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RESILIENCE IN FRAGILE SITUATIONS

Background Note

Country case studies: Building economic resilience in **Lebanon** and **Libya**

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Country case study: Building economic resilience in Lebanon and Libya

Background note for the MENA-OECD Economic Resilience Task Force

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This background note analyses drivers of fragility and outlines possible way forward to build economic resilience in Lebanon and Libya. The note was prepared as analytical material for the Economic Resilience Task Force, which is part of the MENA-OECD Competitiveness Programme.

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Country case study: Building economic resilience in Lebanon and Libya

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INTRODUCTION

Economic resilience

Economic resilience is more than economic growth. Thirty of the 58 fragile contexts listed in the 2018 OECD States of Fragility report are in middle-incomes countries, though conventional wisdom dictates that economic growth is the way out of fragility (OECD, 2018a). Going beyond common assumptions, it is necessary to identify the pillars of economic resilience in fragile states and the ways in which it can be promoted.

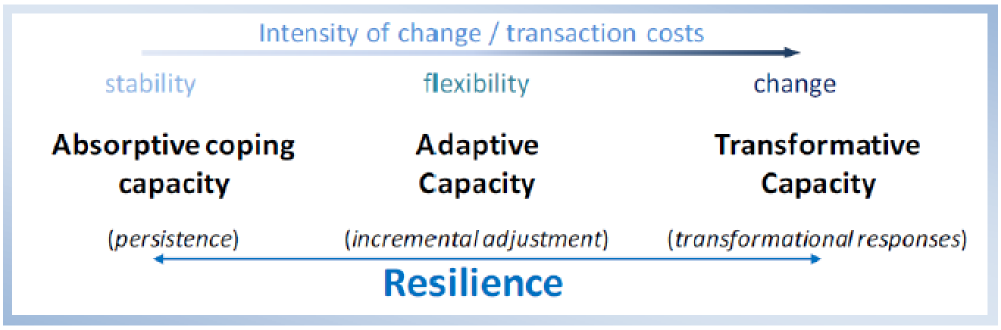
Resilience is the ability of households, communities and nations to absorb and recover from shocks, while positively adapting and transforming their structures and means for living in the face of long-term stresses, change and uncertainty (Mitchell, 2013; OECD, 2014). There are different levels of analysis: regions and countries at the macro level; sectors and clusters at the meso level; and firms and households at the micro level (Figure 1).

Figure 1. Levels of analysis of economic resilience

Economic resilience implies a passive aspect, in terms of exposure to risks or level of vulnerability, as well as the active capacity to react to shocks. This note focuses on the notion of economic resilience as the "policy-induced" ability of an economy to recover from or adjust to the negative impact derived from an external or internal shock (Briguglio et al, 2009). This definition emphasizes the active approach towards developing the coping capacities that allow dealing with external or internal shocks.

Resilience can be boosted by strengthening three different forms of capacities: absorptive, adaptive and transformative (Figure 2). The *absorptive capacity* refers to the ability to adopt coping strategies to absorb a shock, neutralising or minimising its negative impact through mitigation or prevention mechanisms. The *adaptative capacity* covers the mechanisms to respond to a damage once incurred. And the *transformative capacity* is the capacity to fundamentally change the system in response to a shock.

Figure 2. The relationship between absorptive, adaptive and transformative capacities for strengthening resilience



Source: Béné et al., 2012

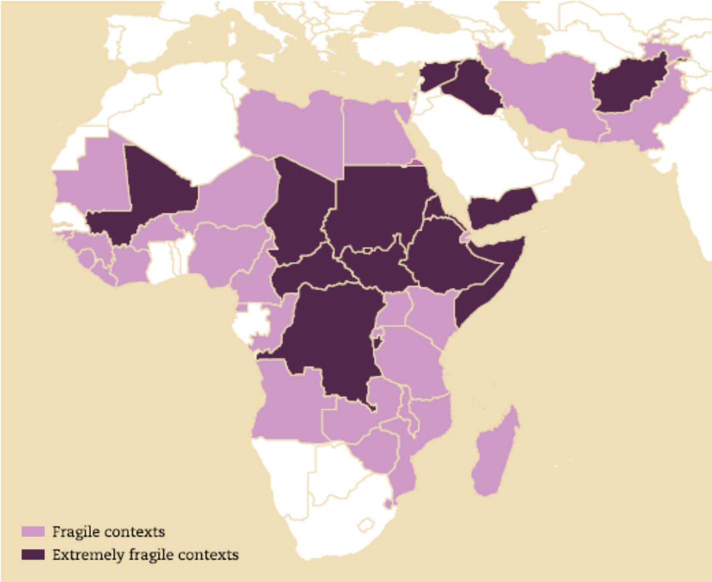
There is no generally accepted methodology to operationalise and measure economic resilience. The literature focusses on economic resilience in context of recovery from economic crises, not on fragile contexts per se. The 2008 global financial crisis showed that the interconnectedness of economies in today's globalised world strongly increased contagion risks. OECD countries have dedicated many resources to identify risks and policies that increase resilience to future crisis (Caldera Sánchez et al, 2015). In OECD economies, macro-prudential regulations and tax policies can help mitigate the build-up of vulnerabilities before a crisis. Monetary and fiscal policy can contribute to accelerate the recovery. Structural policy settings – especially housing, labour and product market regulations – play a key role in enhancing the resilience of economies to shocks.

However, the effectiveness of the different available policy tools will depend on the level of development of the economy, among other things. For instance, fiscal multipliers tend to be smaller in emerging economies (IMF, 2008 and Ilzezti et al., 2011). Furthermore, the types of policies needed will fundamentally depend on the nature of the shocks. The MENA region has been direly affected by conflict in the past years, either directly or through spillovers from neighbouring countries (Figure 3).[1] In 2014, the region accounted for 45% of the world's terrorist incidents, 68% of battle-related deaths, 47% of internally displaced people, and 58% of refugees (OECD, 2018a).

The negative economic and human impact on these countries and the region as a whole has been catastrophic and they will take a long time to recover. With an agreement that peacebuilding, humanitarian and development efforts need to be coordinated, the issue is how to support the recovery of these economies and bring prosperity to their citizens.

[1] The *States of Fragility 2018* framework classifies 58 contexts as fragile, of which 15 are considered extremely fragile. Within the MENA region, the following are classified as fragile: Yemen, the Syrian Arab Republic, Iraq, Libya, Mauritania, Egypt, and West Bank and Gaza Strip. See annex for the full list from the report. Although Lebanon and Libya are not included in this classification, they are considered target countries for the MENA-OECD Economic Resilience Task Force given the large impact the Syria way has on these countries.

Figure 3. Fragile contexts in the OECD fragility framework 2018



Moving from fragility to resilience in the MENA region

Building economic resilience in the MENA region should be seen as part as the broader effort to prevent conflict – and recover from ongoing or recent ones. Recent research shows that prevention is economically beneficial (United Nations and World Bank, 2017). And yet, in 2016 only $8.2 billion was allocated to peacekeeping while $22.1 billion was spent on humanitarian operations and conflict crisis management. Prevention entails inclusive and sustainable development, addressing inequalities and developing risk-informed strategies.

Building economic resilience requires reconciling short-term responses to immediate needs with a long-term vision, and ultimately undertaking structural reforms that build the capacity of economies to react to future external and internal shocks. That means that there will be no short fixes, and successful implementation will largely depend on realistic objectives. But having a long-term objective from the start can guide taking steps in the right direction. Prioritising and sequencing reforms and interventions is even more important in fragile contexts given the added obstacles and sensitivities.

Recent instability in the MENA region has exacerbated pre-existing vulnerabilities. Low levels of diversification made economies in the region uncompetitive and exposed them to price volatility. Public-sector employment dependency coupled with decreasing capacity of the public sector to absorb new entrants to the labour market led to high levels of discontent. Sectors of society that were already excluded from the economy, such as women and youth, were among the most affected, and have become more exposed to the negative effects of conflicts.

Governments in the region were already aware of these systemic liabilities and had made considerable efforts to undertake structural reforms towards increasing diversification, opening to international investment, and addressing inclusion. Some governments have developed a new economic vision for their country and, in fact, any support from the international community should feed into national economic reform agendas in order to strengthen the capacity of national and local governments, as well as other non-state institutions that can contribute enormously to overall resilience.

Each country faces a specific set of challenges and counts on different assets; therefore, tailored policies are needed. However, there are enough similarities to develop a common framework or approach that can help MENA economies affected by conflict or fragility to conceptualise their way towards increased resilience and stability. Through the discussions held by the stakeholders of the MENA-OECD Economic Resilience Task Force, several overarching messages have emerged:

- Transforming the economies of MENA countries affected by conflict or fragility will inevitably require increasing **diversification and job creation**. The lack of jobs has been one of the root causes of political upheavals in the past years and the lack of diversification has exacerbated the impact of crises.
- In order to achieve these goals, it will be essential to better **leverage external sources of revenue** including foreign direct investment (FDI), official development aid (ODA) and remittances. Economic integration and trade should be further pursued, albeit taking into consideration potential negative effects and ensuring positive social outcomes.
- **Domestic sources of revenue** should also be mobilised including by promoting private sector development – specifically supporting SMEs and entrepreneurs –, increasing budget management and tax collection capacities, and tackling other critical issues affecting fragile economies such as informality and illicit activities.
- Although diversification and job creation are goals common to other countries in the region, fragile contexts require tailored policies that enable **implementation** – especially by **prioritising, sequencing** and taking into account **local capacities** – and do no harm.
- Economic growth alone will not be enough, since social unrest and radicalisation are strongly related to real and perceived inequalities as well as unmet expectations. One of the factors contributing to resilience is social cohesion. Therefore, countries need to **promote inclusion** of vulnerable groups, among others, by empowering women economically, working with youth so they do not become a lost generation, providing opportunities for refugees, addressing the needs of demobilised militia or decreasing regional disparities.
- The transformational reforms required have to be adopted through participatory processes. A **new social contract** is needed. A holistic economic vision should be developed through a process of **social dialogue**.

Structure and purpose of the background note

Although there is general consensus on what needs to be done, the recurring questions are: Where to start in order to ensure sustainability and impact? Which policies should be given priority? And how to implement them?

