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EDITORIAL

Renewing Our Strategic Partnership with Lebanon: Addressing New Priorities, Solving Old Problems

With the launching of the Country Assistance Strategy (CAS) for the years 2005-2008, Lebanon and the World Bank will renew their partnership and identify new priorities for advisory and lending services (see full article on CAS objectives, processes, and outcomes beginning on Page 7).

New priorities to be identified: A quick diagnosis of the current conditions reveals pressing needs for the short/medium term, which present possible areas of cooperation. These can be grouped into three clusters of activities: (1) support for economic management, including debt management, monetary policy, fiscal policy, and structural reforms conducive to sustainable growth (such as telecom, power, trade logistics, etc.); (2) mitigation of poverty resulting from the difficult economic adjustment ahead, especially through locally targeted programs, such as social services, basic infrastructure, education, and health; and (3) support for resource and environmental management, especially relating to management of water resources, waste water, and solid waste.

The above three clusters of activities need to be addressed in tandem--bringing the macro economy out of its current imbalances is a necessary condition for sustained debt reduction and economic growth. But, this requires large primary surpluses over the coming years, which means higher fiscal revenues and lower expenditures, which, in turn, is likely to negatively impact those most vulnerable in society. The success of a painful transition period to sustainable growth requires public support, a perception that the burden is shared equally, and that the most vulnerable groups are protected through targeted social programs. Finally, while this difficult transition takes place, many capital investments and maintenance operations, which would benefit the public, are likely to be postponed. While this might be unavoidable in an environment of fiscal contraction, it might cause degradation to the natural environment that is difficult to reverse. The risk is especially high for the contamination of ground water aquifers, pollution of coastal areas, and improper disposal of solid waste. The role of the World Bank in any of the above clusters (or additional ones) will be determined through upcoming CAS consultations with the Government, followed by consultations with Parliament, Civil

Society, the Private Sector, and bilateral and multilateral donors.

But old problems need to be addressed: Moving forward successfully also requires learning the lessons of past experience. The World Bank portfolio of projects, not unlike that of other donors, has suffered from very slow ratification by Parliament, slow disbursement of funds, and frequent requests for extensions of project closing dates. The result is that projects often take twice as long to implement, imposing additional costs and delaying the realization of the benefits to project beneficiaries.

To illustrate, the Bank's existing portfolio in Lebanon consists of US\$529.44 million in commitments for 13 projects. Although nine of these projects are five years older or more, as of July 31, 2003, only US\$164.79 million have been disbursed. The average age of the portfolio is five years for Lebanon, much higher than that of the region. Ratification of loans by Parliament has taken more than a year for the last three projects (compared to an average of seven months for the MENA region and six months for all Bank projects worldwide). Sincere and much appreciated efforts have been made by the Government to remove bottlenecks and expedite implementation on a case-by-case basis. Yet, many challenges are systemic in nature and require long-term solutions. With so many unfinished projects and un-disbursed funds on the books, new lending is predicated on a concerted effort by all sides involved to improve the performance of the portfolio and close old projects to make room for new ones. ***It is in Lebanon's own national interest to show that it can increase its absorptive capacity and implementation quality so that donors can come forward with badly needed support.***

This issue of the Update, as with previous ones, sheds light on important themes and sectors of relevance to Lebanon's challenges. In addition to exploring the objectives and process of a CAS exercise, this issue pursues the discussion of trade in the MENA region and of the provision of infrastructure services, namely energy.

TRADE, INVESTMENT, AND DEVELOPMENT IN MENA

In advance of the Dubai Annual Meetings of the World Bank and IMF, the World Bank Middle East and North Africa (MENA) Department has published a report studying trade in the MENA region. The report, “Engaging with the World: Trade, Investment & Development in the Middle East & North Africa”, proposes radical reforms of the region’s economies through faster integration to world trade. (An abstract is available at www.worldbank.org/mena).

MENA’s Key Economic Challenge for the Future. At an average of 15 percent, unemployment is the greatest challenge for MENA countries’ economic management. In the coming decade, 4.2 million young people will enter the labor market every year, a number twice the average of the 1980s and 1990s. It is estimated that to absorb such labor force into productive employment, GDP growth in MENA countries should double to reach 6 percent per year. A potential demographic gift runs the risk of turning into deeper social crises in the absence of adequate growth in jobs.

MENA Lagging in Trade Integration. In recent years, some countries, such as Jordan and Tunisia, have taken the lead in adopting an export-oriented strategy, and results are starting to show, with growth rate around 5 percent. Also, with notable economic benefits, some oil-rich countries, such as Algeria and Iran, as well as a number of Gulf countries, in particular the United Arab Emirates, have started opening their borders to trade and foreign investment.. Through the Pan Arab Free Trade Agreement, the series of Euro-Med Agreements and the Free Trade Agreement with the United States, Lebanon has been moving towards better regional and international trade integration.

Notwithstanding this progress, the level of integration of MENA countries as a whole remains substantially insufficient. This region has the lowest proportion of its population covered by membership in the WTO. In the 1990s, the region has been the only one in the world to witness a standstill, or even a decline in trade integration and foreign investment. Exports other than oil are a third of what they could be. Openness to manufacturing imports is one-half of what would be expected. Overall, trade is only a third of the potential, given the region’s favorable characteristics in terms of size, income, and geography. And, the Foreign Domestic Investment (FDI) inflows that the region could expect would be five to six times what they are today—some 3 percent of GDP, as compared with 0.5 percent.

Continuous regional conflict, economic sanctions, and a limited presence in WTO have all played a part in these flagging trends. However, inadequate economic policy is also largely to blame for the weak progress on trade, investment, and growth.

The Promise of Trade Reform. The report estimates that even if only half the region’s trade and private investment potential were realized over the next 10 years, GDP growth could increase by as much as 3 percentage points—half from more private investment, and half from the greater productivity that openness would encourage. Importantly, this would meet the growth in jobs required in the region in the coming decade, both to absorb the new entrants to the labor force and to address the stock of unemployed.

“*Engaging with the World*” warns that such shift in economic policy and economic structure will be possible only if supported by good national economic policies. In the short-term, the consequence could even be negative, as job losses might out-number job creations, but the rewards of good policies in the long term are huge.

Reap the Benefits and Minimize the Costs: Lesson from the Fast Integrators. In many MENA countries, some sectors will likely suffer significant job losses—such as agriculture, public enterprises, and capital-intensive manufacturing. Business expansion takes time, and in some cases the investment climate may not be sufficiently attractive—leaving restructured and export-oriented companies without incentives to expand and to absorb labor released by the shrinking sectors. Thus, job destruction may outpace job creation, because lowering trade barriers may initially hurt sheltered domestic producers and displace unskilled workers in import-competing industries.

It is therefore important that the content, pace, and sequencing of reforms be tailored to specific settings. Indeed, many successful countries (such as China, India, and Vietnam) have often undertaken what looked at first to be incomplete (or non-orthodox) approaches to liberalizing trade and investment. But, they have produced outcomes that are often better than in other cases where reforms have been more orthodox and complete (as in Argentina or Brazil). In China, India, Indonesia, Mexico, Vietnam, and elsewhere, transition issues have generally been handled well through:

- Liberalizing early in key areas and inputs, and addressing key bottlenecks (such as customs or inspections) to jump-start new export-oriented activities.
- Embarking on large-scale and upfront domestic investment deregulation to foster new entry and job growth.
- Delaying state enterprise downsizing, but exposing them to competition and reducing the scale of their operations so that losses are held in check by hard budget constraints.

The evidence on the pace and sequence of trade reforms from experiences around the world suggests the following:

- First, to build momentum, programs must start boldly and then follow through with further measures.
- Second, programs that decisively reduce import quotas or import licensing monopolies succeed more than those that retain such privileges. That step sends a clear signal that no rent-seeking, special enclaves deserve more protection than others.
- Third, there must be across-the-board cuts in tariffs, setting as little administrative discretion as possible, and progressively lower ceilings within a time-bound program.
- Fourth, reforms must go well beyond at-the-border trade policies to eliminate behind-the-border impediments in customs, standards, ports, and other barriers. Indeed, trade reform cannot work without such complementary reforms.
- Fifth, trade reforms must be accompanied by consistent and bold investment deregulation to free up new entry and allow private investment to respond. This is probably the most decisive element in the success or failure of the entire program.
- Sixth, the financial sector needs to allow the shift in resources from previously protected and unproductive state enterprise-dominated sectors to the new exportable sectors.
- Seventh, a case for gradualism can nevertheless be made for sectors in which job losses are likely to be significant.

Reforms in Resource-Poor Countries: Egypt, Jordan, Lebanon, Morocco, and Tunisia. Although there are differences, countries in this group are relatively advanced in their broad direction of reforms. The challenge now is for these resource-poor countries to move on to a new round of more decisive and credible trade liberalization. There is little reason for gradualism, after more than a decade of adjustment time for domestic industry, enormous

pressures in domestic labor markets for new jobs, and huge potential benefits of accelerated reform. Exchange rate policies need to be supportive of an accelerated round of trade reform. Significant adjustments of real exchange rates, through nominal rate adjustments or domestic demand measures, need to precede trade reforms. Tunisia has a managed float, with a real exchange rate target. Jordan and Morocco have pegged exchange rate policies. Morocco's persistent overvaluation in the past contributed significantly to its poor export performance during the 1990s, but it has improved more recently. Egypt's recent shift to a floating exchange rate offers the opportunity to slash tariff protection across-the-board, since the depreciation that has occurred will protect import industries. In Lebanon, sustainable macroeconomic reforms are needed before the country can reap benefits from trade reforms.

