from Dubai. But unfortunately, many are also regretting to have invested in Lebanon since they are facing daily hassle procedures that are an impediment to their operation in the country (see administrative procedures).

39% believe that the availability of a competent local partner is a reason for investing in Lebanon.

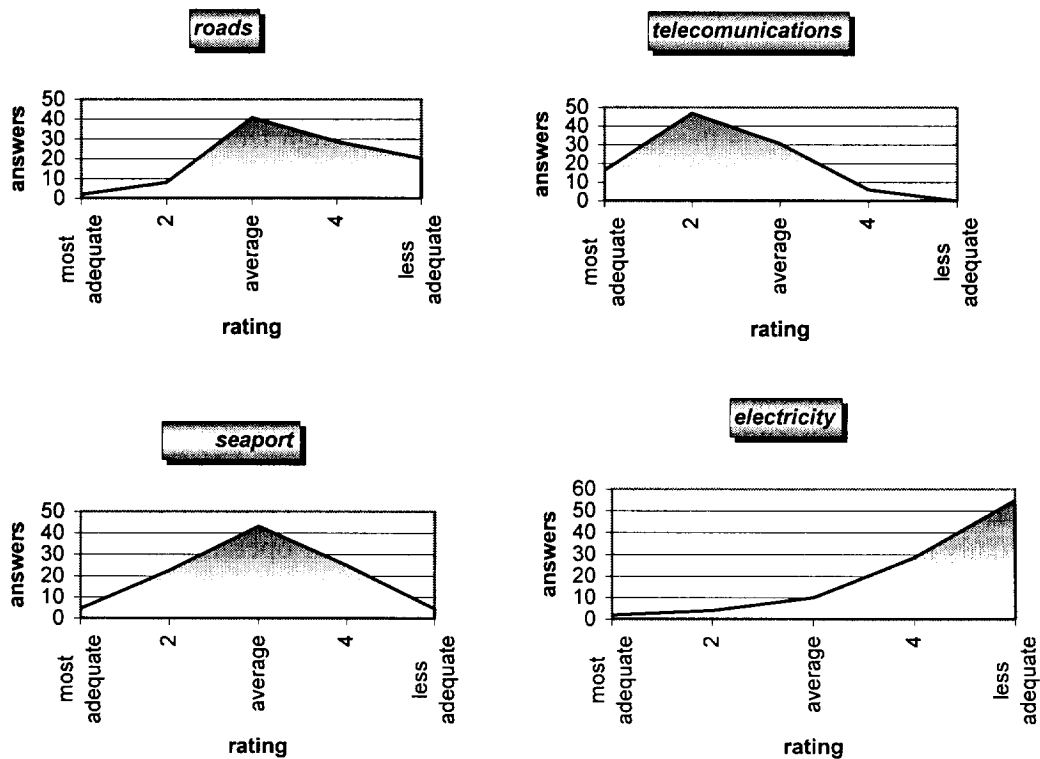
60% believe that entrepreneurial culture is a major reason for investing in Lebanon.

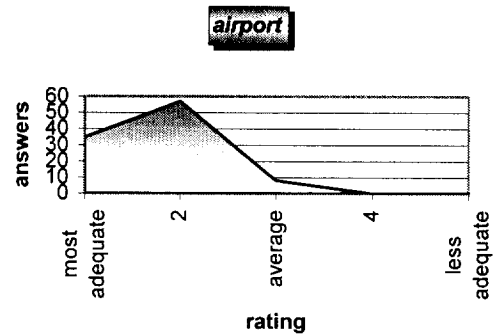
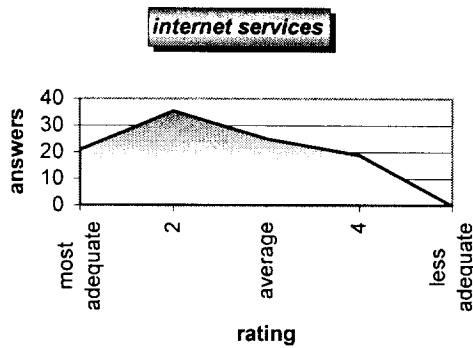
51% have a local partner

5- Infrastructure

Several positive developments have taken place since 1991. Basic infrastructure has been restored, laying out the foundations for sustainable increases in private sector's activity. Today, clear advances have been made in the physical reconstruction of the national infrastructure although some progress needs still to be made. To illustrate, many companies would rather set their own electricity generators than using the EDL services, which are considered insufficient and highly expensive. Some even have been waiting for an electricity connection from the Electricity Du Liban (EDL) for two years.