This background note aims to support the discussion on the answer to these questions through the scope of two specific country cases: Libya, engulfed in direct internal conflict; and Lebanon, strongly affected by the war in Syria and the refugee crisis. The economic characteristics of these countries differ significantly, which necessarily means the policy priorities and mechanisms for implementation are also expected to be tailored. The choice of the two case countries where made in consultation with the co-chairs of the MENA-OECD Economic Resilience Task Force.

The background note will start by analysing the key drivers of fragility in each country. Given that fragility is a multidimensional concept, the note will give a brief overview of the five dimensions assessed in the States of Fragility report: economic, security, political, societal or environmental dimensions.[2] The second section will look at the pillars of economic governance with the aim of identifying priority actions.

The purpose of the background note is to help policymakers, donors and international organisations form a better understating and to reflect on their approach to support economic resilience in these countries. Ultimately, the objective of this note is to stimulate the discussion of the MENA-OECD Economic Resilience Task Force, in turn enriching the analysis and conclusions.

[2] The data used for countries classified as fragile according to the States of Fragility methodology comes from that database. In the case of other countries, other sources are used.

Country Case Study 1:

LEBANON

Lebanon has one of the most diversified economies in the MENA region, with growth traditionally driven by real estate, construction and tourism. With the services sector accounting for 76% of value added, and manufacturing representing a high proportion of industrial production, Lebanon has a very developed economic structure (World Bank Indicators, 2017). Coupled with a high level of openness, a well-developed banking system, and a strong private sector, the economic fundamentals position it well to resist to shocks.

However, policy uncertainties and macroeconomic imbalances limit Lebanon's resilience. The Syrian crisis has strained Lebanon's public finances and service delivery. Poverty incidence among Lebanese citizens and income inequality have increased. Beyond the impact of the crisis, recent economic developments point to an underlying erosion of competitiveness and productivity levels. With an increasing fiscal deficit and high public debt, a significant fiscal adjustment is necessary, including restraining public wages, gradually reducing energy subsidies, and increasing VAT rates (IMF, 2018a).

And yet, the current time might offer a window of opportunity to undertake structural economic reforms. On May 2018, parliamentary elections were held for the first time since the outbreak of the war in Syria. In 2017, a budget was adopted for the first time in 12 years, followed by the adoption of the 2018 budget. Although the President is still in the process of forming a new national unity government, the government has made strong signals that it is committed to reforming the economy.

Any international efforts to support Lebanon should feed into national strategies. In that sense, Lebanon has made strides in the past year by developing a new economic vision and reform agenda. The CEDRE conference for the development of Lebanon, hosted by the French government on 6 April 2018, showed that the country continues to benefit from strong international support.[3] Commitments to fund the government's Capital Investment Programme (CIP) reached USD 11 billion, paving the road for infrastructure development and economic transformation. Overall, the international community stands behind Lebanon and recognises the critical contribution it makes to regional security and stability.

However, the support of the international community is contingent on the government implementing its new "Vision for stabilization, growth and employment", announced by President Saad Hariri. The Vision defines a comprehensive reform agenda to warrant a sound macroeconomic framework through fiscal adjustment, undertake structural and sectoral reforms to ensure the sustainability and increase the impact of investment projects, and to promote diversification. The government commits itself to address anti-corruption, fiscal governance, public sector restructuration, and customs modernisation and capital markets. Other reforms will focus on the sectors targeted for the investment projects, including the electricity, solid waste, water, and telecommunications sectors.

Having been strongly affected by political gridlock over the past years, the Lebanese government needs to strengthen its capacity to engage in comprehensive policy reforms. In the meantime, the private sector further emerged as a substitute for government action in certain sectors. The success of the overall reform agenda will need to rely on strong and transparent partnerships between the private and the public sector to rebuild trust among economic actors and to gather support for reform efforts. Appropriate institutions are needed to support the reform process.

This case study first looks at current drivers of fragility in Lebanon, then proceeds to focus on potential priorities to build a resilient economy. Despite the existing risks and

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[3] https://www.diplomatie.gouv.fr/en/country-files/lebanon/events/article/lebanon-cedre-conference-06-04-18

vulnerabilities, Lebanon counts with enough strengths, institutional basis and human capital to aspire to international standards. In designing new policies, the government should benchmark against good practices and learn from peers and other countries that have implemented similar transformational reform agendas.

1. Drivers of fragility[4]

The Syrian war has a negative impact on Lebanon and its economy, but it has particularly exacerbated pre-existing fragilities. Increasing poverty and inequality, regional disparities, and weak state control over force and territory are key drivers of fragility. Lebanese society has shown an extraordinary resilience to many shocks in its recent history. The fact that the huge inflow of refugees – estimated to represent 16% of the population – has not translated into major civil unrest talks to Lebanon's capacity to adapt. Although tensions are high, an important effort has been done to integrate refugees in the schooling and health system. This strength of the Lebanese society should be leveraged as the country implements structural economic reforms paving the way for greater resilience.

Political Fragility

The power-sharing arrangement that helped end the Lebanese civil war hampers the decision-making process. The 1975-1990 civil war drastically undermined state-building efforts, creating a war economy between warring factions based on competition for resources. The Syrian presence further weakened the role of institutions and undermined their ability to govern. The current Lebanese political system, rooted in the Taif Agreement (National Accord Document, 1989), is based on a sectarian division of constitutional powers and administrative positions, guaranteeing the representation of the main confessional groups. While it ended the war, it is also hampers the decision making process.

Regular political gridlock weakens institutions and the capacity of the central government. The central government if often blocked by political deadlock, decreasing its legitimacy and credibility. Political parties, transformed in militias during the war, filled this political vacuum, and the Lebanese's allegiance to political parties is often stronger than it is to the State and its institutions. The country experiences regularly extended periods of political vacuum or deadlock that elections cannot resolve.

Societal Fragility

The predominant confessional system and the legacy of recent conflicts limits Lebanon's capacity to rebuild social cohesion. Although the Taif Agreement called for the eradication of political confessionalism, this has not happened. Changing demographics and regional political tensions are testing the current power balance to the limits. Additionally, with a succession of interrelated wars, foreign occupations and a series of high-profile assassinations, Lebanon carries a heavy legacy of human rights and humanitarian law violations (International Center for Transitional Justice).

High levels of poverty and increasing inequality are accentuated by under-provision of public services. Despite the lack of data, about 28% of the population was estimated to be living in poverty in 2004, and by 2014 the Syria crisis had pushed about 170,000 additional people into poverty (Le Borgne, 2016). There are large regional disparities in headcount poverty rates, with the North, South, and Bekaa being the poorest. The

[4] Lebanon is not in the OECD list of fragile states.

increasing substitution of faulting and under-invested public services by the private sector can exacerbate inequality. Domestic workers and refugees are excluded from the social safety net. Private sector workers are not covered by a pension scheme, making them vulnerable at the time of retirement. Low spending on public education negatively affects the poorest. Access to justice is cumbersome and expensive for the most vulnerable.

The influx of over a million Syrians has sparked tensions between generally poor host communities and Syrian refugees. While the influx of Syrian seasonal or low-wages workers is traditional to Lebanon's economy and society, the arrival of millions Syrian Sunni people has a dramatic effect on the social balance of Lebanon. Lebanon has long maintained that it is not a country of asylum, a final destination for refugees, or a country of resettlement. The permanent integration of Syrian refugees, therefore, is not viewed as a solution. A clear push for return into Syria is perceptible from religious leaders and authorities.

Security Fragility

The State does not have exclusive control over the military and police Hezbollah has established near full control of the South and some other parts of the country, including some suburbs of Beirut, whose access is not granted to the Lebanese Police or army. The war in Syria brought additional fighting groups, including Islamist terrorist groups affiliated to ISIS being active in Lebanon.

Resort to violence to resolve disputes is still recurrent and Lebanon's crime rates is increasing. Since the war, many light weapons circulate in Lebanon and Hezbollah is not the only group with illegitimate arms. Most political leaders and their parties have weapon stocks and armed personnel at their disposal. Situations of blatant lawlessness occur daily as well as numerous conflicts with Syrian refugees. Political violence is high – between 2005 and 2013, there were several dozens of political assassinations or attempts thereof (Malaeb, 2018).

Economic Fragility

Poor infrastructure chokes the economy, with major deficiencies in key basic services, including, electricity, water supply, sanitation, transport, waste management, and telecommunications. The quality of Lebanon's infrastructure is amongst the poorest in the world, ranked 130th out of 137 countries (Schwab, 2017). The county's debt burden as well as the absence of official budgets from 2005 to 2016, has resulted in a sharp fall in public spending on infrastructure. Electricity is one of Lebanon's major problems since the civil war, ranked as the second biggest obstacle to invest into Lebanon (EBRD, 2016). In order to cope with frequent and long power cuts, 92% of households depend on expensive generators, despite the electricity operator's large and subsidized budget. Inefficiency and corruption in this sector, represents one of the largest burdens on the public budget. In 2013, electricity subsidies reached $2.20 billion or almost 15% of the government budget.

Corruption deepens inequalities and hinders economic activity. Lebanon is one of the most corrupt countries in the world (Transparency International, 2017), which deepens inequalities, but also affects negatively the business climate and foreign investment. Businesses are hindered by patronage networks that monopolise the economy and prevent competitiveness. Petty corruption also applies for daily basic services. While the Lebanese Penal Code criminalises corruption and bribery, enforcement of these laws is poor.

A cumbersome business environment limits firm creation and productivity. Estimates show that around 90% of private firms are small with less than five employees, but these firms employ around 70% of the active labour force, and contribute around 80% of the GDP (Bertelsmann Stiftung, 2016). However, bureaucracy, corruption, limited access to credit or public finance and poor infrastructure hinder the growth of small enterprises.

Refugees work in the informal economy and their presence has increased competition for low wages. The country initially pursued an open-door policy towards Syrians, but refused to recognise them as refugees or grant them formal access to jobs. As a result, the vast majority of Syrian labour force work in the informal sector – as before the Syrian war but at a larger scale – with no protection and with limited fiscal benefits for the State. Food prices and house rents have increased and competition for jobs has grown.

Environmental Fragility

Poor water management limits access across the country. Due to its mountainous topography, Lebanon has more rainfall than its middle-eastern neighbours. However, its overuse and poor management results in daily cuts in most parts of Lebanon. The Lebanese water sector is made up of numerous entities with overlapping functions, decreasing management efficiency (Fanack Water, 2016). International funding agencies play an important role in developing Lebanon's water sector in terms of capital investments in water supply, wastewater and irrigation projects, as they provide up to 70% of funding for water investment (Fanack Water, 2016). However many projects are not aligned with that of the water establishments or the Ministry of Energy and Water.