These countries need to accelerate tariff reductions and apply them across-the-board, reduce peak tariffs, and simplify a still complex tariff structure. For example, the simple average tariff rates in Morocco and Tunisia at 36 percent and 30 percent, respectively, remain more than double the average for all low- and middle-income countries, while Egypt's (21 percent) remains well above.

Reforms in Labor-Abundant, Resource-Rich Countries: Algeria, Iran, Yemen, and Syria. These resource-rich countries have a more complicated task in shifting from state-dominated and protectionist economic systems to open, market-led systems. Much of the core support for reform has to come from the very sectors that stand to lose initially from trade policy reforms—the dominant, protected public enterprises and private sectors.

Not only do they first need to achieve macroeconomic stability—as most have—at a reasonable level of oil prices, but they also need to deal with the massive distortionary effects of oil rents on traded goods and services. This means managing the booms and busts better, avoiding the stop/go cycles of structural reform and backtracking, and progressively reducing the rent-seeking effects of oil. For example, during the 1979–1981 boom, more than 40 percent of Indonesia's oil windfall was saved abroad, and supporting exchange rate policies allowed the non-oil sectors to grow despite the oil boom.

Across-the-board cuts in tariffs spread the costs of reform across all sectors, increasing the benefits and reducing resistance. The goal should be a uniform tariff rate of about 10 percent (a target lower than in

resource-poor countries because offsetting oil revenues should permit lower trade taxes).

All these countries would benefit from deregulation of services and the introduction of competition to state-owned and -operated activities—in ports, transport, telecommunications, and finance. The waiting time for a fixed telephone landline is 10 years in Syria and six years in Algeria. The advent of cellular telephones has reduced the access problem, but is not a complete solution. Freight costs are about twice benchmark levels. Algeria, Iran, and Syria severely limit foreign bank activity in varying degrees, with state-owned banks dominating (up to 95 percent of assets).

Deregulation of domestic and foreign investment is also critical for export activities. Attracting more FDI will require deep-seated reforms to improve the business climate.

Reforms in Labor-Importing, Resource-Rich Countries: the Gulf Cooperation Council (GCC).

The resource-rich GCC countries face two main challenges. The first is accelerating non-oil growth to generate adequate employment opportunities for the 70 percent of the population under age 30. The second is reducing vulnerability to oil price fluctuations. On both accounts, the smaller GCC countries have done well. But, challenges remain. Per capita incomes in Saudi Arabia have fallen (in nominal terms) from a high of about US\$17,000 in the early 1980s to about US\$9,000, an almost unprecedented drop.

The GCC countries have embarked on deeper reforms that promise to sustain these basic policy directions and accelerate their integration with the global economy. They have established a US\$335 billion customs union, which will allow them to forge a larger common market with lower trade barriers to the rest of the world, with a standard 5 percent external customs tariff.

Challenges in trade lie mainly in four interlinked areas. First, labor markets suffer from wage rigidities, skills mismatches, and institutional factors. Second, the Government wage bill, defense and security spending, and subsidies and entitlements are straining Government budgets. Third, structural policies to diversify economies will need continued attention, especially privatization of non-oil industries. Fourth, making the GCC customs union work will require establishing common customs rules and procedures, harmonizing technical and regulatory procedures (standards, security, inspection, and licensing), increasing transparency, and minimizing administrative barriers.

The Regional Agenda for Trade Reform.

Anchoring reforms in revitalized regional trade agreements and in multilateral forums, such as the WTO, will help lock in reforms with domestic constituencies and strengthen the credibility and commitment to reform generally.

The Euro-Med Agreements and the Barcelona Process could be strengthened by accelerated commitments by MENA countries to reduce trade barriers, liberalize services, and phase in domestic agricultural reforms. The European Union could offer immediate, expanded access to its markets for agriculture, as well as increased temporary migration, funds for managing transition costs, and more efficient rules of origin.

Second, substantial expansion in regional trade is possible if the barriers to trade and investment are progressively eliminated. Intra-regional trade agreements could be strengthened by mutual agreements to reduce product exclusions in agriculture and services, and to harmonize customs and regulatory processes (standards, investment and other licensing processes, visa restrictions).

Third, MENA countries would do well to maintain open access to world markets, anchoring their trade and investment reforms in a multilateral framework such as the WTO, which will give them greater credibility. But first, more countries in the MENA region will have to become full members of the WTO.

Getting Support from MENA's Main Partners.

High income countries, particularly the European Union and the United States, can help sustain the transition by opening their markets, (especially for agriculture), and helping with labor force mobility (please refer to the article entitled "Rich Countries Should Show the Way on Trade" on Page 4 of the First Quarter 2003 Lebanon Update).

MENA's trading partners need to rethink the challenges in this region, including the devastating effect of persistent conflict, sanctions, and the disincentives of strategic aid. There is strong evidence to suggest that the incidence of violence and conflict has had a hugely negative influence on trade and investment integration, rivaling the influence of poor domestic policies. Persistent conflict has had large neighborhood effects throughout the MENA region, affecting not just the conflict-ridden countries but also their neighbors. The effects of such conflict have probably shaved up to 2 to 3 percentage points off the region's annual growth in the past two decades.

THE WORLD BANK PREPARES ITS COUNTRY ASSISTANCE STRATEGY FOR LEBANON

What Is A Country Assistance Strategy (CAS)?

The World Bank develops a Country Assistance Strategy (CAS) in cooperation with each of its client countries. The CAS explains the developmental goals of the client country and sets the level and composition of economic and sector work and financial and technical assistance that the Bank seeks to provide the client country in support of its developmental goals. The CAS takes into account an assessment of the client country's priorities and needs, past portfolio performance, and creditworthiness. The Bank uses the CAS as a guiding document, as well as a benchmark to account for its diagnosis and the programs it supports.

The CAS is normally planned for a three- to four-fiscal year¹ period for the Bank Group's² activities in the client country and is developed in cooperation with the Government and, often, with civil society. However, the CAS is not a negotiated document. Any differences between the client country's own agenda and the strategy advocated by the Bank are highlighted in the CAS document. The Bank's Board of Executive Directors reviews each CAS.

The CAS document: (a) describes the Bank Group's strategy based on an assessment of the priorities in the client country; and (b) indicates the level and composition of the assistance to be provided based on the strategy and the client country's portfolio performance.

Though the Bank is best known for its financial services, the assistance it provides also includes analytical and advisory services, and learning and capacity building, using various instruments (see section on the definition of the different types of instruments used for the implementation of Bank

assistance on the following page). Some of the instruments typically proposed in the CAS document are: thematic and sector-specific strategies, ad hoc reports, institutional capacity building grants, seminars, and technical assistance.

Following the Board's review of a CAS, the Bank then issues a CAS Public Information Notice (CPIN) and a Chairman's Summary of the Board's review. At the Government's request, the full text of the CAS may also be disclosed.

CAS Consultation

The CAS is a development framework for the World Bank's assistance in a client country. Its objective is to identify the key areas where Bank assistance can have the largest impact on poverty reduction.

The CAS is prepared with the Government and other stakeholders in a participatory way to benefit the client country's needs. Participation has helped improve the quality, effectiveness, and sustainability of projects, and has strengthened ownership and commitment of the Government and other stakeholders.

Feedback on the needs and priorities for each participating client country is a necessary part of the Country Assistance Strategy. All interested parties can express their comments and participate in a dialogue with Bank experts and other organizations regarding issues of vital importance to achieve economic welfare for all citizens.

Ten Features Of A Good CAS

1. **Client Focus.** A good CAS is grounded in the client country's political, economic, and social context. The CAS starts with a discussion of the client country's conditions and the Government's priorities and development strategy. It includes an evaluation of the implementation and effectiveness of ongoing reform programs; their implication for private sector development and sustainable growth and development; and their social impact. The CAS is carried by strong client country ownership and broad stakeholder consultation (pursued with prior general agreement of the Government), but candidly acknowledges

¹ World Bank Fiscal Years start on July 1 and end on June 30

² The Bank Group comprises five institutions: the International Bank for Reconstruction and Development (IBRD); the International Development Association (IDA); the International Finance Corporation (IFC); the Multilateral Investment Guarantee Agency (MIGA); and the International Center for Settlement of Investment Disputes (ICSID).

differences between the Bank and the authorities, when they exist.

2. Strategic Selectivity. A good CAS is the central vehicle for making strategic choices in client country program design and Bank resource allocation, with the objective of maximizing development impact. This involves: (i) assessing the relative magnitude and likelihood of the impact of alternative Bank Group activities on the ground; (ii) taking into account the Bank's comparative advantage, vis-à-vis others, track records, costs, and risks; and (iii) prioritizing activities accordingly across and within sectors and by instruments (product mix).

