THE DAILY STAR
LEBANON

October 06, 2012

Lebanon's industrial policies will fail

By Sami Atallah

The Lebanese government has just launched a series of measures to support the industrial sector. These policies are largely fiscal in nature, providing subsidies and import protection, and supporting certain sectors such as aluminum and other energy intensive industries. The government's hopes to increase investment in the industrial sector, improve the quality of goods and overall competitiveness, and create new jobs, or at a minimum maintain employment at current levels.

Not surprisingly, these measures are a reaction to the current situation in Lebanon. With Syria in flames, the industrial sector has lost a major artery through which to export its products. We can add to this a rise in transportation costs. Meanwhile, the dumping in Lebanon of imported products originally destined for Syria has hurt industrialists further.

As well as these emerging problems, the industrial sector has been suffering for years from high electricity costs, poor trade logistics, monopolized market structure, poor financial intermediation, and an overvalued exchange rate. These problems have pushed prices up while lowering prospects for diversification.

The announced measures are unlikely to solve the major ills of the sector. In fact, the policies are misguided. They are isolated measures, taken in an ad hoc way, that favor larger and influential industries, and they are overly focused on the electricity problem. They also fail to link fiscal and trade support to the performance outcomes of firms. The policies will neither maintain employment nor create new jobs; they will most likely simply increase the profits of the industrialists.

What would have been more useful is to think deeper about the sector and where it ought to be going. The government should support the diversification of industry, which represents a key factor for solid growth and job creation. Countries experiencing high growth rates have a larger and more diversified manufacturing sector, exporting sophisticated products. Furthermore, the manufacturing capabilities of these countries are not determined by factor endowment.

With this in mind, here are few observations about the performance of Lebanese industry: First, exports per capita doubled between 2000 and 2007, from $600 million to $1.25 billion. Not only has Lebanon's industrial sector grown as quickly as those of upper middle income countries, but it has widened the gap further with other Middle East and North African countries. Consequently, exports as a percentage of GDP rose from 14 percent in 2000 to 25 percent in 2007.

Second, the level of export sophistication has also substantially increased, and this by 36 percent, from $10,207 in 2000 to $13,924 in 2008. Therefore, compared to other non-oil middle income labor exporting countries, Lebanon has fared fairly well. It has not only achieved one of the highest growth rates, along with Tunisia; its level of sophistication was the highest among this group.

Third, Lebanese industrialists manufactured 103 new products between 2000 and 2008, of which 40 were highly sophisticated. These include ceramics, glass pigments, self-adhesive plates, paper board, glasses for spectacles, watches, spoons, forks, clock cases, and watches, among other goods.

What is important about this is that the manufacturers figured out a way to compete internationally despite the lack of support from the government. The government must understand the reasons for such success in order to sustain it. This understanding will not only allow for increased diversification of the sector through the production of new products. It also represents the best way to create skilled jobs for the Lebanese, who would otherwise seek work outside the country.

Furthermore, the fact that the industrialists were able to become competitive puts into question the soundness of the new measures that the government has adopted. Moreover, these fresh policies will impose a high cost on Lebanon's finances, and if they are not effective then there really seems to be no point in introducing them.

What the government needs to do instead is to support the development of new and highly sophisticated products. So instead of choosing sectors or providing across-the-board tax incentives, the government must provide incentives to produce new products and target activities that have spillover effects whereby they may crowd in other investments. Moreover, the support should not be open ended.

A good starting point is to a create a policy process whereby the government is able to learn from the industrialists what public inputs they require to diversify. The process must be transparent to ensure that the policies do not favor a few influential firms at the expense of others, and to limit room for rent seeking and outright corruption.

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A version of this article appeared in the print edition of The Daily Star on October 06, 2012, on page 7