Pollution of air, land, water and sea is one of the most pressing environmental issues in Lebanon. Waste collection and disposal is highly dysfunctional, as exemplified by a continuous garbage crisis. Unregulated landfills and dumpsites are spread across Lebanon. As a result, rivers, springs and groundwater are polluted by raw sewage and other wastes, both domestic and industrial, discharged without pre-treatment. As waste are dumped on seashore or directly into the sea, Lebanon's inability to manage its waste has become a regional issue for its Mediterranean neighbours.

2. Levers for resilience

Lebanon counts with many assets and it can leverage its strengths to address many of the stress factors identified and to develop a resilient economy. The "Vision for stabilization, growth and employment", supported by Lebanon's political forces and backed by the international community, outlines a comprehensive and ambitious agenda for reform (Box 1).

Building on this Vision for economic reform, this section outlines some of the priority areas for action in order to increase economic governance and enable sustainable and inclusive growth (See summary in Table 1). The reform agenda should be rooted on meaningful social dialogue, which will require supporting institutions that can build consensus across confessional lines. Some of the priority areas will be to improve macroeconomic and fiscal policies, successfully implement the CIP, and promote the development of the private sector.

Box 1. CEDRE and Lebanon's "Vision for stabilization, growth and employment"

The Vision focuses in four areas:

- **Increasing public spending on infrastructure** projects to generate employment, which will be done through the CIP, a development plan spanning over the next 10 years, focusing on eight essential sectors: transport, water and irrigation, wastewater, electricity, telecom, solid waste, and tourism and industry.
- **Ensuring a sound macroeconomic framework** through fiscal adjustment. The government commits to a fiscal consolidation of 5 percentage points of GDP over the next five years through measures that increase government revenues – such as tax collection improvement and electricity tariff increases – and spending cuts – including cutting subsidies to *Electricité du Liban*.
- **Undertaking structural and sectoral reforms** to ensure the sustainability and increase the impact of investment projects.
    - *Structural reforms* will focus on anti-corruption, fiscal governance, public sector restructuration, and customs modernisation and capital markets. The government also commits to a series of initiatives that should improve the business environment, including the revision of the Code of Commerce, the development of the regulatory framework to sustain e-government and e-banking initiatives, and other reforms related to access to finance and the judicial system.
    - *Sectoral reforms* will aim to improve the policy and regulatory frameworks of the sectors benefitting from investment projects. That is, the government commits to review the legislation and institutional governance of the electricity, solid waste, water, and telecommunications sectors.
- **Promoting diversification** of the economy to develop Lebanon's export potential.

2.1. Building a new social contract and ensuring inclusion

Although the government has outlined its vision for reforms, society needs to buy-in and therefore a proper process of consultation has to be in place. Social dialogue is not a linear process and it can happen simultaneously through different channels. On one hand, tripartite discussions are essential to bring governments, workers organisations and employers' organisations on the same page. Given the economic nature of reforms and the focus on private sector development, the private sector has to be consulted and engaged. In the case of Lebanon, particular attention needs to be paid to confessional lines and to the needs of refugees and host communities. Vulnerable sectors of the population such as women, youth and marginalised regions, need to be at the table.

- **Actively engage in dialogue:** Given the particularities of Lebanese society, efforts to increase social cohesion should address confessional divisions. To start, social dialogue needs legitimate and convening institutions. Also, there needs to be a solid voice capable of representing the private sector in order to have public-private dialogue – essential for economic policy-making and successful implementation of economic reforms.

    - <u>Strengthen institutions for social dialogue</u>: It is essential to root the design and implementation of reforms in an inclusive and representative social dialogue process. This will require political will, but also institutions that have a mandate and legitimacy to represent the different voice. Lebanon is a multi-religious society and its political system aims to balance the delicate equilibrium between groups through a power-sharing agreement for representation in the country's institutions. Social dialogue needs to engage the different groups of society.

      The Economic and Social Council of Lebanon could play a relevant role in reactivating tripartite dialogue. However, the Economic and Social Council was only reactivated in October 2017 after 15 years of suspension. It is virtually a new institution, and, as such, it has to build strong foundations for its analytical capacity and advocacy leverage.

    - <u>Support Public Private Dialogue (PPD)</u>: Although Lebanon is famous for having a well-developed private sector and there is a high level of freedom of association, the landscape of business organisations is highly fragmented (OECD, 2018b). There are multiple employers' organisations and chambers of commerce representing various sectors and interests.

      The main private employers' organisation is the Association of Lebanese Industrialists (ALI), which is represented in multiple national bodies including the Economic Consultative Committee to the Prime Minister and the official committee of trade agreements. Other influential players are the Lebanese Businessmen Association (RDCL), the Lebanese Economic Forum (LEF), and specialised organisations such as the Beirut Traders Association (BTA) and the Associations of Banks in Lebanon (ABL). However, there is no umbrella organisation or platform that brings together these business organisations, which translates into a weaker position of the private sector and no cohesive approach.

On the other hand, there have been previous attempts to institutionalise PPD. "Improving the Business Environment in Lebanon (IBEL)" was a PPD platform focused on identifying business climate reform recommendations, but it is no longer operational and there is not much evidence regarding its achievements (OECD/EU/ETF, 2018). There are ongoing initiatives to launch PPD mechanisms, and the Ministry of Industry is developing an action plan and the SME strategy envisions the creation of regular PPD roundtables to monitor progress on its implementation.

- **Develop targeted measures to bring in vulnerable groups:**
  - Address the needs of refugees and host communities most affected by the refugee crisis, and reduce regional disparities**:** The large influx of refugees over the past decade has heightened tensions with the local communities who fear competition for jobs and reduced access to public services. Refugees are concentrated in the poorer areas of the country, which already suffered from high unemployment rates. Northern Lebanon is one of the country's least developed regions, suffering from high poverty levels and hosting over 250 000 Syrian refugees (UNHCR, 2017). The region has the highest unemployment rates in the country, with 65% unemployment in Minniyeh Denieh and almost 60% in Akkar (VASyR 2015).

    Given that the labour market did not have the capacity to generate jobs for the increased demand, employment-creation initiatives are needed to support these communities (UNDP et al, 2017). Labour-intensive multi-year infrastructure and rehabilitation projects could generate employment for host communities and refugees, and it could be a criteria to prioritise projects within CIP. Industrial zones and the Tripoli Special Economic Zone could also contribute to activate the economy in marginalised areas.

    Refugees face specific legal barriers accessing the labour market. One of the main challenges for refugees in Lebanon is the difficulty to obtain residency and work permits. Clarifying and easing the residency-permit process would reduce mobility restrictions, fear of arrest, detention, abuse and exploitation.

  - Empower women economically**:** A new Ministry of Women's Affairs was established in 2016, marking an important effort in bringing women empowerment into the public sphere. However, much remains to be done to increase women's participation in politics and decision-making positions as only six women serve on Lebanon's 128-person parliament, the current Cabinet of 30 ministers has one woman.

    While women have equal access to men in terms of education, there are barriers to their entry into the labour market – especially among the youth. In 2014, young Lebanese men were twice as likely to work as young Lebanese women with employment ratios of 52.3% and 25.6%, respectively, and the share of young women neither in employment nor in education or training was more than threefold that of young men (ILO, 2014).

    In Lebanon, initiatives to empower women economically inevitable must address the specific needs of women refugees. As a result of the demographic trends of Syrian refugees in Lebanon, there is an unusual high number of households headed by women and with many children. Supporting economic integration of Syrian women refugees therefore is essential to protect this collective and local initiatives have much potential. In neighbouring Jordan, the municipality of Zarqa introduce a home-based business license to integrate into the labour market housewives that have difficulties leaving their home (CMI, 2018).

2.2. Ensuring sound fiscal and macro-economic conditions

- **Undertake fiscal consolidation by increasing domestic revenues and improving domestic spending:** The fiscal balance has deteriorated in the last years, mostly due to weak revenue collection or tax exemptions. Lebanon is currently the third most indebted country in the world (Schwab, 2017), with a public debt estimated at 150% of GDP. The government announced an ambitious fiscal consolidation programme of 5 percentage points of GDP over the next five years as part of the "Vision for stabilization, growth and employment". The government commits to undertake measures to increase revenues through improved collection and reduced exemptions, as well as cutting spending and reforming the highly-subsidised electricity sector. The challenge will be to achieve this goal without jeopardising social safety nets.

  In 2017, Lebanon increased the VAT from 10% to 11%. While the increase in taxes can help meet the budgetary needs of the government, consumption-based taxes have a more regressive impact. The welfare and macro-economic effects must be assessed as the government design the announced tax reform. Furthermore, fiscal consolidation should be done within a medium-term framework.

  Transparency should be an integral part of this reform programme. Lebanon has made enormous progress in meeting the international standards of transparency and exchange of information in the past two years. In 2016, Lebanon joined the Global Forum on Transparency and Exchange of Information for Tax Purposes and is benefiting of an induction programme.[5] Since then, Lebanon has signed and ratified the Convention on Mutual Administrative Assistance in Tax Matters, has committed and implemented automatic exchange of information, and has obtained a provisional largely compliant rating in the context of the fast-track procedure.

- **Prioritise horizontal governance for the implementation of CIP:**
  - Promote transparency and integrity**:** Fighting anti-corruption is a top priority in Lebanon, particularly in the context of the context of the "Vision for stabilization, growth and employment". Lebanon is party to the United Nations Convention against Corruption (UNCAC) since 2009 and the legal framework contains basic provisions against corruption including in the Penal Code and the Illicit Wealth Law.[6] But the enforcement of these provisions seems very poor and both the government and the private sector acknowledge that corruption is endemic and conflicts of interest are widespread.

[5] The Global Forum on Transparency and Exchange of Information for Tax Purposes is the multilateral framework within which work on tax transparency and exchange of information is carried out by over 145 jurisdictions.

[6] The Lebanese Penal Code criminalises active and passive bribery, passive trading in influence, extortion, embezzlement and money laundering. Bribery of foreign public officials and officials of public international organizations is not criminalised. Other provisions are contained in the Illicit Wealth Law of 1999. Bribery of foreign public officials and officials of public international organizations is not criminalised.