3. Poverty Focus. A good CAS includes a high quality diagnosis of the profile and causes of poverty. It links the proposed Bank program clearly to the poverty assessment, and explains how key lending and nonlending services contribute to poverty reduction.

4. Macroeconomic and External Framework. A good CAS is based on a strong analysis of macroeconomic performance, prospects, and risks. It discusses the external environment and implications for the client country's development agenda and vulnerability, and the Bank program.

5. Governance and Institutions. A good CAS diagnoses governance/corruption, institutional effectiveness, and implementation capacity issues and, where relevant, addresses them in the proposed Bank lending or nonlending program.

6. Self-Evaluation and Lessons from Experience. A good CAS must include a frank discussion of the track record of Bank involvement, a thorough and candid portfolio analysis, and "lessons learned". It fully integrates findings from the Bank Operations Evaluation Department (OED), Quality Assurance Group (QAG), and self-evaluation studies.

7. Comparative Advantage and Role of the Bank. A good CAS is based on strong coordination and collaboration with external partners (IMF, multilateral development banks, bilaterals, the private sector, NGOs, etc.). It includes a Bank lending and nonlending program, and involves a division of labor with others in line with the comparative advantage of the Bank and its partners in supporting the client country.

8. Collaboration Within the Bank Group. A good CAS integrates an IBRD strategy into a consistent overall Bank Group strategy, within which IBRD, IFC, and MIGA operations complement each other in promoting private sector development.

9. Bank Program Scenarios, Triggers, and Monitoring Indicators. A good CAS includes: (i) well differentiated scenarios for Bank assistance (low, base, high case), with a strong link between performance and aid effectiveness and the level of Bank support; (ii) specific, monitorable triggers for switching between scenarios that focus on key reform challenges; and (iii) clear, monitorable indicators for evaluating the development effectiveness of the Bank program.

10. Risks. A good CAS thoroughly treats risks to the client country (economic/financial, both domestic and external, political, social, and environmental); proposes risk mitigation measures; and candidly recognizes the risk to the Bank (exposure/financial, as well as reputational).

Definition Of The Different Types Of Instruments For Bank Assistance.

g Lending

Investment Loans. Investment loans finance a wide range of activities aimed at creating the physical and social infrastructure necessary for poverty reduction and sustainable development.

Programmatic Adjustment Loan. The Programmatic Adjustment Loan is provided in the context of a multi-year framework of phased support for a medium-term Government program of policy reforms and institution building.

Guarantees. Guarantees promote private financing in borrowing member countries by covering risks the private sector is not normally in a position to absorb or manage. All Bank guarantees are partial guarantees of private debt, so that risks are shared between the Bank and private lenders. The Bank's objective is to cover risks it is in a unique position to bear, given its experience in developing countries and its relationships with governments.

g Analytical and Advisory Activities

The Bank undertakes a broad range of analytical and advisory activities to support its development mission. Some of these activities are as follows:

Economic and Sector Work examines a client country's economic prospects (i.e., its banking or its financial sectors, and trade, poverty, and social safety net issues). The Bank's diagnostic work is shared with clients and partners. The results often form the basis for assistance strategies, government investment programs, and projects supported by IBRD lending.

Advisory Services provide information and knowledge on numerous facets of the Bank's work (i.e., environmentally and socially sustainable development, health, nutrition and population; the financial sector; and law and justice). The Advisory Services focus on specific development topics. Thematic Groups share "lessons learned" in order to improve the quality of Bank activities.

Learning and Capacity Building. The Bank conducts learning and knowledge sharing programs to enhance the skills and development of its clients, staff, and partners. The lead unit in this area is the World Bank Institute (WBI), whose work includes training courses, policy consultations, partnerships with training and research institutions worldwide, and the creation and support of knowledge networks related to international development.

g Other Products

Global Environment Facility (GEF) Medium. GEF Medium-Sized Projects are those for which GEF financing is no more than US\$1 million. They are considered by the GEF Council and Implementing Agencies under expedited procedures intended to move them quickly from the concept stage to the approval stage of the GEF grant. The smaller size grants, and the projects they finance, are creating opportunities for a range of new project proposers to access GEF resources and contribute to the international effort to protect the global environment.

Global Environment Projects. The World Bank plays two important roles in the Global Environment Facility. First, with its long experience in funds management, the Bank is a selected trustee of the Global Environment Facility Trust Fund. Second, the Bank is a GEF Implementing Agency, and plays the primary role in

ensuring the development and management of GEF investment projects. About two-thirds of all project-related GEF resources are allocated to the World Bank's GEF portfolio. The portfolio of projects under implementation includes projects directly managed by the Bank, as well as those managed by the International Finance Corporation, the Inter-American Development Bank, and the Asian Development Bank.

Institutional Development Funds. The Institutional Development Fund (IDF) is a Bank grant facility designed to finance discrete, generally innovative, upstream, capacity-building activities that are identified during (and closely linked to) the Bank's policy dialogue and economic and sector work. The IDF is considered a fund of last resort, financing eligible activities for which no alternative source of financing is available, including Bank/IDA lending, the United Nations Development Programme (UNDP) and other loans or grants. The amount of a grant does not exceed US\$500,000. Because the IDF's resources are limited and the demands on them are growing, grant proposals are subject to stringent review and a high degree of selectivity. A Management Committee, not the Board of Directors, approves IDF grants.

Montreal Protocol. The World Bank is one of four Implementing Agencies (along with UNDP, UNIDO, and UNEP) for the Multilateral Fund for the Implementation of the Montreal Protocol. The Montreal Protocol Operations Unit staff at the World Bank coordinates the efforts of other World Bank staff and local partners to assist countries to meet their obligations under the Montreal Protocol. The World Bank works with local government and financial agency partners to enable national execution of Ozone Depleting Substances (ODS) phase out activities.

BANK GROUP OPERATIONS

■ IBRD Ongoing Projects

The current World Bank portfolio in Lebanon consists of 13 Projects for a total commitment amount of US\$529.44 million, of which US\$164.79 million has been disbursed through July 31, 2003.

Irrigation Rehabilitation and Modernization Project (IRMP). (US\$57.23 million). The Project is designed to help increase agricultural production, agriculture-based income and employment in previously neglected rural areas, and achieve improved sustainable management of water resources.

Revenue Enhancement and Fiscal Management Technical Assistance Project (REFMTAP). (US\$19.94 million). The Project seeks to support Government efforts to enhance revenue and strengthen fiscal management.

Health Sector Rehabilitation Project (HSRP). (US\$35.7 million). The objective of this Project is to improve Lebanon's health conditions through better allocation and use of resources in both the public and private sectors.

Solid Waste / Environmental Management Project (SWEMP). (US\$25.0 million). This Project is designed to help improve the methods of solid waste collection and disposal; improve cost recovery and modernize municipal management and finance systems; and strengthen the management capacities of sector institutions.

National Roads Project (NRP). (US\$42.0 million). The objective of this Project is to improve the capacity of the road administration to undertake the rehabilitation of the primary road network.

Agriculture Infrastructure Development Project (AIDP). (US\$24.0 million). The Project's objectives are: (a) increasing farmers' incomes and conserving the environment through land terracing and development and storage of runoff water; (b) improving access

to rural areas; and (c) upgrading institutional capabilities.

Vocational and Technical Education Project (VTEP). (US\$29.0 million). The Project's objective is to improve the performance of the VTE System by making it more demand-driven and responsive to market needs.

General Education Project (GEP). (US\$56.6 million). This Project is designed to support the Government's efforts to enhance the capacity of the Ministry of National Education to function as an effective manager of the education sector and to restore the credibility of the Public Education System.

First Municipal Infrastructure Project (MIP-I). (US\$80.0 million). This Project aims at addressing urgent municipal works while setting the stage for the gradual assumption of responsibility for municipal services at the local level.

Commitments and Disbursements as of July 31, 2003			
Project Name	Approval Year	Loan Amount	Amount
			Disbursed
US\$ Million			
Irrigation Rehabilitation and Modernization	1994	57.23	48.69
Revenue Enhancement and Fiscal Management Technical Assistance	1994	19.94	18.27
Health Sector Rehabilitation	1994	35.70	22.86
Solid Waste/Environmental Management	1995	25.00	08.26
National Roads	1996	42.00	23.13
Agriculture Infrastructure Development	1996	24.00	13.93
Vocational and Technical Education	1998	29.00	03.80
General Education	2000	56.57	01.93
Municipal Infrastructure – I	2000	80.00	23.72
Community Development	2001	20.00	00.20
Ba'albeck Water and Wastewater	2002	43.50	0
Urban Transport Development	2002	65.00	0
Cultural Heritage and Urban Development	2003	31.50	0
TOTAL		549.44	164.79

Community Development Project (CDP). (US\$20.0 million). This Project is designed to raise living standards in targeted poorer communities, and to raise economic activity levels in such communities by investing in grass-roots social and small infrastructure activities, and in employment creation.