A number of companies were interviewed and the following data shows foreign investors evaluation of infrastructure adequacy:





In Lebanon, foreign companies consider infrastructure conditions as adequate except for roads conditions that vary from an area to another inside the country. Electricity services are considered very bad and expensive. However, when it comes to the International Airport of Beirut, clear efforts have been made since the beginning of 1990s and the result is very satisfactory to foreign investors.

"The country is not equipped for business, except for the downtown, which is very expensive."

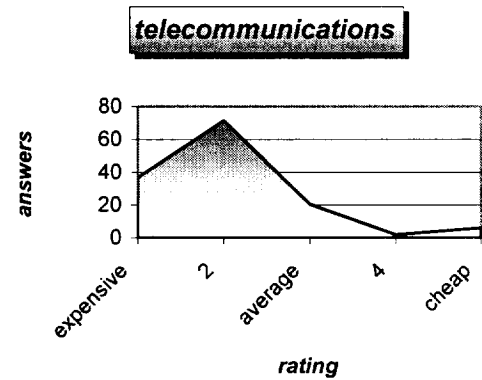
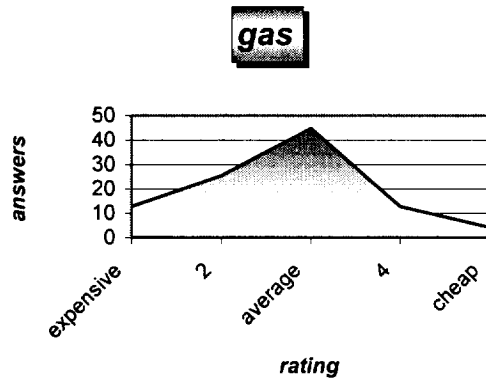
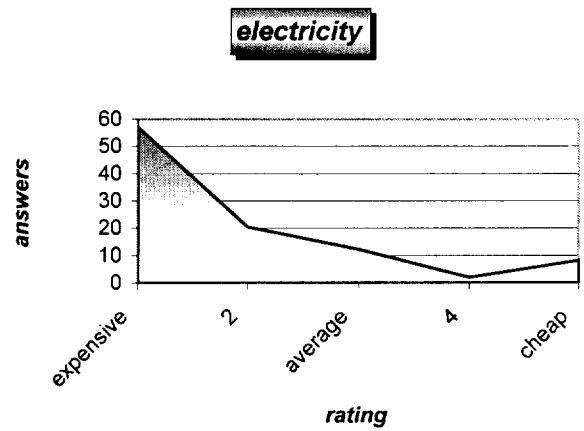
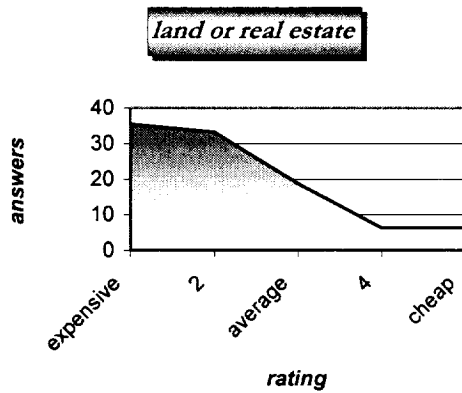
"The telephone lines were cut down because of the rain, our work had to be suspended until the lines were recovered from the rainstorm."

"There is no adequate infrastructure (...), we had to do ourselves the landscaping around the hotel we are building, we also had to finance the construction of the road that leads to the location of our project. Municipalities and government administration bodies couldn't help out in achieving all this because they don't have the necessary funds and resources for such large investment projects".

The importance of infrastructure in a host country is reflected in the ability to link specialized affiliates in mutually supporting networks of activities through adequate infrastructure facilities.

Costs of infrastructure-

The survey has shown that foreign investors evaluate the costs of infrastructure in Lebanon as follows:



Costs of production and labour, transportation and utility, costs of energy, telecommunications (and Internet services) and electricity are considered high. Costs of living are also high. Complains were heard about apartment rental high fees.

6- Opportunities for FDI: IT Sector and Tourism

Countries that cannot provide a broad range of resources may still be able to attract specialized FDI, because complex integration strategies make it possible to match specific locational advantage with the needs of a single functional activity that requires specific types of skills. Typically however, such specialized resources have to be of high quality (e.g. workforce with technological sophistication and adaptability)⁹.