Initial steps have been taken recently, including the adoption of the Access to Information Law in January 2017, and the appointment for the first time of a State Ministry to Fight Corruption in December 2016. The first Lebanese National Anti-Corruption Strategy was also announced by the Minister of State for Administrative Reform following the CEDRE Conference, but not yet adopted.

In parallel with fighting corruption in the private sector, much can be done to promote integrity and enable a responsible business conduct of the private sector. There is some basis to work on. Lebanon has ratified 6 of 9 core international human rights instruments and is a signatory to two additional ones[7] (UN OHCHR, 2017 b-c). Lebanon has also ratified 50 ILO Conventions, including seven out of eight fundamental Conventions and two out of four priority Governance Conventions (ILO, 2017a). CSR Lebanon Forum is a government-supported network of businesses that has been promoting corporate social responsibility for over 10 years. In terms of environmental practices, the 2002 Lebanese Environmental Law No. 444/2002, envisions a 50% discount on import tariffs for equipment and technologies that protect the environment, as well as a 50% tax discount for activities that support the protection of the environment.

- Provide enabling conditions for the implementation of infrastructure projects: Lebanon has barely exploited foreign investment to develop its infrastructure over the past decade. Only one greenfield infrastructure project involving a foreign investor has been recorded over the past ten years. The lack of government budgets has resulted in a sharp fall in public spending on capital projects. But the development of the Capital Investment Plan (CIP), if properly implemented, should change this trend. CIP spans over the next 10 years, focusing on eight essential sectors: transport, water and irrigation, wastewater, electricity, telecom, solid waste, and tourism and industry.

  Poor governance of public investments is a major reason for the failure of infrastructure projects, in terms of budget, time and outcomes (OECD, 2015). This is further compounded when complex procurement methods, such as Public-Private Partnerships, are used to get private sector participation. In order to ensure value for money, complex infrastructure projects require efficient, effective and transparent governance systems. The adoption of the Public Private Partnership (PPP) Law in August 2017 could serve as the basis for private sector participation in CIP projects. But it needs to be duly applied and enforced.

Establish a monitoring mechanism for CEDRE to ensure disbursements and implementation of projects: **Lebanon is receiving large amounts of ODA, half of it being humanitarian aid (**

[7] Lebanon is a signatory to the Convention for the Protection of all Persons from Enforced Disappearance and the Convention on the Rights of Persons with Disabilities; however, no action has been taken on the Convention on the Protection of the Rights of All Migrant Workers and Members of their Families.

- Figure 4). Non-humanitarian international assistance was long to reach Lebanon at the beginning of the Syria crisis because Lebanon is a middle-income country, not eligible to receive ODA. After the 2016 London conference, the World Bank's Global Concessional Financing Facility has helped Lebanon accessing concessional funding in response to the refugee crisis. But funds were deemed insufficient to address the economic and humanitarian consequences of the Syrian conflict.

  In the April 2018 CEDRE conference, the Lebanese Government presented the "Vision for stabilization, growth and employment" outlining an ambitious reform agenda. The international community has committed to fund the government's Capital Investment Programme (CIP), but disbursements will be conditional upon implementation of reforms. It will therefore be necessary to establish a mechanism that monitors implementation of CEDRE to increase international confidence in its vision and pave the way for allocations to the future phases of CIP. This mechanism needs to transparent, agile, and open to the different stakeholders involved.

Figure 4. ODA flows to Lebanon

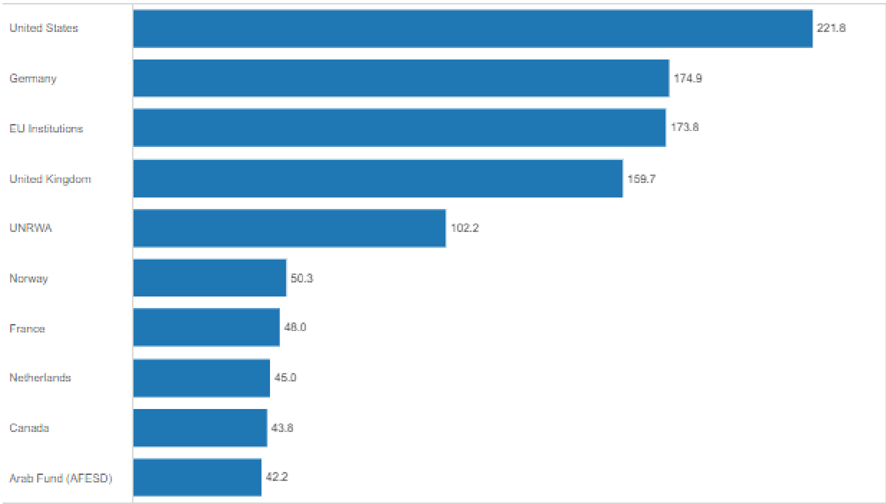
Receipts for Lebanon

	2014	2015	2016
Net ODA (USD million)	821.0	974.9	1,138.5
Net ODA/GNI (%)	1.8	2.1	2.4
Gross ODA (USD million)	965.8	1,162.6	1,312.5
Bilateral share (gross ODA) (%)	60.0	71.4	74.1
Total net receipts (USD million)	604.3	964.4	1,511.6

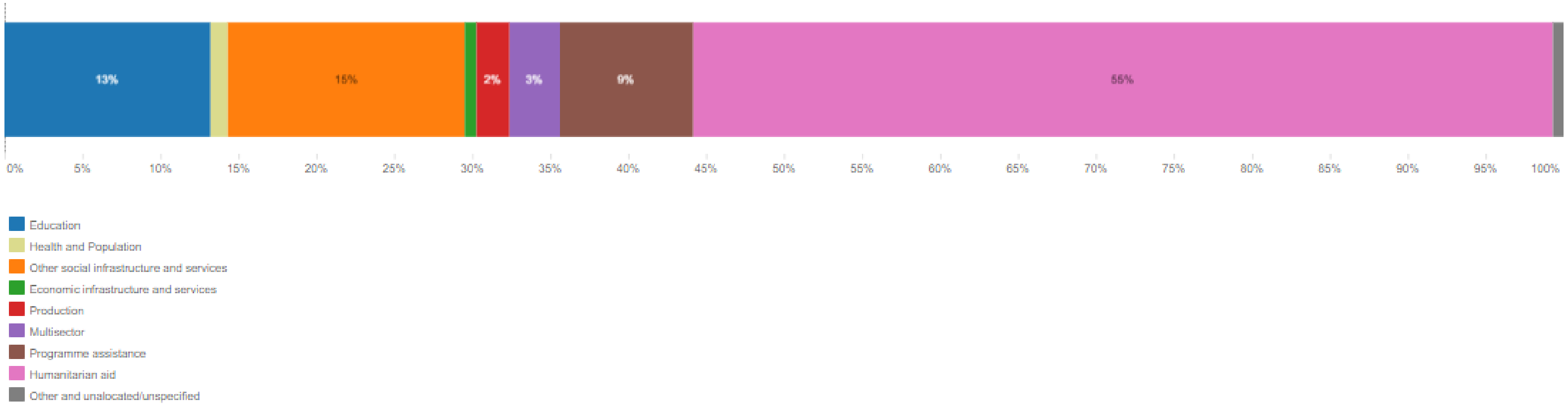
For reference

	2014	2015	2016
Population (million)	6	6	6
GNI per capita (Atlas USD)	7,980	7,720	7,680

Top Ten Donors of Gross ODA for Lebanon, 2015-2016 average, USD million



Bilateral ODA by Sector for Lebanon, 2015-16 average



Source: OECD-DAC: http://www.oecd.org/dac/financing-sustainable-development/development-finance-data/aid-at-a-glance.htm

2.3. Promoting private sector development

- **Increase quality investment:** Lebanon's FDI performance is impressive in terms of the level of inflows but also for their regularity. FDI increased after the onset of the global financial crisis, reaching a peak of USD 4.8 billion in 2009 before gradually decreasing to pre-crisis levels. In 2015, inflows dropped to USD 2.3 billion their lowest level in a decade, down 50% from their peak. However, given the civil war in neighbouring Syria and the general turmoil in the region, FDI inflows have held up remarkably well. Real estate and hotels and tourism accounted for 82% of capital expenditure between 2003 and 2015. A large proportion of greenfield investment originates from GCC countries, with the United Arab Emirates responsible for 50% of the total.

    - Strengthen the investment legal framework: Investments in Lebanon are mainly governed by the Investment Development Law No. 360 of 2001, which focuses on investment incentives. Lebanon's investment legal framework could be strengthened by ensuring key guarantees for investors are reflected in the investment law. The 2001 Investment Development Law does not include the usual investment guarantees which are usually the core of investment laws. Although key guarantees of property protection are found in other legislation such as banking laws and the Expropriation Law No. 58 of 1991. The Law is also silent on obligations binding upon investors.

      Lebanon's banking sector is one of the most open in the MED region, with nearly no restrictions in the sector (Marouani et Munro, 2009; Ianchovichina et Mottaghi, 2013). Yet, the World Bank Services Trade Restrictions Database (STRI) database reveals a number of restrictions in the services sector that discriminate between foreign and domestic investors. For instance, market entry is prohibited in maritime auxiliary services as well as in legal services. In the telecommunication sector, foreign ownership is limited to 66% and acquiring state-owned entities is not allowed. For domestic road freight, foreign ownership cannot exceed 49% of capital for all legal forms of entry.

    - Improve investment promotion and facilitation policies: The investment promotion agency, "Investment Development Authority of Lebanon" (IDAL), was created in 1994. Although it does not have a role as strong as other IPAs in the region, its responsibilities have been reinforced with the 2001 Investment Development Law. IDAL operates as a one stop shop for investors, helping them obtain required permits, providing information to investors, and managing the fiscal incentives offered by the law.

      However, there is little co-operation and coordination with other Lebanese national and sub-national entities such as the newly created Tripoli Special Economic Zone, industrial zones, etc. In a recent survey conducted on 10 IPAs, IDAL had the lowest number of institutional relations compared to its neighbours (OECD, 2018c).

      A particular area where IDAL can play a critical role is in the attraction of diaspora direct investment. Diaspora members can be effective anchor/first-mover investors and could contribute to a more balanced territorial distribution of FDI. In fact, IDAL recently developed a "Lebanese 2015 Diaspora Direct Investment (DDI) Strategy", for which it organised a series of focus group meetings in different countries to better identify the profile of Lebanese diaspora investors around the world.