Ba'albeck Water and Wastewater Project. (US\$43.5 million). The major development objectives of the Project include: improving the access of satisfactory water supply and wastewater services to the region's residents; introducing appropriate sector reforms—particularly the development and strengthening of the capacity of the existing Ba'albeck Hermel Water and Irrigation Authority and, once it is established, the Bekaa Regional Water Authority; and involving the private sector in the operation and maintenance of water and wastewater facilities by preparing for a Management Contractor (MC) through a lease or concession contract that would secure the long-term financial needs for sector investments. The Board of Directors approved the Project in June 2002.

Urban Transport Development Project (UTDP). (US\$65.0 million). The Project's objectives are to

provide the city of Beirut and the Greater Beirut Area with the basic institutional framework that is currently lacking, and to support critical investments needed to maximize the efficiency of existing urban transport infrastructure. The Board of Directors approved the Project in June 2002.

Cultural Heritage and Urban Development Project (CHUD). (US\$30 million). The Project will finance site conservation, enhancement investments, and associated urban infrastructure improvements in selected sites, and provide technical assistance to strengthen the capacity of the Directorate General of Antiquities, Ministry of Tourism, and targeted municipalities in cultural heritage preservation and tourism development. A signing for implementation of the Project was held in July 2003.

■ IFC Projects in Lebanon

Uniceramic. The Project supports the modernization of the company's existing production line and the expansion of the plant's capacity of glazed ceramic floor tiles.

Bank of Beirut and the Arab Countries (BBAC) Credit Line. The Project offers innovative residential mortgages to middle income customers.

Banque Saradar SAL. The Project involves an equity investment in common shares of the company.

Byblos Bank Syndicated Credit. The Project aims at providing long-term project finance to small- and medium-sized enterprises in Lebanon for infrastructure project finance, and to increase its housing loan portfolio.

Société Générale Libano-Européenne de Banque. IFC extended a Line of Credit to Société Générale Libano-Européenne de Banque to be utilized in support of its housing finance program.

Fransabank. IFC extended a credit line to Fransabank to support its housing finance program.

Agricultural Development Company (ADC). The Project is designed to rehabilitate and expand the existing facilities of ADC, which is involved in the poultry business, into an integrated broiler meat production facility.

Lebanon Leasing Company (LLC). The Project involves the establishment of Lebanon's first leasing company, providing lease finance to local small- and medium-size enterprises. It also includes two credit lines from IFC to fund LLC's leasing activities.

Middle East Capital Group (MECG) The Project consists of the establishment of the first regional investment bank in the Middle East, and is headquartered in Beirut.

Banque Libano-Française. The Project offers innovative residential mortgages to middle income customers.

Bank of Beirut Lebanon Credit Line. The Project consists of credit lines to four Lebanese private sector commercial banks for on-lending to local small- and medium-sized enterprises in the private sector and to middle income families to finance either the purchase of their first residence or the expansion of their existing home.

Idarat, SAL. The Project funds the company's investment program in hotels and restaurants and is designed to help revive the tourism industry, which is a key sector in Lebanon.

Idarat SHV (Société Hôtelière "de Vinci" SAL). The Project supports the Company's investment in a Greenfield 5-plus stars "boutique" all suites hotel in an up-scale residential district of Beirut.

ECONOMIC DEVELOPMENTS IN THE SECOND QUARTER OF 2003

■ The Challenges After Paris II: Growth

Seven months after Paris II, it is clear that the virtuous circle initially hoped for has indeed been triggered [in the form of interest rates reduction on debt, increased reserves, conversion from United States Dollars (US\$) to Lebanese Pounds (LBP), and active engagement by the commercial banks]. However, results on the fiscal and financial fronts have been somewhat short of initial targets. The real challenge remaining is growth of the real economy. Nothing short of structural reforms in vital sectors will put the economy back on a growth path and reverse the debt dynamics in the medium- to long- term horizon.

An assessment of the results of Paris II shows that financial flows have largely been realized: by the end of June 2003, donors had transferred US\$2.39 billion of the Paris II pledge, and commercial banks another US\$2.65 billion under the zero percent contribution agreement that immediately followed the conference. Net private inflows are estimated at US\$1.76 billion. The Central Bank then replenished its foreign currencies reserve, the dollarization rate fell, and interest rates on public papers declined (see corresponding paragraphs below).

Challenges remain on both the fiscal and economic fronts. On the fiscal side (see *Public Finance and Public Debt* section, Page 14), by mid-year, Lebanon remains unable to generate a substantial primary surplus with current expenditures, excluding debt service, increasing by 15.5 percent, and total deficit to payment ratio reaching 39 percent, largely above the budgeted figure. Judging from the results of the first half of 2003, reaching the target of 27 percent for the year will be a huge challenge within the remaining six months. On the economic side, activity in the non-financial private sector has yet to materialize, with lending interest rates to the private sector remaining high and private absorption subdued (see box on Page 16 titled: *Why didn't Paris II Entail a Large Decrease in Lending Interest Rates?*).

Unless support obtained through Paris II leads to decisive action and credible steps on fiscal policy, debt management, financial sector development, privatization, and structural reforms, it will be difficult to shield the country from financial turbulence and realize sustainable growth in the

medium- to long-run. Alone, donors' financial support cannot suffice, and missing the opportunity to move rapidly on these fronts would likely bring Lebanon back to a situation similar to that prevailing on the eve of Paris II. In the short term, the challenge for the coming months resides in sustaining efforts of fiscal discipline to bring the country's indebtedness on a clearly declining trend. While a *successful privatization program is key to reducing the stock of public debt, more critical is the need to ensure efficiency, competition, and rational tariff structures in newly privatized services, in order to foster growth in the long run.* The social cost of the proposed adjustment program, (including the fiscal contraction that is currently ensuing), will require continued attention. Mitigating the adverse consequences of fiscal contraction for the disadvantaged and poorer sections of the Lebanese society is crucial per se, as well as building a social consensus on the proposed program.

Using the most recent data available, the following briefly summarizes economic developments during the period January-June 2003: Real Sector Indicators; Public Finance and Public Debt; and the Financial Sector.

■ Real Sector Indicators

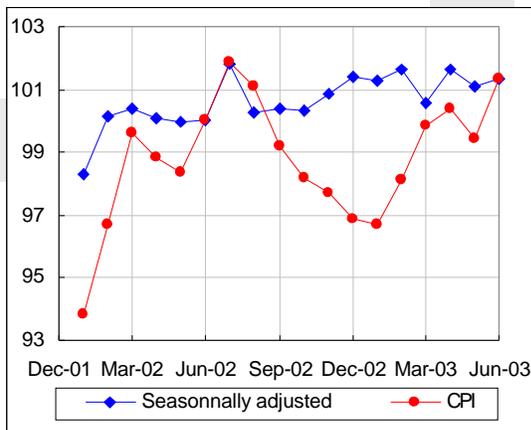
GDP Growth. ParisII related capital inflows did not translate so far into a recovery of economic activity and growth. Despite the absence of accurate National Accounting statistics, most of the available indicators converge to signal continued slow GDP growth in the Second Quarter of 2003 (Q2-2003), while some other indicators underline the role of foreign and public consumption in sustaining demand and activity. Nevertheless, the rebound of investment, which remains the main condition for sustainable growth in the future, is yet to be seen. Increased financial stability did not produce the drop in interest rates needed to trigger investment, and neither did it boost foreign direct investments, despite some leading projects supported by incentive packages provided by the Investment Development Authority of Lebanon (IDAL).

Historical trends show that imports of merchandise amount to 40 percent of GDP. As such, a change in imports somewhat reflects a change in private demand (private investment and consumption). Over the last year (from June 2002 to June 2003), imports grew in value by 2.7 percent, but most likely declined in volume, with the depreciation of the Lebanese Pound

vis-à-vis the Euro (a 23 percent decline throughout the period, while about half of imports originate from the Euro zone). Figures available until the end of May 2003 show that the decline in non-essential imported goods is even more pronounced: excluding food items (20 percent of total imports) and oil, other imports declined by 6.1 percent in value over the period. Moreover, by the end of April, imports of industrial equipments declined by 7.3 percent, which suggests that investment suffered even more than final consumption. The decrease in demand seems to have accelerated in the Second Quarter of the year as imports increased by 1.2 percent only in value between Q2-2002 and Q2-2003.

A second indirect indicator of changes in private demand is the average inflation in consumer prices observed between the first half of 2002 and the same period in 2003. According to the Consultation and Research Institute (CRI), consumer prices rose by only 1.4 percent during this period. This, while during the same period, the implementation of the Value Added Tax (VAT) (whose impact on prices is particularly apparent in February and March 2002, see Figure 1) and the strong depreciation of the Lebanese Pound vis-à-vis the Euro, mechanically exerted an upward pressure on domestic prices. The fact that prices did not increase more rapidly clearly indicates that domestic demand remained subdued over the last year.

Figure 1. Consumer Price Index
(Index 100: June 2002)



Source: World Bank staff calculations based on CRI.

Another indicator of the slowing activity is the decrease by 2.4 percent in cement deliveries for the first five months of 2003 (compared with the same period in 2002).