Being able to develop locational advantage in respect of computer literate labour force and a relative competitive telecommunication infrastructure, Lebanon is therefore able to attract FDI in industries in new areas. IDAL have identified some industrial investments in areas that might give Lebanon a comparative advantage, such as skill intensive rather than labour intensive industries, high value added industries, low energy intensive requiring limited natural resources, environmentally friendly export oriented industries¹⁰.

⁹ "World Investment Report 1998, Trends and Determinants", UNCTAD. p.111.

¹⁰ "Industries Potentially Suitable For Lebanon", Investment Development Authority of Lebanon IDAL, Beirut, May 2000, p.1-2.

22% of the interviewee believes that the existence of a technological base in Lebanon is a major reason of interest to invest in the country

Lebanon also offers favorable environment for tourism because of the good weather and archeological and natural resources, languages and beauty of the country. Lebanon is a cosmopolitan country. Little is being done, however, to promote tourism.

Lebanon needs to focus on specific sectors, notably IT. Lebanon enjoys the availability of qualified people; this is an important asset since technologies have become one of the most important tools for competition. Technological improvements in products including services and processes have become the key to competitiveness. This underlines the importance of access to created assets. Transnational corporations seek new opportunities by making acquisition of local assets notably "created" assets that can help them maintain their competitive advantage. Created assets include communications infrastructure, market networks, technology, and innovative capacity and are critical for enabling firms to maintain their competitiveness in a changing world (see Human Resources paragraph III). Technology and capacity for continuous innovation are the major created assets¹¹.

III – BUSINESS FACILITATION

1- Bureaucracy And Administrative Procedures

Most foreign investors consider bureaucracy and administrative procedures as the main difficulty they face in getting approvals to invest and in operating in the country. In Lebanon serious concerns rise from the complexity and length of administrative procedures, corruption, and an inadapted legal and regulatory framework.

a- Complex administrative procedures

"Dealing with administrative procedures and bureaucracy in Lebanon is a 'daily frustration'"

¹¹ "Foreign direct Investment in Developing Countries", Padma Mallampally and Karl P. Sauvaint, Finance & Development, A quarterly magazine of the IMF, March 1999, Volume 36, Number 1. p. 6.

68% of interviewees believe that the *complex administrative procedures for registration of the company* are a problem in starting up activities in the country.

58% view that it is the major or biggest problem

Some believe that the complexity of administrative procedures is due to the political set up in the country, some others complain about the behavior of the small government employees who are given too much empowerment.

Political interference

Political interference resulted in a number of cases in preferential and discriminatory treatments. Some representatives of foreign investors criticized also the new Draft Law on Investment, which is said to enhance and legalize the discretionary interference of the government in FDI approval process.

Actually, the lack of fixed standards and relevant norms allows the FDI approval to be linked with or influenced by the political interference of government authorities. That is, authorizations are issued by government decrees after the intervention of the prime minister. An example was given by a foreign investor who seemed frustrated with the fact that a hotel was built in a residential area on land where the law normally forbids constructions of the kind, and yet the permit has been issued.

Also in public bidding or tender process, foreign companies have been spending money on studies for the preparation of their proposal, unfortunately there were cases of alliances behind the scene before the offer was done. The lack of transparency in contract award process is a problem, because of preferential treatments. Likewise, the results of contract award are not made public because there are no specific guidelines for the bidding process. It has been also said that there were no pre-qualification systems for tenders, and professional approach in contracting is not well established¹².

One investor said "in order to be able to operate in the country, the investment project needs primarily to meet the Lebanese government's expectations and contentment. This is very hazardous for foreign investors".

¹² This issue is linked with The Standard of Treatment of Foreign Investors- Rule of Law; see paragraph I.

**72% believe that the *lack of transparency in administrative procedures* is a difficulty faced by the company in operating in the country.
62% view it as one of the three major difficulties in operating in the country**

Corruption and the Role of Government Employees

**66% of the interviewees view *Corruption and Bribery* as the major barrier
56% view it as the first major barrier**

It has been recognized by many foreign companies that in Lebanon bribery is a way to overcome the complexity of procedures and political support can also help to facilitate all the procedures to start investing and operating in the country.

"It depends on whom you know and how much you pay!"