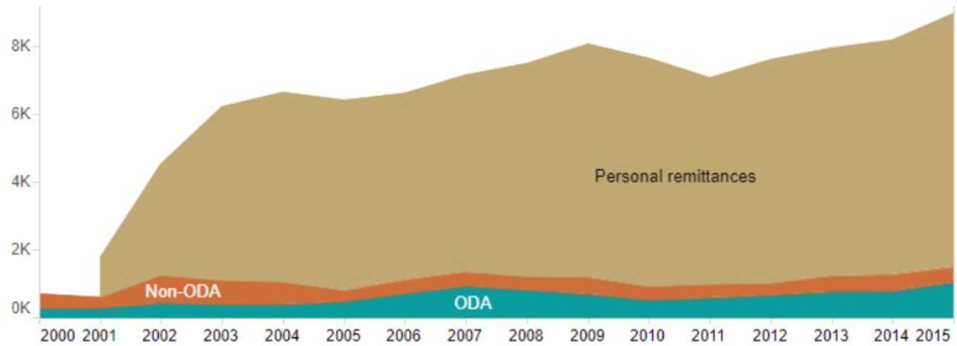
Another objective of IDAL should be to support the diversification of FDI inflows, including the countries of origin, by developing an outreach programme with other countries.

- Develop the Tripoli Special Economic Zone (TSEZ): Special economic zones can help attract investment and increase competitiveness in the industrial sector. Lebanon has had a program of industrial zones for several decades. In 2008, the government enacted a law to establish a special economic zone in Tripoli, Lebanon's second largest city, which has suffered from economic stagnation and high unemployment for years. The TSEZ is expected to attract further investment by providing security pockets for business and investors and applying innovative regulatory mechanisms. It could also reduce regional disparities and become a source of job creation.

  However, whether it reaches its full potential will depend on a number of aspects in the design and implementation. The TSEZ should ensure strategic alignment and technical coordination with relevant ministries and public authorities such as the Ministry of Industry's North Lebanon industrial zone, Beirut logistics free zone, IDAL, and the Ministry of Public Works and Transport. It should develop clear, predictable and transparent regulations in strategic areas for business operation, such as business registration and licensing, customs clearance and inspection procedures, one-stop shop services, land allocation, or environmental and labour standards. The TSEZ should ensure the efficient use of tax incentives for investment through careful design and monitoring.

- **Increase the productivity of remittances inflows**: Remittances represent an important financial flow to Lebanon, and are a major contributor to Lebanese resilience (Figure 5). It is estimated that there are around 14 million Lebanese people overseas – more than three times the resident population – who send back more than 20% of Lebanon's nominal GDP in remittances (Awdeh, 2012). Remittances offer an economic buffer for a population that is poorly protected by social safety nets and they can smooth consumption during periods of macroeconomic shocks. Personal remittances receipts have been relatively stable since 2013 (UNCTAD, 2017); however, their economic impact remains muffled. Channelling remittances towards more productive sectors could therefore have a major impact on the economy.

Figure 5. Composition of external inflows, 2000 – 2015



Note: ODA includes bilateral ODA and multilateral concessional flows. Non-ODA flows include: other developmental flows, officially-support export credits, FDI, other private flows at market terms

and private grants. Adjusted gross disbursements, three-year moving average, USD million, 2015 constant prices. The data refers exclusively to flows from DAC countries.
Source: OECD DAC Statistics. Accessed on November 2018.

- Channel remittances towards more productive sectors: The majority of remittances go to finance consumption goods or small personal projects such as summer houses in the Lebanese country or mountainside. But real estate generates relatively limited long-term local employment, beyond the initial construction boom. Moreover, it is not tightly integrated into global production chains, and therefore do little to support the technological and skills upgrading of Lebanese workers and companies. Since IDAL recently developed a "Lebanese 2015 Diaspora Direct Investment (DDI) Strategy", the strategy should pay close attention at how to leverage remittances to develop viable local industries that generate local employment and income-generating opportunities.

- Develop enabling legal and regulatory frameworks for diaspora bonds and remittance securitization: In order to drive economic growth, remittances must trickle into public and private investments through formal financial channels which can generate employment and develop local sectors. On the public side, the Lebanese government can raise funds for infrastructure and social projects, finance its budget deficit, and service its external debt through issuance of bonds to Lebanese diaspora. Coupled with tax incentives, diaspora bonds can become attractive investment channels for Lebanese expatriates while catering to their sense patriotism in helping their country develop. On the private side, remittance securitisation represent a cheap and efficient way for private banks to raise capital while providing security through a special purpose vehicle (SPV).

- Develop banking links with destination countries for Lebanese expatriates: Lebanon's developed banking sector with repatriable foreign currency accounts, free capital movement, and financial literacy among the diaspora and recipient community make a good ground for remittances. However, the presence of Lebanese private banks remains limited to only a share of destination countries for Lebanese expatriates – mainly Gulf countries (Awdeh, 2012). Large parts of the Lebanese diaspora in Africa and Latin America can only send money back to Lebanon by physically carrying it home. By promoting innovative money transfer technologies and encouraging private banks to expand presence abroad, a larger share of the remittance inflows can be captured in the formal financial sector.

- **Support SMEs and entrepreneurs:** Stimulating growth of the domestic private sector can improve macroeconomic stability, and reduce pressure on the state for wealth and income, thus diminishing political instability, and the risk of violence. This will also be helpful in the longer term to diversify the tax base. Reforms will be necessary to stimulate the private sector through promotion of enterprise creation, critical to create jobs for the qualified Lebanese workforce. Regulatory support to simplify business regulations, and create strong incentives for investment in new sectors will also be urgent.

    - Improve the legal and institutional framework for SME policies: SMEs have much potential to create jobs, particularly needed for refugees and affected host communities. Comparing to other MENA countries, Lebanon had a fairly less developed SME policy, with a fragmented institutional landscape and lack of official data (OECD/EU/ETF, 2014). In recent years, the government has made some efforts to develop a complete SME and entrepreneurship policy agenda

(OECD/EU/ETF, 2018d): an SME law was developed, although it is still pending parliamentary approval, and an SME strategy was also drafted, with the SME Unit in the Ministry of Economy responsible for overseeing coordination. An Action Plan for the implementation of the SME strategy would be developed after the adoption of the SME Law.

- Make access to public procurement opportunities easier for SMEs: Public procurement contracts account for about 18% on average in the MENA region, which represents a considerable source of revenue and could offer growth opportunities for SMEs (OECD/EU/ETF, 2018d). In the context of the CIP, integrating SME in the value chain would be particularly important so they can benefit from international investment. Simplifying and modernising the public procurement system through the approval of an existing draft law and the creation of an e-procurement platform could help in this regard.

- Support SMEs in the services sector, especially internationalisation efforts: Given the weight of the services sector particular attention should be directed at improving the competitiveness of SMEs in this sector. The trade sector has also suffered from Syria's war given that land access to other countries has been severely interrupted. Lebanon could promote other alternatives by leveraging its geographical position and the existence of a number of trade and investment treaties such as the European Free Trade Association, the Trade and Investment Framework Agreement with the United States and the GCC-Lebanon FTA. However, SMEs need support to meet international standards in order to participate in regional and global value chains.

- Tackle informality**:** While providing survival options, informal economic activity has many negative effects. To start, informal workers are not covered by regulations or social safety nets. Informality limits the potential of businesses, it is more difficult for informal firms to obtain financing or access markets. Furthermore, informality imposes unfair competition to firms complying with regulations. The informal economy was already large before the Syria crisis – close to 50% of informal employment in 2009 (ILO, 2015) –, but the arrival of refugees has increased it. In 2013, unemployed Syrian refugees were estimated to represent more than half of all unemployed persons in the country.

  Tackling informality is difficult as the underlying reasons driving it are many. Governments need to develop a comprehensive strategy that makes it attractive and easy for firms to comply with regulations. Such strategies should combine horizontal policies that improve the business climate overall, as well as targeted measures that focus on existing informal firms. In the case of Lebanon, measures should prioritise locations hosting large numbers of refugees, which are also the country's poorest, –such as the Bekaa, North Lebanon and Mount Lebanon governorates – and they must integrate host communities. Local governments are well positioned for this task and many initiatives are already being implemented. But although local initiatives have much potential, they need to be complemented with more comprehensive strategies in order to improve the design building on lessons learned and enabling scaling up to have a larger impact.

  For instance, the Syrian Economic Forum, in collaboration with the municipal government and local chambers, developed a programme to formalise Syrian businesses in Gaziantiep, a Turkish city hosting 325,000 Syrians – 90% of which outside of refugee camps (CMI, 2018). The intervention combined training on regulations, technical assistance in the licensing process, and financial support to cover fees. As a result, 217 firms registered and 96 work permits were issued. However, one of the barriers identified was the difficulty of obtaining work permits, which are conditional upon reaching a certain quota of locals.

Table 1. Summary of policy tools – Lebanon

Objective	Policy area	Policy tools
Building a new social contract and ensuring inclusion	• Actively engage in dialogue	• Strengthen the institutions for inclusive dialogue • Support PPD
	• Develop targeted measures to bring in vulnerable groups	• Address the needs of refugees and host communities most affected by the refugee crisis, and reduce regional disparities • Empower women economically
Ensuring sound fiscal and macro-economic conditions	• Undertake fiscal consolidation	• increasing domestic revenues • improving domestic spending
	• Prioritise horizontal governance for the implementation of CIP	• Promote transparency and integrity • Provide enabling conditions for the implementation of infrastructure projects
	• Better target ODA	• Establish a monitoring mechanism for CEDRE to ensure disbursements and implementation of projects
Promoting private sector development	• Increase quality investment	• Strengthen the investment legal framework • Improve investment promotion and facilitation policies • Develop the Tripoli Special Economic Zone (TSEZ)
	• Increase the productivity of remittances inflows	• Channel remittances towards more productive sectors • Develop enabling legal and regulatory frameworks for diaspora bonds and remittance securitization • Develop banking links with destination countries for Lebanese expatriates
	• Support SMEs and entrepreneurs	• Improve the legal and institutional framework for SME policies • Make access to public procurement opportunities easier for SMEs • Support SMEs in the services sector, especially internationalisation efforts • Tackle informality

Country Case Study 2:

LIBYA

Libya is an upper-middle income country with significant hydrocarbon production, revenues and reserves. However, the rentier nature of the Libyan economy means that the state is the main source of income and wealth, while society lacks cohesion.