The last two components of demand, exports and public consumption (see *Public Finance and Public*

Debt section on the following page), contributed positively to GDP growth over the period. Exports receipts were 40 percent higher in the first six months of 2003 than that of the same period of 2002. Nevertheless, the relatively moderate parts of these two components in the GDP (6 percent for exports and 9.6 percent for public consumption in 2002 – World Bank staff estimation) limit their impact on the total growth. Moreover, both dynamics of exports and public consumption decreased in Q2-2003, which might indicate a slower growth during this period. Thus, exports grew by 25 percent between Q2-2002 and Q2-2003 against 61 percent for the First Quarter, and public consumption increased by 12.1 percent against 19.2 percent in Q1-2003.

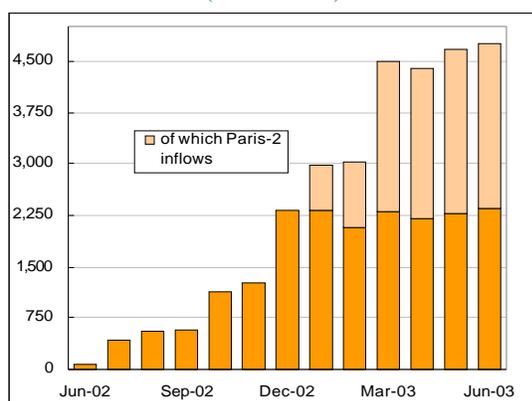
Other developments could signal a slight recovery of some components of the private demand in the first six months of 2003. One is the increase in commercial banks' credits to the private sector (0.73 percent in June 2003 compared to June 2002). The larger increase was in LBP loans (4.5 percent), which benefit from several incentives and subsidies over their interest rates (special housing schemes). The total value of cleared checks (in LBP and foreign currencies) rose by 5.2 percent over the period, suggesting an increase in the volume of financial transactions. Cleared checks in LBP rose by 13 percent, which is consistent with both the rise in LBP loans to the private sector and with the increase in public consumption.

On the other hand, passengers' entry/exit at Beirut International Airport decreased by 2 percent in the first five months of 2003 compared to the same period of 2002, maybe as a consequence of the war in Iraq, which might have contributed to a further reduction in the demand for Lebanese goods and services.

Trade and the Balance of Payments. The balance of payments substantially improved in the first half of 2003, as a result of reduced trade deficit and increased capital inflows. The latter was almost entirely the outcome of Paris II contributions (US\$2.4 billion as of end June 2003).

Capital inflows occurred mainly in Q1-2003, while Q2-2003 registered only a US\$246 million net inflow, due to the US\$200 million Qatari Eurobond subscription. All in all, net private foreign capital inflows [which increased by US\$1.5 billion in Q4-2002 (Source: World Bank staff calculations)] remained mainly stagnant in the first half of 2003 (see Figure 2).

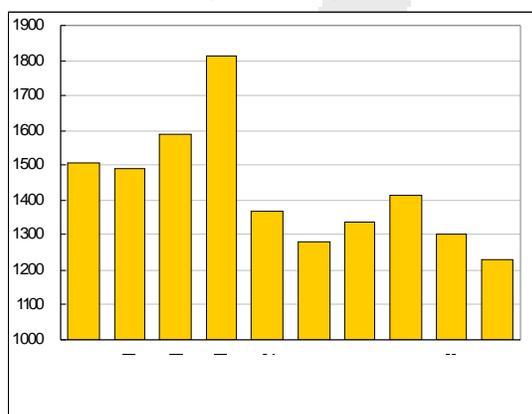
Figure 2. Cumulative Net Capital Inflows
(US\$ million)



Source: World Bank staff calculations based on BDL .

The trade deficit dropped by 4.4 percent in the first six months of 2003 compared to the same period in 2002 (see Figure 3).

Figure 3. Quarterly Trade Deficit
(US\$ million)



Source: World Bank staff calculations based on MOET.

Trade patterns experienced important changes between the first half of 2002 and the first half of 2003. While the import structure by origin or by type of goods did not change dramatically, exports have largely benefited from the depreciation of the US\$ vis-à-vis the Euro. Exports to Europe rose by 108 percent between the first five months of 2002 and 2003 and reached US\$281 million (48 percent of total exports). The structure by type of goods also changed, with the share of pearls and precious stones in total exports rising from 25 percent in June 2002 to 37 percent in June 2003. Exports in this category increased from US\$126 million to US\$257 million in 12 months, and this surge contributed to the total increase in exports by 65 percent. Switzerland seems to be the main destination for exporting pearls and precious stones, with US\$142 million shipped in the

first four months of 2003. The cumulative figure for the year 2002 was US\$129 million.

Public Finance and Public Debt

Public Finances. The Public Deficit (budget plus treasury) in Q2-2003 stood at 39 percent of total payments as in the First Quarter of the year. This means that for the first half of the year, the Government remained far from reaching its target of a 27 percent deficit for the entire year 2003. The Government of Lebanon stated that the targeted deficit could not be met if privatization and securitization programs were to be delayed. Such operations might have a mitigated effect on the Public Deficit, as they might reduce the debt service, but at the same time, especially in the case of securitization, they could deprive the Government from future receipts and delay badly needed reforms in these sectors. The reduction of the difference between targeted figures and achieved deficit needs further fiscal efforts.

The cumulated deficit for the first six months of 2003 reached US\$1,395 million, while the primary surplus (the difference between public revenue and expenditures, excluding debt service) amounted to US\$258 million for the same period (see Table 1).

Table 1. First Six Months Public Finances
(US\$ million)

	2001	2002	2003
Total receipts	1,493	1,873	2,187
Tax Revenues	949	1,316	1,473
VAT	0	236	402
Customs	489	504	505
Other Tax Revenues	459	577	565
Other	434	420	542
Treasury Receipts	111	137	172
Total Payments	2,660	3,159	3,581
Excluding Debt Service	1,020	1,049	1,197
Debt Service	1,327	1,489	1,652
In LBP	1,116	1,094	1,082
In FX	211	395	570
Treasury Payments	313	621	732
Surplus / Deficit	-1,167	-1,286	-1,395
Balance to total payments	-43.9%	-40.7%	-38.9%
Primary Surplus	160	203	258

Source: Ministry of Finance.

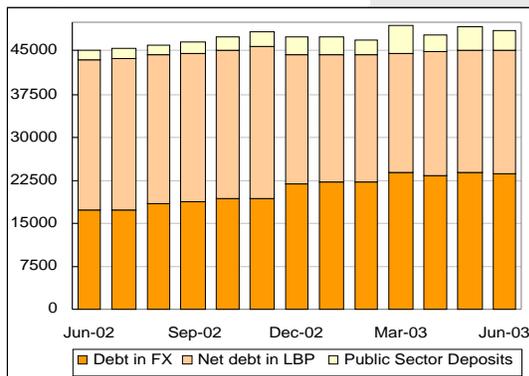
Total receipts rose by 16.7 percent between the first six months of 2002 and the same period in 2003, with the collection of the VAT in January 2003 — US\$120 million — contributing mechanically for 39 percent of

the total increase. On the other hand, with continued stagnant economic activity, other tax revenues declined by 2.1 percent.

Total payments increased by 13 percent with Treasury payments rising by 18 percent (US\$111 million) and budget expenditures by 12 percent. Public consumption (budget and treasury payments, excluding debt service) rose by 15.5 percent. Of the Treasury payments, 46 percent represent payments of expenditures incurred on previous years' budgets (arrears). The service of the debt increased by 11 percent. The debt service in Foreign Currencies (FX) rose by 45 percent, due to the large increase in outstanding foreign currency-denominated bonds (Eurobonds). The service of the debt of LBP-denominated bonds (TBs) decreased by only 1 percent despite the decrease in the outstanding TBs (US\$2 billion) and the large drop in LBP-interest rates (see box on the following page). The Central Bank has indeed swapped all the maturing TBs between June and October 2002 into two-year maturity TBs at interest rates varying from 16.34 percent to 18.5 percent in order to avoid a surplus of LBP liquidity on the market. These swaps mechanically increased the debt service of the LBP-denominated debt, thus offsetting the effects of the decrease in the outstanding debt stock.

Public Debt. Net Public Debt stood at US\$30 billion by the end of June 2003, up from US\$29.4 billion by the end of December 2002, and from US\$28.9 billion by the end of June 2002. The net debt in LBP amounted to 47.8 percent of the total net Public Debt by the end of June 2003 (see Figure 4) after decreasing to 45.7 percent at the end of March 2003. LBP-denominated net debt increased by 4 percent since the end of March 2003 as a result of a US\$900 million drop in Public Sector Deposits since the end of March 2003.

Figure 4. Gross Public Debt (LBP billion)



Source: Ministry of Finance.