In administrative procedures, investors face problems mainly with government employees. In order to finalize official paperwork, or to obtain licenses or permits, one has to pay great amounts of money in bribery, even though the requested document or paperwork is legal and the official employee's duty to provide it. Some believe that the corruption of government employees is due to the fact that they have very low-income revenues. Some others consider that low-ranking government employees are given too much authority, and that this is due to the Lebanese culture: hierarchies are reversed, the low-ranking workforce seems to give itself a wider margin of decision than the one that is at the top of the organization hierarchy. For illustration, the minister who has the highest authority to take a proper decision shows to be more flexible and more open to suggestions than the low-ranking government employees who are not often professionally qualified.

Moreover, foreign investors believe that there are too much intermediaries in the Lebanese professional environment, this is unusual in western cultures. Bribery is said to be frequent not only in Lebanon but also in other Arab countries. Some foreign companies (mainly European companies) got used to this scheme and didn't consider this issue as a problem as long as their work is being done. Bribery is being indirectly included in their budget. On the contrary, some other firms (mainly US firms) refuse to pay for the purpose of having their work done, they believe that they have to be extremely transparent and very accurate in their expenditures. In fact, for these companies bribery is an impediment that hinders their operation in the country.

"Our company law forbids bribery; as a result we are not treated as we should be. Moreover, we face problems with customs procedures because we cannot entertain bribery in our system."

"We once received a phone call from a person asking for a job opportunity based on information revealed in our file that was submitted to the government authority for approval. Isn't there any secrecy in government agencies?!"

b- Costly administrative procedures

If administrative procedures appear to be costly for some, it is not the cost of permits per se that is high; it is rather the parallel costs that include bribery, as well as the unaffordable delays and time spending that cause daily expenditures and opportunity losses. These are hassle costs related to corruption and administrative efficiency.

"Our Company paid more than its capital (!) to cover the costs of procedure to obtain the necessary permit to start up the activities

"Compared to Dubai and Tunis, in Lebanon the overall procedures for starting up the activity is almost four times longer."

c- Lengthy administrative procedures and poor coordination between government agencies

Although foreign and Lebanese investors are treated alike and foreign investors are not required to obtain an a priori authorization to invest, they have to obtain permits from various government authorities. The delays in administrative procedures, the complex bureaucracy, the lack of clarity with requirements needed, the difficulties in identifying the competent authority, and the political involvement, all together make procedures burdensome and bring in unnecessary and lengthy formalities, which give bad reputation to the country¹³.

Most frequently, the lack of coordination between different government authorities and ministries is the main reason of the delays in administrative procedures. Similarly, investors have difficulties in finding out the actual competent authority they should contact primarily.

¹³ "The delay in the growth of downtown activity is being exacerbated by delays in the issues of occupancy and construction permits. "We all have problems with permits"(...). Around 20 retailers have already made a commitment to open, but are waiting for the final piece of paper. "Getting an occupancy permit is a very simple procedure. Normally it is like going to the newsagent. But the government has been delaying issuing these permits for months (...)" We should have opened in September but the building's landlord hasn't yet received an occupancy permit, and Electricité Du Liban is not providing most of the buildings in Solidere with electricity for the moment. Most of the retailers have their own generators". Shopping City, Downtown: Steady Return of Retailers Back to Business, Lebanon Opportunities, January 2000, page17.

The authority of each government body is not defined clearly. Foreign investors deal with the complexity of existing laws. They don't know which competent authority they should refer to. Once they get to a purported competent authority, they were sent to another one, which in its turn denies its authority over the case: it is a vicious circle. They never know exactly where the ongoing procedure will end up and when it will be completed. It is very arbitrary, and the course of the procedure sometimes depends on the mood of the government employee. In some case, files were lost.

There is no effective coordination between these authorities to facilitate the course of the procedure. In particular, each ministry and public body has its own procedures to secure necessary authorizations and acts independently careless of the fact that the procedure, which comprises several authorizations from different sources, requires coherence and coordination¹⁴.

In this connection, it should be noted that, in many FDI enterprises the foreign partners are not physically present in the country, and thus they are not usually aware of the complexity of the procedures. If foreigners were to manage their company in Lebanon on their own, it would be very difficult for them to understand the system and stay in the country.

"Access to information was difficult to obtain- our company was not able to understand whether having a foreign partner would legally influence the course of our activities especially in i- control of foreign exchange, ii- appropriation of land and property, iii- quantity of investment, iv- entry to stock exchange".