The Libyan economy faces many challenges. First, the economic structural settings prior to 2011 already made the country economically fragile, starting with the overdependence on hydrocarbons and public sector employment – hydrocarbons represented 65% of GDP, 96% of the government budget revenue, and 95% of exports (IMF, 2013). The legacy of the socialist-rentier model – in 2012, 85% of the labour force worked in the public sector (World Bank, 2015) – still translates today in a meagre formal private sector, which accounts for 5% of GDP and 14% of employment (Schneider et al, 2010). Furthermore, the country lacked institutions, making even more difficult to design, approve or implement any policy.

Second, the 2011 revolution and relapse into conflict in 2014, have had a devastating impact on the economy making the situation severely fragile. Fighting over oil facilities drastically decreased oil production –from 1.42 millions of barrels per day in 2014 to 0.39 in 2016 (IMF, 2018b) – and damaged refining and exporting facilities.[8] Other effects from the conflict including infrastructure loss, and the paralysis of the banking sector, have led to the halving of income levels – dropping from USD 46.9 billion in 2014 to USD 17.2 billion in 2015 – and a drastic decline in public service delivery.

Economic diversification should be the long-term goal for Libya, but recovery and reconstruction will inevitably take precedence. These two need not be excluding or contradictory. Short-term measures for the immediate recovery should be guided by the goals for the future. International donors should buy into this approach in order to provide constructive support.

Although a political solution is needed, it is necessary to adopt measures in the meantime that prevent the country's economic collapse. The lack of institutions –and the implementation and absorptive capacities– will also limit the breadth of policies that can be adopted in the immediate. That makes sequencing particularly important, as well as capacity-building. This case study first looks at current drivers of fragility in Libya, to then focus on potential priorities to build a resilient economy.

[8] The data for 2014 (oil production and GDP) is an average for the period 2000-2014.

1. Drivers of fragility

Libya is among the 58 contexts considered fragile in the 2018 *States of Fragility* report, with particularly high levels of fragility on the economic and security dimensions (Table 2and Figure 6). Security is the most worrisome dimension, with high risks and low coping capacities, placing it in the top ten countries on the 2017 Global Terrorism Index. Libya has very little control over its territory as well as low government effectiveness. On economic fragility, when compared to the average fragile context, Libya shows weaker GDP growth rate, higher unemployment and heavier reliance on resource rent.[9] The country's indicators on women in labour force and regulatory quality are far below average.

Table 2. Libya's faces particularly high levels of economic and security fragility

Libya's scores on the OECD's fragility framework

Dimensional fragility levels (1 = Severe fragility; 5 = Minor fragility)				
Economic	Environmental	Societal	Political	Security
1	3	2	2	1

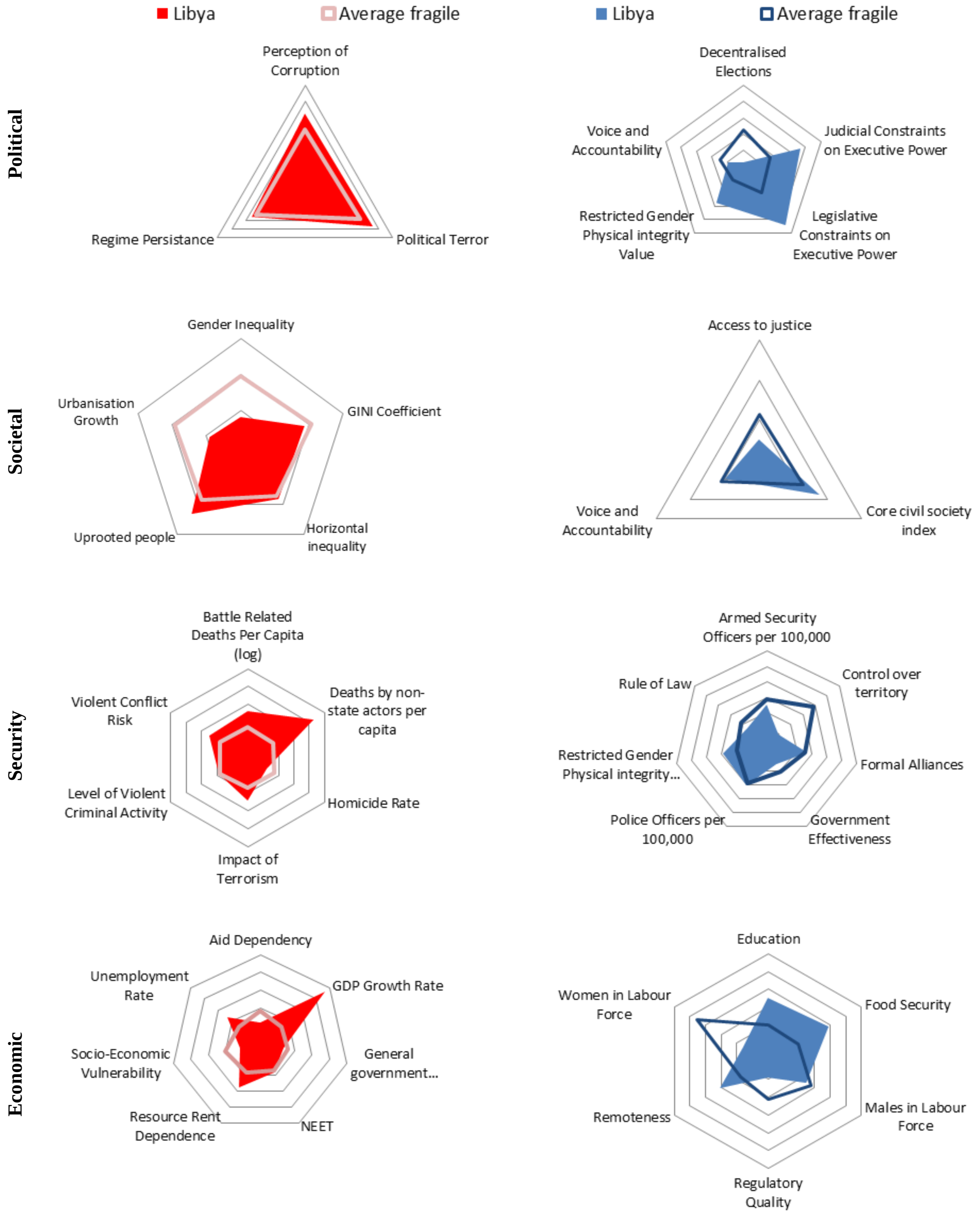
Source: *States of Fragility 2018*.

On political fragility, Libya scores low on the regime persistence indicator reflecting the country's current transitionary phase. Libya also shows the worst possible score on the political terror indicator which captures state-sanctioned killings, torture, disappearances and political imprisonment. On the perception of corruption indicator, Libya was the fifth worst performing country in the world after Somalia, South Sudan, North Korea and Syria. The country also scores low on voice and accountability which measures processes for channelling grievances and participation in the political sphere.

Libya shows high vulnerabilities to risks affecting societal cohesion that stem from inequalities and social cleavages. Coping capacities such as functioning of the state as well as informal mechanisms within a community or society are weak. Libya's high levels of societal risks are mostly consequences of a large number of uprooted people. Libya also has a high level of horizontal inequality, measured by how different social groups enjoy similar levels of civil liberties, including access to justice, private property rights, freedom of movement and freedom from forced labour. Neither urbanization growth nor gender inequality represent important risk factors in Libya.

[9] Education and food security scores reflect the pre-war situation because of the lack of recent data available. Information on the Gini index of economic inequality was not available for Libya.

Figure 6. Libya's risks and coping capacities compared to other fragile contexts



Note: Variables have been standardized, i.e. they are set on the same scale. No data is available for restricted gender physical integrity value, so it was estimated. The left figures display risks compared to average fragile countries. Items outside the average represents a higher risk than the average fragile countries. The right figures represent coping capacities compared to the average fragile countries. Areas outside the average form represents better coping capacities than average.

Political Fragility

Historical fragmentation and the legacy of Gaddafi resulted in weak national institutions. Gaddafi based his rule on three of the country's largest tribes, giving them control over all key positions in the armed forces, police and intelligence service. By 2011, Libya had no political alliances, network of economic associations or national organisations, including basic forces of law and order. The government is not in capacity to arbitrate disagreements equitably among all actors, tribes and armed militias with disparate interests. The Central Bank and National Oil Company are basically the only functioning institutions.

A chaotic political transition has delayed peace and provided ground for different armed groups. After the war, two authorities claimed governance of Libya: the House of Representatives and the General National Congress (GNC) in Tripoli. The GNC was elected in 2012 with the mandate of forming a constituent assembly to write a new constitution, but was forced to relocate to Tobruk in the East. The UN brokered a cease-fire in December 2015 between the main factions leading to the formation of the Government of National Accord (GNA), but it has not been endorsed by the House of Representatives. In addition, smaller rival groups compete and control parts of the territory.

An attempt to hold presidential and parliamentarian elections by the end of 2018 has been postponed. Current international attempts to break the political gridlock are focusing on the organisation of new election, but this will be a delicate process potentially increasing tensions. The UN Special Envoy for Libya is calling for a national conference in early 2019 preceding any call to the ballot box. The international community is encouraging competing Libyan factions to come together to produce a constitution and election laws, which are crucial steps before elections are held as they could establish conditions for a more credible and less violent election process.

Numerous international sanctions have been imposed, targeting key persons and sectors in Libya. The UN, EU and US have imposed several sanctions on Libya since 2011 targeting illicit crude oil exports, setting arms embargos that include "dual use" goods, imposing travel restrictions, prohibiting certain transactions and requiring member countries to freeze the assets of entities and various individuals involved in trafficking.

Societal Fragility

Libya's society is organised along tribal loyalties, with a limited sense of nationhood. Libya was historically administered as separate territories or city states. The country has about 140 tribes and some 30 influential large families with the majority of Libyans relying on their tribal connections for most aspects of their lives, from security to economic welfare. National identity has not transcended regional and tribal affiliations.

The sharp decline in oil exports since 2011 has severely impacted public services and increased poverty levels and inequality. Libya's rentier economy allowed for the state to provide generous fuel and food and basic services such as health and education. The current crisis broke this model, with erratic power supply and recurrent food shortages the new norm. A large share of the population is now either vulnerable to poverty or has fallen into it – a situation exacerbated by cumulative inflation and expanding black markets.