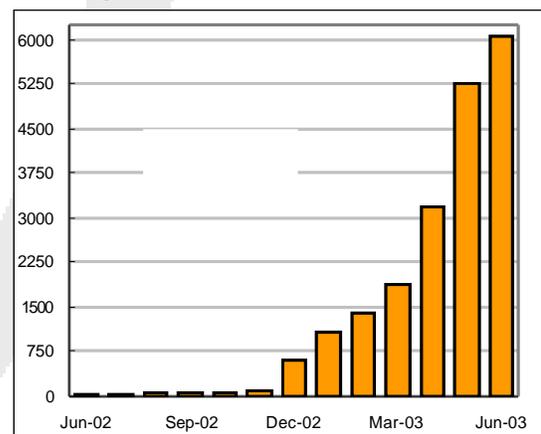
TBs portfolio held by the Central Bank rose by US\$1.2 billion, while the Banks and Non-Bank's TBs portfolio decreased by US\$1.4 billion. In the absence of new TBs auctions, the Central Bank is recapturing a part of maturing TBs in its portfolio, either directly or indirectly through the partial re-investment of funds collected as CDs issuances in TBs.

The debt denominated in Foreign Currency rose by 7.5 percent between December 2002 and June 2003, and by 37 percent compared to a year ago. As a consequence of the large increase in foreign exchange reserve, the Ministry of Finance managed in April to reimburse the US\$500 million maturing Eurobonds. It is the first time since the beginning of Lebanese sovereign issuances in Foreign Currency that the Government repays at maturity instead of rolling over its debt. Issuance of Eurobonds, which represent the counterpart of Paris II contributions from donors, continued in Q2-2003 with US\$200 million subscribed by Qatar.

Financial Sector

The financial sector evolution during Q2-2003 was mainly influenced by the large increase in the CDs portfolio which reached US\$4 billion at the end of June, compared to US\$1.2 billion at the end of March and US\$400 million at the end of December 2002 (see Figure 5). The surge in CDs portfolio since the beginning of the year was financed by a US\$1.86 billion increase in LBP deposits and a US\$1.1 billion decrease in Banks portfolio of TBs.

Figure 5. CDs Portfolio (LBP billion)



Source: World Bank staff calculations based on BDL.

The Central Bank pursued the issuance of LBP-denominated CDs. Most of the CDs issued in Q2-2003 had a three-year maturity. Interest rates on CDs

usually officially vary between 5 percent and 9 percent, depending on maturities. But, the yield on the three-year CDs reached 12.32 percent starting April 2003. The Central Bank indeed provided commercial banks with special three-year CDs at a 9 percent interest rate. Then, interest for the three coming years were immediately discounted and paid to the Banks,

which *de facto* increased the yield of CDs. This practice allowed the Banks to keep high remuneration for their LBP depositors, which encouraged conversion to LBP, increased the reserves of the Central Bank, and limited the possibility of a sudden reversal of conversions.

WHY DIDN'T PARIS II ENTAIL A LARGE DECREASE IN LENDING INTEREST RATES?

Low interest rates are an important characteristic of a favorable investment climate. The lower the interest rates are, the higher the number of profitable investment projects. Economic agents and the Lebanese Government were expecting that the financial restructuring triggered by the Paris II Conference would lead to a general decrease in the interest rates on the Lebanese market. This decrease was indeed sharp on the LBP-denominated Treasury Bills: rates on the two-year paper dropped from the 16.34 percent swap rate to 9.41 percent. The average yield of Eurobonds also decreased from 13.6 percent at the end of October 2002 to 5.7 percent at the end of June 2003 (Sources: World Bank staff calculation based on Banque du Liban Monthly Bulletin and BLOM's Weekly Lebanon Brief). But, on the other hand, interest rates on both private deposits and loans remained high, and the spread between deposits and loans even widened. Hence, prospects for resumption in private investment remained low.

Average Interest Rates	October-02		May-03	
	LBP	US\$	LBP	US\$
Loans to the Private Sector	16.32	9.74	14.74	9.11
Private Sector Deposits	10.65	4.20	8.23	3.47
Spread	5.67	5.54	6.51	5.64

There are several reasons to explain this slow decline in lending interest rates:

First, the decline in interest rates on both LBP and US\$ is neither fully indicative for the market nor representative of its situation. The decline observed on two-year Treasury Bills illustrates only partially the recent movements, which took place in the Lebanese marketplace. Since early 2003, the Central Bank has been undertaking a massive issuance of Certificate of Deposits (CDs). With yields on three-year CDs reaching 12.32 percent, the Central Bank is providing the market with a new indicator on its evaluation of the level of risk of the Lebanese Pound, in lieu of Treasury Bills, which have not been issued since January. Using rates on CDs to measure the actual decline in interest rates gives a less rosy picture of the evolution of the perceived risk premium related to the sovereign risk (and hence, to the risk related to any lending in Lebanon). Moreover, most of the lending to the private sector is denominated in US\$, and the decline in the Eurobond yields did not translate into a decrease in the borrowing cost of the Government in foreign currency as, besides the very particular case of Paris II Eurobonds issuance, there were no new Eurobonds issuances or renewals.

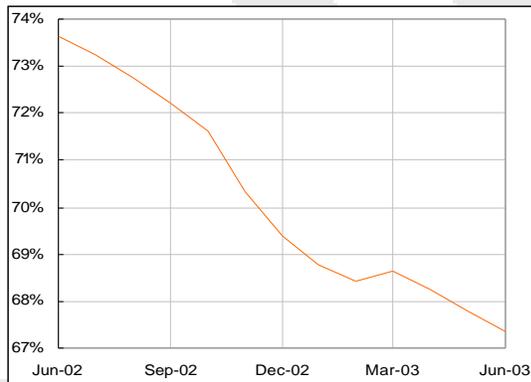
Second, the public sector absorbed most of the new liquidity available on the market. The pool of savings available for the private sector did not increase and hence, did not exert a downward pressure on lending rates. Paris II was followed by the acceptance of commercial banks to subscribe to US\$4 billion worth of Treasury Bills and Eurobonds at zero percent. With 10 percent of their assets becoming unremunerated, banks had little choice but to maintain (or even enlarge) the spread between the rates at which they remunerated their deposits, and the rate at which they lent to the private sector to maintain minimum profitability. This effect was reinforced by the decline in the LIBOR, which affected the remuneration of banks' deposits abroad. Besides, since January, the Central Bank has been pulling out of the market US\$3.5 billion through highly remunerative Certificate of Deposits to sterilize most of the available liquidity in LBP. Commercial banks were then given little incentives/possibilities to lend at cheaper terms to the private sector.

The conversion of foreign currencies to Lebanese Pounds and the increase in LBP deposits since the beginning of the year resulted in a drop of the Dollarization Rate of Deposits from 69.4 percent in December 2002 to 67.4 percent in June 2003 (see Figure 6). Currency conversions, ParisII inflows, and Banks contribution at zero percent in Foreign

Currencies enabled the Central Bank to increase its Foreign Currency Reserves from US\$ 5.1 billion at the end of December 2002 to US\$8.1 billion at the end of March 2003, and US\$9.38 billion at the end of June 2003. The coverage rate of Total Money Supply in LBP by the gross Foreign Currency Reserves

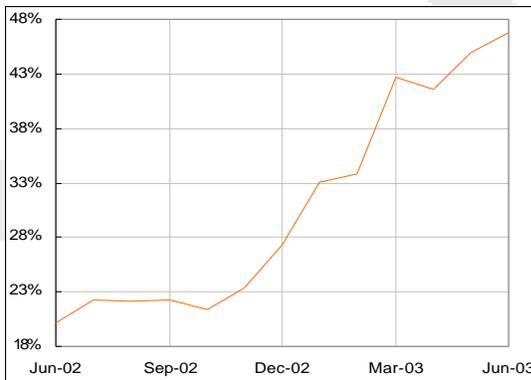
climbed to 46.4 percent at the end of June 2003 (see Figure 7).

Figure 6. Dollarization Rate



Source: World Bank staff calculations based on BDL.

Figure 7. FX Reserves' Coverage of Money Supply in LBP

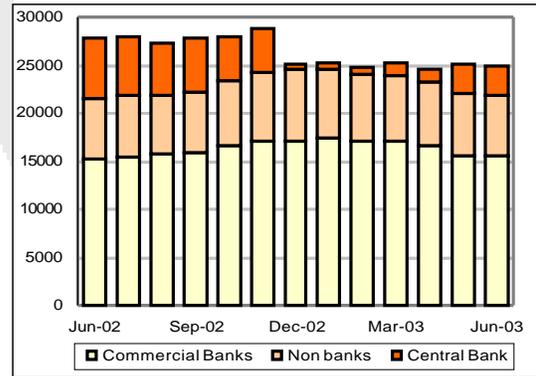


Source: World Bank staff calculations based on BDL.

Since June 2002, the Money Supply grew by 13 percent and deposits in the banking sector increased by US\$5.5 billion. This increase is for 46.3 percent linked to the accumulation of interests (Source: World Bank staff calculations), while the remaining 53.7 percent (or US\$3 billion) are mainly linked to the net private capital inflow over the period, estimated at US\$2.3 billion. The Money Supply in LBP increased by 29.4 percent during the same period, while its equivalent in FX increased by only 4 percent as a result of the conversion to the LBP. Despite the substantial decrease in average interest rates on deposits in LBP and FX, respectively by 242 and 73 basis points between October 2002 and May 2003, banks continued to maintain an important spread with the rest of the world, which allowed Lebanon to attract and keep deposits.