*d- Complications in Customs Procedures*¹⁵

56% of the interviewees view customs procedures in Lebanon as the first major trade barrier that hinders the operation of their company

¹⁴ "المشكلة التي واجهتها الشركة مع الحكومة الحالية كانت في "عجزها عن اتخاذ أي قرار، إذ على الرغم من موافقة وزارات البيئة والصناعة والعدل على المشروع، إلا أن كل جهة كانت تترك حسم القرار إلى الجهة الأخرى، ولم يعين مجلس الوزراء لجنة تتمتع بصلاحيات محددة لتتقوض معنا". المستقبل الاقتصادي ٢٠٠٠\١٠\١٠ "بعد قرار ترحيل مشروع تكرير الزيوت إلى سوريا شركة إي.سي. آر تؤول نقل استثمارها أملا بقدم "حكومة قرار"

¹⁵ "Countries that fail to keep pace with world class standards for customs administration will find that investors simply cannot afford the high logistics costs imposed by customs inefficiencies. Finance ministers in these countries will find foreign direct investment FDI migrating to nations with more sophisticated customs administrations. Moreover, customs inefficiency imposes a significant tax, hidden but very real, on consumers and traders - taxes whose 'revenues' are not realized by the government, but rather comprise a dead waste to the economy". Policy statement, Trade liberalization, foreign direct investment and customs modernization: a virtuous circle, Committee on Customs and Trade Regulations, 8 October 1999.

http://www.iccwbo.org/home/statements_rules/statements/1999/trade_liberalization.asp

Too many complains about the customs procedures are heard. First, procedures to clear goods from the customs are slow and very costly. Some investors said that they didn't face a problem in customs because they had connections in the airport or seaport. Second, the process of sorting products and defining them in the customs is a major problem to foreign investors and thus many products are being taxed highly and unfairly.

A company stated that charges paid to clear the imported merchandise are often much greater than the customs duties rate. The recent reduction in the customs duties will not make significant changes as long as there are impediments such as the administrative procedures and the expenses incurred due to the fact that the merchandise remains in stock in the seaport for long time before it is delivered.

e- Inadapted Legal and Regulatory Framework

The regulatory framework related to administrative procedures is described as 'archaic'. It is said to be outdated and cannot deal with new technologies particularly when it comes to tax collection. Foreign investment projects make use of automated sophisticated systems for the most part of their operations, therefore, old laws are inconsistent with the usage of modern techniques. Furthermore, laws related to construction are illogical, small meaningless contraventions delay big projects. Laws are in fact tailored to small constructions and buildings and to small investment projects. Existing Laws are inadequate and not applicable to large investment projects.

2- Investment Promotion and Facilitation Services

The Lebanese Investment Promotion Agency - IDAL

An investment promotion agency was established in 1994 to attract private capital investment for the massive post-war reconstruction of the country. During the mid-1990s it became the single government body associated with efforts to sell the government reconstruction program to skeptical investor in the world, offering a range of projects. The Investment Development Authority of Lebanon's (IDAL) main function is to streamline investment procedures and accelerate the flow of investment into Lebanon¹⁶.

IDAL's role in facilitating procedures has been acknowledged by the majority of the interviewed companies; almost all companies who had an experience with the Lebanese one-stop-shop IDAL were satisfied with the services provided. In fact, IDAL accelerates time for the process of registration and approvals for foreign investments and helps reduce hassle costs of these procedures. It supports investors in establishing a company or a representative office in obtaining approvals required by various ministries, obtaining required work permits, licenses, visas, and clearing imports and exports through customs. Some went on saying however, that IDAL's role consists of "simply replacing lawyers, and executing the same work".

¹⁶ "IDAL's main role is to identify and promote public and private sector investment opportunities, to provide general and specific services to investors as well as to advise the government on investment related issues." Kamal Hayek, Setting Up a One-Stop-Shop Service. Regional Workshop on Investment Promotion Techniques in the Arab Countries, October 30-31, 2000. Amman-Jordan

The majority of the interviewees considered that IDAL itself is a “victim of the system”. The one-stop-shop doesn’t change the system and its imperfections.

Some commercial representatives of foreign embassies were not enthusiastic about the Lebanese one-stop-shop. IDAL is considered as an additional government agency with its own bureaucracy. Investors are unable to find at IDAL the business data they need, particularly on local company names that would be interested in joint projects with potential foreign investors. Some foreign investors claimed that IDAL always wanted to play the role of intermediary when it comes to provide contacts with local companies.