Violence continues to have a devastating impact on access to health, education, and justice. Medical facilities are bombed or looted and medical personnel targeted, attacked and even taken hostage or arbitrarily detained. Over 20% of primary health care facilities are closed and the rest are not well ready for service delivery (WHO, 2017). The health needs of the 217 000 IDPs, refugees and migrants have increased. Many public schools are being used as shelters for internally displaced families and it is estimated in Benghazi that more than half of all school buildings have been damaged or completely destroyed. The justice sector is dysfunctional due to the volatile security environment, the lack of government effective control over detention facilities, continuing mass arbitrary detentions and torture committed mainly by militias, the passing of abusive or politically motivated laws, as well as judicial killings during the transition period (Salah, 2014).

Security Fragility

After the war in 2011, armed brigades proliferation resulted in exacerbated violence. Armed groups and brigades, refusing to disarm, have contributed directly to the onset of the second conflict. Those brigades are motivated by a blend of self-defence, status, criminality or political aims. The GNA struggles to exert control over territory held by rival factions, as geographical and political divisions between the East, West and South increase. Across Libya, security remains the major fear for families and explains why many refuse to send their children to school. Widespread insecurity is also having a major impact on the Libyan economy. Pervasive insecurity is compounded by the widespread availability of small arms and light weapons.

The lack of central security forces in large ungoverned spaces helped create a haven for terrorism groups. As in other crisis contexts, insecurity has created a pull factor leading to the recruitment of youth engaging in ISIS's jihadist activities. Libya is a major transit route and training ground for ISIS.

Economic Fragility

The economy is overly dependent on hydrocarbons, which have become an object of fighting between the different factions. Libya's economy is almost entirely dependent on crude oil, gold and gas exports. Import revenues decreased sharply as the country plunged into civil war and world oil prices dropped. The non-hydrocarbon sectors remain stagnant except for pre-revolution real estate projects, showing the lack of diversification of Libya's economy. In early 2015, armed conflict between rival forces for control of the country's largest oil terminals caused a decline in Libyan crude oil production, which never recovered to more than one-third of the average pre-revolution rate. Arrangements between the conflicting parties allowed the oil sector to increase production in 2017, but this doesn't represent a structural economic improvement. Extremists affiliated with the Islamic State of Iraq and the Levant (ISIL) have a presence in many cities across Libya including near oil infrastructure, threatening future government revenues from oil and gas.

Large public workforce and subsidies drain public resources. The Central Bank of Libya continues to pay public wages (36.4 % of GDP) and to fund subsidies for fuel and food (9.2 % of GDP). The public payroll was used as a stabilising instrument in a context of multi-factional conflict, and has consequently increased. With low revenues, this has increased the deficit, estimated around 26% in 2017. The deficit is being financed mainly through cash advances from the Central Bank of Libya and issuing government bonds in the East. Consequently, at the current pace of spending, Libya will either exhaust foreign exchange reserves or be forced to make emergency financial adjustments.

Infrastructure investment needs are massive. Due to decades of isolation, economic sanctions and neglect, Libya's infrastructure was in a poor state even before 2011 and has only deteriorated since then. The country suffers from widespread power cuts in its largest cities. Living conditions, including access to clean drinking water and medical services, have all declined.

High unemployment rate, but inadequate labour market. Libya's private sector faces many constraints, hampering both its development and growth potential. Limited opportunities exist for integrating youth and ex-combatants into a labour market that needs a complete revamp, shifting from a subsidised public sector model to a market economy, for which the labour force is not ready. Youth unemployment rate stands at approximately 48% in Libya. About 85% of Libya's active labour force is employed in the public sector, a high rate even by regional standards (Elgazzar et al, 2015). Employment in industry (largely the oil sector) and agriculture accounts for only 10% of the labour force.[10]

Dependency on food imports coupled with barriers to trade threaten food security. The hot and dusty climatic condition in most parts of Libya do not favour agriculture, which has never been given a priority. Agriculture is irrigated, putting a strain on very scarce water resources. As a result, Libya's agricultural production does not feed its population making the country a net food importer. But Libyan waters and ports are considered high risk by merchant shipping, and food imports have dropped. Food prices in Libya also rose due to higher insurance costs or more expensive and dangerous overland deliveries via Tunisia and Egypt. Moreover few banks are willing to issue letters of credits due to late payments.

Environmental Fragility

Libya is water insecure and quickly depleting its water resources. Annual rainfall is low even in the most arable areas of Libya. The depletion of underground water is a major environmental concern for Libya. Overuse in agricultural developments is causing salinity and sea-water penetration into the coastal aquifers. The Great Manmade River, a network of pipes that supplies water to the Sahara from the Nubian Sandstone fossil aquifer system is the world's largest irrigation project but taps into a finite fossil water reserves. In fact, 95% of Libyan water comes from groundwater and 2.3% from surface water, less than 1% from desalination plants. Before the crisis, Libya was considering importing water from Turkey and Gabon.

Water pollution and desertification of fertile areas are a significant environmental problem in Libya. Environmental law is not respected. The combined impact of sewage, oil waste products, and industrial waste threatens the coast and the Mediterranean Sea generally. The desertification of existing fertile areas is being combated by the planting of trees as windbreaks. Before the crisis, the Libyan government planted more than 200 million seedlings in western Libya as an effort to prevent further soil erosion and desertification.

[10] The latest official figures are from 2012. However, ILO/World Bank modelled estimates show relevant trends persisting in 2017.

2. Levers for economic resilience

Moving from fragility into stability in Libya will involve tackling many fronts, therefore prioritising will be a prerequisite. Libya has to address a double challenge: halting an acute economic crisis, and transforming its economic model. This section outlines some priority areas for the government to develop a comprehensive vision that can address such challenges (See summary in Table 3).

2.1. Building a new social contract and ensuring inclusion

Libya has to develop a new economic vision for the country. This will entail engaging in a consultation process across society. Also, the transformation of the system should take into consideration those groups that are more vulnerable, and how can social safety nets be reproduced without depending on public sector jobs or on subsidised goods and services.

- **Set the foundations for inclusive dialogue:** The economic transformation needed in Libya will require to renegotiate a new social contract. The main challenge will be to develop an institutional framework almost from scratch that has the capacity to bring the different groups of the population without the tradition of doing so.
    - <u>Establish the basis for social dialogue:</u> Given the depth of changes expected and the weakness of state institutions, establishing a legitimate process for dialogue will not be automatic. Such process has to take into account the tribal structures of Libya's society, and ensure regional representation.
    - <u>Create a platform for Public-private dialogue (PPD)</u>: Public-private dialogue in particular should also be promoted. But again, reliable parties are needed in order to have any sort of dialogue. Although there are many business organisations in Libya, they are fragmented and have varying degrees of representation. Libya followed the model of Anglo-Saxon countries, in which chambers of commerce are the principal organisation representing the private sector, as opposed to the French model, were employers organisations play a more prominent role.
- **Address the needs of vulnerable sectors and groups**: The lack of social cohesion, regional disparities, low integration of women in the economy, and a large number of youth engaged in combatting activities are major issues that have to be address in order to develop an inclusive economic model.
    - <u>Reduce regional disparities</u>: Although Libya's population is fairly homogeneous in terms of religion or ethnic groups, there is little social cohesion between the different tribes. The current conflict can be interpreted as a fight to control resources, and there is an important tribal and geographical dimension to such fight.

      In order to be sustainable, a political agreement should be reached addressing regional needs with some level of decentralisation, including the necessary resource allocation. Development plans and infrastructure projects could be developed to provide economic opportunities in marginalised areas. Integrating the southern regions will also be essential to curb illicit trade routes.

- Address the needs of demobilised militia members**:** Integrating militias will be a critical challenge in the coming years, and a multi-dimension strategy should be developed. About 300,000 Libyans are estimated to have joined some sort of combatant organisations, most of them males (Elgazzali, 2015). Many of them were already unemployed.

  To some extent, militias should be integrated within the state's security forces. But also, many former militias would prefer to have a job in another field. Developing vocational training programmes to upgrade skills can support integrating former combatants into the labour market. But given that one of the barriers is precisely the lack of available jobs, cash-for-work programmes can be helpful in the short-term, supporting on-the-job training as well.

- Empower women economically**:** Gender inequality is hampering growth. Although literacy and education gaps have decreased over the past decades, large disparities persist regarding the integration in the labour market. Women account for about 4.2% of all self-employed and employers, and only about 34% of the employed labour force, where they are mainly in public sector jobs – in 2013, 91% of working women were employed in the public sector (OECD, 2017). Additionally, unemployment rates for young females reached 69% in 2014.

  The lack of resources and basic rights limits women's potential to enter the labour market or to become entrepreneurs. This includes restrictions on mobility, property and inheritance rights, and access to credit. Over half of currently or formerly married women do not personally have financial savings, 64% do not own items of high value, such as a car or jewellery, and only 12% own land or an apartment (Abdul-Latif, 2013). This suggests that women are severely disadvantaged in terms of starting their own businesses and being able to pledge collateral for financing.

2.2. Ensuring sound fiscal and macro-economic conditions

Given the depth of the transformation needed, the weakness of institutions, and ongoing volatile context, domestic public finance reform needs to follow phased approach. International public finance should be used catalytically to encourage these reforms, provide technical assistance where needed, bring in knowledge and lessons from other contexts, and monitoring progress. There may also be an opportunity for conditional approaches – perhaps around the potential lifting of sanctions on the Libyan Investment Authority (LIA).

- **Address the cash-crisis and avert a deep macroeconomic crisis:** In the short-term, the priority in Libya should be to stabilise the economy and avoid a situation in which the government exhausts its reserves and faces full collapse. Protecting key institutions and having access to additional resources could be part of the first steps.
  - Protect institutions critical to macroeconomic and financial management: Although policymakers cannot control the duration or resolution of the conflict, measures can be taken to mitigate the economic impact. Libyan authorities should protect the institutions most relevant for macroeconomic management. The National Oil Corporation should be kept as one entity, the Central Bank and finance ministries should be unified. Additionally, the exchange rate should be devalued to stabilise macroeconomic and financial developments (IMF, 2018b).