Financial resources received from donors and commercial banks seem to have been used to cover the deficit in the first half of the year. After reducing its TBs portfolio in Q1-2003, the Central Bank increased its financing to the Government by the end of Q2-2003, thus monetizing part of the debt.

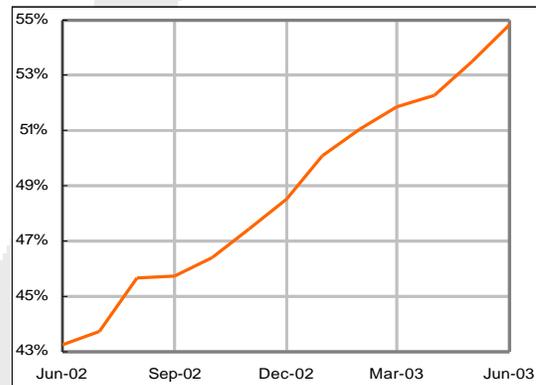
Figure 8. Holders of LBP Treasury Bills



Source: World Bank staff calculations based on BDL.

The Central Bank renewed the monetary financing of the budget deficit with its TBs portfolio rising by US\$1.2 billion in Q2-2003 and by US\$1.7 billion since the beginning of the year. Banks' portfolio of TBs decreased as no new auctions were provided. Non-Banks' TB-holders continued to reduce their portfolio, which decreased by US\$461 million in Q2-2003, and by US\$797 million since end 2002 (see Figure 8).

Figure 9. Commercial Banks' Exposure to Sovereign Risk



Source: World Bank staff calculations based on BDL.

Banks' total exposure to sovereign risk continued to progress during Q2-2003 with the rise in their CDs portfolio, registered as deposits with the Central Bank in their consolidated Balance Sheet. Banks' total exposure to sovereign risk surged to 54.3 percent at

the end of June 2003, up from 42.7 percent in June 2002 (see Figure 9).



ENERGY IN THE MIDDLE EAST AND NORTH AFRICA

Provision of infrastructure services in parts of the Middle East and North Africa (MENA) region continues to be a challenge. While the previous issue of the Update (Q1-2003) featured a piece on the challenges and opportunities facing the provision of water and sanitation services, this article focuses on the Energy Infrastructure and Investments, Sector Reform, Cost and Tariff Structure and Breakdown, and Public-Private Sectors Potential Partnerships.

As a result of high population growth, the region's total investment needs in the energy sector are high

The regional population growth rate of 2 percent per year is among the highest in the world, surpassed only by sub-Saharan Africa at 2.4 percent. In 2010, the population in the region is estimated to be 20 percent larger than in 2000 (World Bank, 2002). In addition, annual economic growth in MENA is expected to be in the order of 1.4 percent through 2010, somewhat higher than when compared to the pre-2002 period, when it was 1 percent (World Bank, 2002); although large interregional differences exist: In 2000, economic activity in West Bank and Gaza declined by 6 percent, while it increased by 6 percent in Iran, for example. Thus, investment needs to the energy sector are estimated at about US\$300 billion (in 1990 prices) between 2000 and 2010. Of this amount, US\$160 billion are estimated to be required for the oil and gas sector (World Bank, 2000).

Oil and gas reserves are large, but per capita revenues are falling

Overall, 40.7 percent (58.5 tcm) of the world's proven gas reserves, and 57 percent of the world's proven oil reserves are in the region (Iranian Economic Information Center, 2003 and IEA, 2001). With 221 billion barrels and 23 percent of the world's remaining reserves, Saudi Arabia has the largest oil resources worldwide; the second largest reserves are in Iraq, estimated at 112 billion barrels. Iran has the world's second largest gas resources at 15 percent of global reserves. However, per capita income from oil exports have fallen during the past 20 years. Countries relying on the net-import of fossil fuel resources include: Djibouti, Egypt, Jordan, Lebanon, Morocco, Tunisia, Yemen, and West Bank and Gaza.

Overall access to electricity in the region is good

The average electrification rate in the region is around 90 percent, with many countries performing close to the 100 percent mark. However, 28 million people in

the region still lack access to electricity, and 8 million people rely on biomass for all of their energy needs (IEA, 2002).

The region has a large potential to render the use of energy more efficient

Energy intensity¹ is high in the region, and ranges from 10,626 British thermal units Btu/US\$ in Yemen to 372,894 Btu/US\$ in Bahrain. Most countries are in the range of 20,000-30,000 Btu/US\$. This is relatively high compared with an oil producing country such as Norway (10,619 Btu/US\$), but relatively low compared with oil producing countries such as Venezuela (34,113 Btu/US\$) and Russia (80,316 Btu/US\$). It is high compared with non-oil producing countries. Spain's energy intensity is 7,684 Btu/US\$, and Germany's energy intensity is 5,217 Btu/US\$ (EIA, 2003). Demand management programs - including increased tariffs - can help increase energy efficiency, and thus reduce energy intensity.

The composition of energy consumption in the region varies significantly, reflecting the diversity of economies. For example, in Yemen 69.5% of energy is consumed in the transport sector, while in most other countries the share of the transport sector in energy consumption is between 10%-30%. The industrial sector is most important: in Bahrain (67.6%), Egypt (53.3%), Lebanon (58.4%), Qatar (81.8%), and in the United Arab Emirates (58.4%). Lowest sector shares of industry are found in Djibouti (5.3%) and Yemen (11.2%) (EIA, 2003). Energy consumption for residential and commercial purposes is lower at about 2% to 30% of energy consumption.

The level of carbon emissions vary throughout the region, but carbon intensity is on the whole relatively high

In 2000, per capita carbon emissions in Yemen were 0.2 tons, in Egypt and Morocco 0.5 tons, and in Algeria 0.7 tons. Other countries have high per capita emissions, with Qatar at 14.1 tons, Lebanon and the United Arab Emirates at 9.7 tons, and Bahrain at 8.4 tons. This compares with 2.1 tons of carbon in Spain and 1.5 tons of carbon in Venezuela (EIA, 2003).

¹ Energy intensity is the ratio of energy input required per generated unit of GDP. The stated values are expressed in British thermal units (Btu) per 1995 USD. Figures are from 2000.

Carbon intensity² of GDP in the year 2000 is somewhat higher in the MENA region than compared to OECD countries. It ranges from 0.2 tons of carbon/US\$1,000 for Tunisia and Morocco, to 5.72 tons of carbon/US\$1,000 for Bahrain. For comparison, the carbon intensity of Spain is at 0.12 tons of carbon/US\$1,000, and of Venezuela is at 0.44 tons of carbon /US\$1,000. The high figures suggest a potential for carbon financing in the region.

Tariffs are still too low to ensure cost recovery

Selected electricity prices in the table show that prices have gradually moved to levels comparable to European countries, but, for a number of countries, prices are still too low to ensure cost recovery. Relative prices in MENA remain skewed in favor of households, which continue to pay less than industry (World Bank, 2003).

Tariffs in US cents/kWh		
Countries	Large Industry	Households
Algeria	3.84	1.72
Egypt	2.80	2.50
Iran	1.80	0.7
Jordan	6.0	5.9
Lebanon	12.0	7.2
Morocco	6.92	9.53
Oman	4.9	5.2
Saudi Arabia	1.3	1.3
Syria	2.0	2.0
Tunisia	4.61	6.47
WBG	15.0	15.0
Yemen	8.9	6.0
Spain	5.13	13.17
<i>Source: IEA (2002) and World Bank (2003).</i>		

By early 2003, most countries in the region had initiated reform in electricity, but the region is still lagging in the international context

Policy needs vary in the energy sector’s sub-sectors: electricity, upstream oil and gas, and downstream oil and gas. In the electricity sector, comprehensive analysis of restructuring possibilities are at various stages of completion, or are beginning to be implemented in countries such as Morocco, Lebanon, Yemen, and Tunisia. Many countries have adopted new electricity laws, which includes corporatization and the setting up of a regulatory body.

Egypt has created a holding company with corporate subsidiaries and has established a regulatory agency. The UAE is another example of a country, which has undergone full restructuring, including the establishment of an independent regulator. Five countries have private independent power producers

(IPPs) in operation (Egypt, Morocco, Oman, West Bank and Gaza, and Tunisia). Jordan, which has had a locally privately-owned distribution company for many years, has fully unbundled and is preparing to privatize the other entities as well. In Morocco, about 50% of distribution is operated through private concessions. However, in the international context, regulatory reform as measured by the World Bank’s regulatory reform indicator has been slower in MENA than in other regions.

Private sector participation in the region’s power sector has been low

While global private investment flows in electricity has sharply fallen to 1992 levels in 2001, private investment flows in the MENA have remained at 2000 levels. However, in the electricity sector, only 4% of the world’s FDI was invested in the region (World Bank/PPI Database, 2003). In the area of natural gas, a fair share of FDI has been attracted to the region, 11% of funds spent worldwide. With the current global recession, domestic and regional private sources of financing are becoming increasingly more important as international finances are even more difficult to obtain.

Looking ahead...