The Draft Law on Investment

IDAL has drafted an investment law to restructure itself and “shake up the investment climate”. It aims essentially at restructuring IDAL with more powers to encourage foreign and domestic investments on projects, and easing the tax and bureaucratic burden:

The draft law introduces the following main points:

- Replacing IDAL with a new entity that carries the same name, but is run by seven-member board appointed by the Cabinet for four years.
- Allowing IDAL to hire its own staff without referring first to the Council of Civil Service
- Allowing IDAL to venture into partnerships with the private sector
- Putting IDAL in charge of issuing all licenses and permits, as well as of designing of promotion and advertising campaigns to promote projects both domestically and internationally
- Classifying Lebanon into three investment zones
- Facilitating the issuance of work permits for foreign labour
- Exempting companies that list 40 percent of their shares on BSE from income tax for two years
- Including the development and promotion of agricultural outputs as one of IDAL’s tasks
- Encouraging investment in the field of technology, information, telecommunications, and media through providing incentives for such investments
- Allowing for the introduction of tailor-made incentives through package deals

Source: Lebanon Opportunities, March 2001, Magnet for Investors, p.34-37.

The draft law on investment doesn't tackle the issue of complexity of procedure in the existing legislation

The new draft law gives IDAL the authority to deliver permits. Even if IDAL were to be the unique body that could replace a multitude of other government authorities; this would not remove the authority/competence of other existing government bodies. Does this mean facilitating procedures?

Several foreign companies believe that the draft law would mean adding IDAL to different competent authorities in delivering permits and licenses; rather the government should simplify, reduce ad/or eliminate the procedures and bureaucracy. For example, if an industrial project actually requires permits/approvals from 6 different ministries (environment, interior, etc.), theoretically, IDAL would be the 7th additional authority that will deliver requested permits.

The draft law does not give a solution to the problem. The problem remains principally in the entire system and investors are facing problems not only in the phase of starting up a company but in the course of the operation of their activities as well.

“Starting up the company is honey moon compared to operating in the country”

**90% of the interviewees face *administrative and bureaucratic procedures* in their operations in the country.
58% consider this problem as the first major one in their operations**

What is proposed instead, is to implement a comprehensive plan focusing on *Administrative Reform* to reduce hassle procedures and bureaucratic burden and corruption. Actually, investment facilitation should cover as well after-investment services, that is, services provided to foreign affiliates regarding day-to-day operational matters. After-investment services are noteworthy because they can encourage reinvestment by existing investors, who, if satisfied, provide publicity for the host country, sparking further investment.

Some believe that the draft law opens up the door for discrimination

Some others believe that the new Draft Investment Law in Lebanon has a negative impact on foreign investment because it allows the prime minister to give preferential treatment to some investment projects. Therefore, the draft law needs to be revised.

Moreover, in establishing “package deal”¹⁷, the draft law allows the competent authority (the government authority) “to select winners and losers when it should be left to the market to decide”. The decision is at the discretion of a specific authority, this opens the door to discrimination and more corruption.

3- Social Amenities

Openness in Terms of Social Life

Lifestyle attracts more foreigners than any other country in the region, freedom of religion and speech within limits. Lebanon has a pleasant living environment; there is a good quality of life and high degree of sophistication in social life.

¹⁷ The government would sign “package” contracts with incentives up to a certain number of years holiday from all taxes or a steep reduction in the cost of a construction permit for the right project. The boards of IDAL would also have the authority to allow companies to ignore some existing laws for selected projects.

"Senior technicians would come from Europe and USA to Lebanon rather to other countries in Africa and the Far East even at lower salaries."

Work Ethics

Foreign investors complain about individualism attitude among Lebanese and the absence of teamwork. Moreover, foreigners observe that sometimes locals have no sight on the long run and try to take advantage of the foreign investors. For this reason, some foreigners are reluctant to invest in Lebanon

"They see us like a cow to milk!"

"When government treats with a multinational, they try to rob you".

CONCLUSION

While foreign investment goes beyond sales and distribution, determinants for attracting FDI begin with the adequate national policies, and should be accompanied by measures to facilitate business and promote investment. Lebanon needs to take into account all these factors together.

On the whole, the weaknesses of Lebanon to attract FDI are:

- 1- High political risks
- 2- Commercial risks
- 3- Small market

While political risks and size of market are out of hand, Lebanon needs to reduce drastically the "commercial risks"; the challenge for the future would be to try to strengthen national innovation systems. In order to achieve a real economic growth, Lebanon should take advantage of its main assets, most importantly, human resources. National strategies should focus on increasing products and services in the fields of tourism, IT and agro industry (niche market). As for the main disadvantage in investment activities in the country, they are the burdensome administrative procedures that include unnecessary and lengthy formalities, which give bad reputation to the country.

* *