- Both population and economic growth are putting pressure on existing infrastructure and investments to meet future demand.
- Reform has lagged when compared to other regions, making the region less attractive for private investors.
- Cost recovery of both O&M and investment costs remain weak, which will impede development in the sectors.
- Given the substantial need for capital, local private financing and international public-private partnerships are likely to have a prominent role in the years to come.

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² Carbon intensity is the amount of carbon emitted per unit of GDP produced.

NEWS, RECENT AND UPCOMING ACTIVITIES

World Bank And IMF Annual Meetings



Each year, representatives of the 184 member countries of the World Bank Group (Bank) and the International Monetary Fund (Fund) unite to discuss the course of global economic development and formulate underpinning policy strategies. Around these meetings, the Bank and the Fund organize a number of fora to facilitate the interaction of governments and Bank-Fund staff with non-governmental organizations (NGOs), journalists, and the private sector. The findings of these discussions are readily communicated to the public via the media to ensure the transparency of the Bank and the Fund.

The 2003 Annual Meetings of the Boards of Governors of the World Bank Group and International Monetary Fund, along with related events, will be held in the Dubai International Convention Centre, Dubai, United Arab Emirates, on September 18-24, 2003. This is the 58th Annual Meetings of the World Bank Group and IMF.

The Annual Meetings attract more than 10,000 visitors each year, ranging from financial dignitaries to members of the press. Each country's delegation to the Annual Meetings usually includes its Minister of Finance and/or the head of the Central Bank or their respective equivalents. The rest of the delegation is comprised of advisors, executive directors, management and other staff, totaling approximately 3,500 participants from all delegations.

To keep the financial and economic communities abreast of the developments at the Annual Meetings,

the organizations invite key members of the business arena who have a continuing interest in, or operational relationships with, the Bank and Fund as Observers and Special Guests, respectively. These participants draw from commercial organizations, public and private investment institutions and government bodies. Representatives from other financial institutions (both public and private), commercial enterprises, non-government organizations and private individuals can also seek to attend the Annual Meetings as Visitors in their own interests. The number of Observers, Special Guests and Visitors participating in the Annual Meetings total approximately 5,000 each year.

Accreditation and Registration

The World Bank Group and IMF welcome journalists at their meetings. To obtain press accreditation, journalists must file a request via the online registration system at: <http://www.imf.org/external/am/2003/pressreg/reg.asp>

Non-governmental organizations will be allowed at the discretion of the World Bank Group and IMF to secure one, non-transferable NGO Press credential per organization. NGOs can apply for press credentials via the online press registration system at: <https://www.imf.org/external/am/2003/pr essreg/reg.asp>

For more information, please visit the Annual Meetings website contact information page at: www.imf.org/dubai

World Bank Scholarship and Fellowship Programs



The objective of the Scholarship and Fellowship Programs is to help create an international community of highly trained professionals working in the field of economic and social development. The community will actively participate

in the capacity building efforts in the developing countries.

The Scholarship Program and the Fellowships Program are vehicles for knowledge sharing and capacity building in the developing world. The Programs



provide opportunities for graduate studies leading to a Master's Degree in development-related fields for mid-career professionals from the World Bank member countries, eligible to borrow.

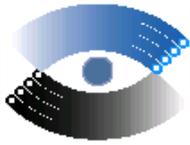
- Ø The *Robert S. McNamara Fellowships Program* (RSM Fellowships) is co-sponsored by the World Bank and Princeton University.

- Ø The *Joint Japan/World Bank Graduate Scholarship Program* (JJ/WBGSP) is solely sponsored by the Government of Japan.

To review your eligibility for the programs or find more information, please consult:

www.worldbank.org/wbi/scholarships/index.html

World Bank Rapid Response – Doing Business Website



The World Bank Rapid Response is a knowledge resource specializing in policy advice on investment climate and privatization for developing countries.

Areas of expertise covered by this service include:

- Ø Economy-wide interventions shaping the investment climate, including foreign investment and corporate governance.
- Ø Private participation in sectors with complex market design and regulatory issues (for example, water, energy, transport, telecommunications, health, and education).
- Ø Privatization transactions and policy.
- Ø Output-based aid—delivering public services through contracts with the private sector.

The *Doing Business* database provides indicators on the cost of doing business in a specific country by identifying specific regulations that enhance or constrain business investment, productivity, and growth.

The principal data collection for the indicators is done through the study of the existing laws and regulations in each economy; targeted interviews with regulators or private sector professionals in each topic; and cooperative arrangements with other departments of the World Bank, other donor agencies, private consulting firms, business and law associations. *The World Bank Rapid Response* prepared a set of templates or questionnaires for use by staff of the World Bank Group, or other agencies, in their work on business environment issues. The initial topics covered included:

- Ø Credit Markets;
- Ø Entry Regulations;
- Ø Bankruptcy;
- Ø Contract Enforcement;
- Ø Labor Regulations.

The full set of topics will be built over the next three years. Once published, each topic will be updated annually. The initial topics will be benchmarked to January 2002. The data set covers 110 economies¹. In 2004 the sample will be expanded to 140 economies.

The *Doing Business* indicators are important to the Bank Group's agenda because the development of a vibrant private sector is central to promoting growth and expanding opportunities for poor people. It is well recognized that encouraging firms to invest, improve productivity, and create jobs requires the right legal and regulatory environment—including protection of property rights, access to credit, and efficient judicial, taxation, and customs systems. But, less is known about detailed legal and regulatory reforms and specific institutions needed to create a favorable environment for doing business.

For example, the database shows it takes 89 business days and costs 48 percent of an average annual income to legally start a business in Jordan. Informality restricts access to credit and safeguards on working conditions. The website allows users to benchmark indicators across all economies in the database and across all regions. Indicators are available for credit markets, entry regulations, bankruptcy, contract enforcement, and labor regulations.

For more information and to access the website, please visit:

<http://rru.worldbank.org/DoingBusiness/>

¹ The sample includes: 22 high-income OECD economies as benchmarks, 24 economies from Europe and Central Asia, 20 from Africa, 5 from South Asia, 17 from Latin America, 12 from the Middle East and North Africa, and 10 from the East Asia and the Pacific region.

RECENT WORLD BANK PUBLICATIONS

Engaging with the World: Trade, Investment and Development in MENA. The countries in the Middle East and North Africa region could ward off a major unemployment crisis in the coming years by expanding trade and private investment, and generating millions of new jobs. The Report warns that the status quo – public sector-driven and protected economies supported by oil, aid, and workers remittances – can no longer generate sufficient growth or jobs, as the experience of the past two years suggest. Instead, it calls on countries to embrace trade and investment reforms, which promise much faster growth and much needed employment opportunities in the region.

Land Policies for Growth and Poverty Reduction (ISBN: 0-8213-5071-4 SKU: 15071). This book looks at the historical, conceptual, and legal contexts of property rights to land. It then considers aspects of land transactions, including the key factors affecting the functioning of rural land markets. Finally, it explores the scope and role of governments and land policy formation and discusses ways in which developing countries can establish land policy frameworks that maximize social benefit.

The Changing Financial Landscape: Opportunities and Challenges for the Middle East and North Africa (Working Paper 3050). Economists have come to acknowledge that finance matters for development more, and in more ways, than had been recognized for a long time. Changes in the financial services industry are providing immense possibilities for economic development. The Paper presents a framework to help understand the changes occurring in the financial landscape. They also attempt to lay out the opportunities and the challenges the Middle East and North Africa region face in light of these changes.

The Private Sector in Development: Entrepreneurship, Regulation, and Competitive Disciplines (ISBN 0-8213-5437-X SKU: 15437). This book attempts to reassess the experience with market-based reforms and critically evaluate the contribution that the promotion of entrepreneurship and competitive markets can make to achieve sustained growth in real per capita incomes and poverty reduction. This objective has assumed particular importance with the adoption of the target of halving poverty by 2015 and other Multilateral Development Goals recently adopted by the international community.

Domestic Regulation and Services Trade Liberalization: A Challenge for the WTO (ISBN 0-8213-5408-6). WTO members have agreed that a central task in the ongoing services negotiations will be to develop a set of rules to ensure that domestic regulations support rather than impede trade liberalization. Since these rules are bound to have a profound impact on the evolution of policy, particularly in developing countries, it is important that they be conducive to economically rational policy-making.

This book addresses two central questions: (1) What impact can international trade rules on services have on the exercise of domestic regulatory sovereignty? and (2) How can services negotiations be harnessed to promote and consolidate domestic policy reform across highly diverse sectors? The book, with contributions from several of the world's leading experts in the field, explores a range of rule-making challenges arising at this policy interface, in areas such as transparency, standards, and the adoption of a necessity test for services trade. Contributions also provide an in-depth look at these issues in the key areas of accountancy, energy, finance, health, telecommunications, and transportation services.

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Data and Statistics

The World Bank offers multiple databases online, some free of charge, and some on an annual subscription basis. Almost all the data reported in the site mentioned below are derived, either directly or indirectly, from official statistical systems organized and financed by national governments. The World Bank, in collaboration with many other agencies, is actively involved in improving both the coverage of and effectiveness of these systems.

To access the on-line databases, please visit:

<http://www.worldbank.org/data/>