- Unlock and enable management of the sovereign wealth fund: A great share of Gaddafi's wealth in Europe was frozen. The interest from those funds goes to accounts belonging to the Libyan Investment Authority (LIA), the country's sovereign wealth fund, which was founded in 2006. LIA is Africa's largest sovereign wealth fund, with $56 billion before the 2011 revolution; but the actual value may be much lower, due to losses stemming from the inability to actively manage frozen equity and bond investments. Control over the LIA is an essential element of the war between rival claimants in Libya. While contested, the LIA is managed by the Government of National Accord (GNA).

- **Increase domestic revenues and improve domestic spending:** Domestic public finance is currently playing a key role in "buying" short-term stability in Libya through fuel subsidies and public service salaries. However, this model is unsustainable and needs to be reformed going forward – for both economic and political reasons. In the longer term, the aim should be to diversify the taxation base, and rebalance the budget between current costs and capital investments.

  - Support tax collection capacity: In 2015, Libya's tax revenues represented 1% of GDP, the lowest rate among fragile economies analyses by the States of Fragility report (OECD, 2018a). This is not surprising given that the previous social contract followed the model of rentier states where in fact there is no tax collection as the government relies on rents from resources. In the medium to long-term, the government of Libya should develop the capacity to mobilise revenues from other sources, including from tax collection on households and firms.

    Tax collection requires institutions and experts with the necessary know-how and capacity, for which initiatives like Tax Inspectors Without Borders (TIWB) can be useful in terms of capacity building and short-term results. Information systems are also fundamental, from the capacity to gather data from taxpayers, to pooling information from different parts of government to having international agreements to track flows beyond the national borders. Instruments like the Base erosion and profit shifting (BEPS), the Automatic exchange of information (AEOI) standard, or the *Revenue Statistics in Africa* could be applicable in Libya.

    These efforts should be connected to overall statistics and data collection strategies, such as the ongoing work carried out under the Paris 21 initiative to develop a National Strategy for Development of Statistics (NSDS) for Libya.

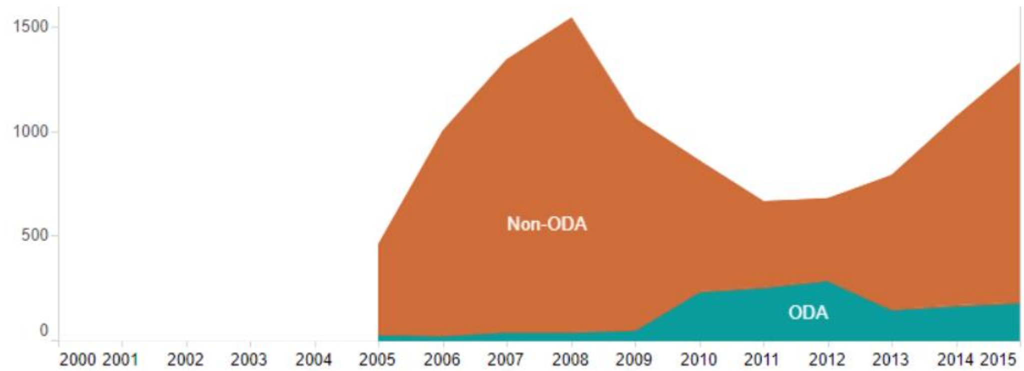
  - Plan a gradual transformation of the subsidies system: Energy and food subsidies are playing a key role in "buying" short-term stability in Libya. Although this model is unsustainable, subsidy reform will be extremely complex given the potential effects on households' welfare and poverty levels. Elimination of food subsidies would double the poverty rate while saving the equivalent of about 2% of the government budget (World Bank, 2015). The elimination of energy subsidies would have a larger effect on poverty, while government savings would be almost 4% of the budget.

    The government should develop a plan to gradually reduce subsidies, although in a progressive manner and analysing the potential effects product by product. Subsidy reform should also be accompanied by a more targeted cash-transfers system to compensate the most vulnerable.

- **Better target official development assistance (ODA):** When looking at external inflows to Libya coming from DAC countries, ODA accounts for less than 14%, of which 48% was humanitarian finance (Figure 7 and Figure 8). International public finance from DAC members is expected to remain relatively small, mostly ODA in the form of project-based grant finance, half of which is humanitarian. Given Libya's hydrocarbon revenues, there is likely little appetite for loan products, even if highly concessional.

ODA must therefore find a niche, based on its comparative advantage, while striving to be catalytic and focused on those most left behind. Given the context in Libya, ODA must also take into account the political economy and conflict sensitivity, looking especially at vested interest, influence and privileges.

Figure 7. Composition of external resources, 2000 – 2015



Note: ODA includes bilateral ODA and multilateral concessional flows. Non-ODA flows include: other developmental flows, officially-support export credits, FDI, other private flows at market terms and private grants. Adjusted gross disbursements, three-year moving average, USD million, 2015 constant prices.
Source: OECD DAC Statistics. Accessed on November 2018.

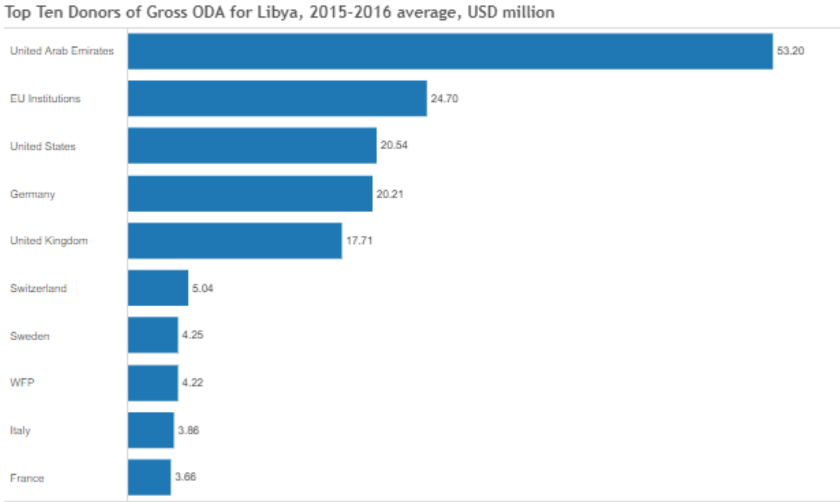
Figure 8. ODA flows to Libya

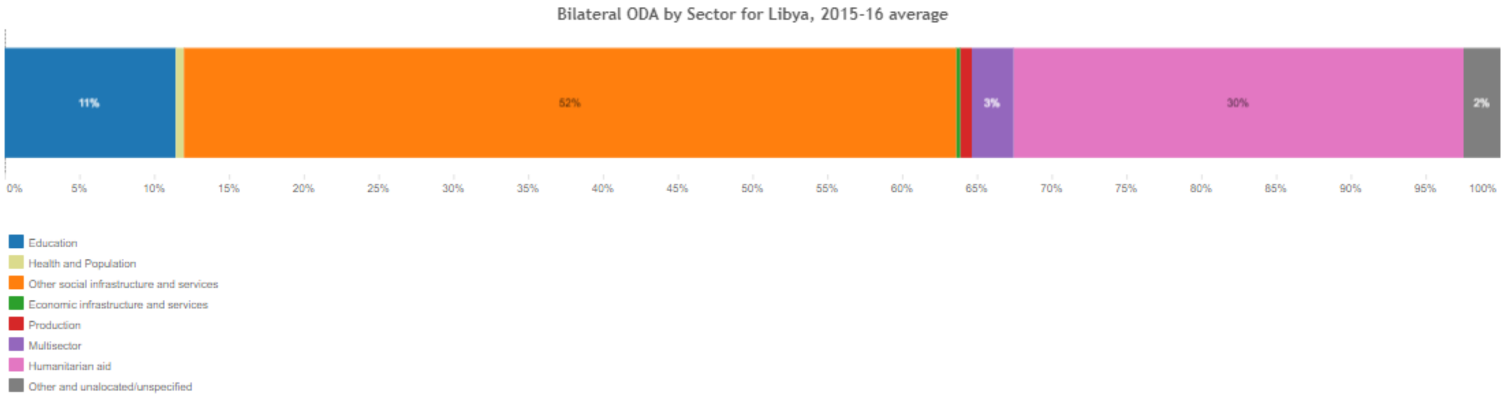
Receipts for Libya

	2014	2015	2016
Net ODA (USD million)	210.3	157.4	179.5
Gross ODA (USD million)	211.1	157.5	181.7
Bilateral share (gross ODA) (%)	78.8	81.0	81.3
Total net receipts (USD million)	1,174.4	418.2	-601.1

For reference

	2014	2015	2016
Population (million)	6.20411	6.23496	6.29325





Source: OECD-DAC: http://www.oecd.org/dac/financing-sustainable-development/development-finance-data/aid-at-a-glance.htm

2.3. Promoting private sector development

Given that Libya is a middle income country and counts on many resources, the main objective should be to support the country gain stability and control over them. While support to reconstruction and stability may initially involve international public flows, especially ODA, the aim is for Libya to eventually finance its own development and stability from domestic resources, a diversified and growing private sector, and eventually international investments.

- **Improve the framework conditions to attract international investment:** Although Libya is far from being an easy destination for investors to come, the government can developed a multipronged strategy to improve the basic conditions and to outreach to risk-tolerant investors. Some of these measures can include improving the investment legal and institutional framework, tailoring investment promotion policies, addressing key infrastructure bottlenecks, or promoting transparency and integrity practices.
    - Improve the Investment legislation: Besides the many risks faced by investors regarding the security and political conditions, Libya's legal framework has many deficiencies that can deter investors including restrictions to foreign investors, lack of enforcement of guarantees, and complex system of incentives.

      Libya adopted a new investment law in 2010 replacing the previous foreign investment laws.[11] This new law lifted many FDI *restrictions* and introduced a number of investors' guarantees.[12] But the law leaves some decisions and rulings regarding the extension, suspension or halting of foreign projects to the discretion of the minister of economy. Additionally, foreign investors face two key restrictions. In case of a joint venture, foreign equity participation is limited to 49% of the company capital, down from the 65% threshold that applied before 2012. Furthermore, in 2013, the government issued a decree that prohibits foreign investors from establishing joint ventures in the form of a Limited Liability Company. As a consequence, the only company form for a foreign investor involved in a joint venture with a Libyan entity is the Joint Stock Company form.

      If a foreign investor seeks full ownership, a minimum capital requirement of five millions Libyan dinars is imposed (3.6 USD million).[13] Discriminatory application of minimum capital requirements between foreign and domestic investors is an exception in international practice, and the Libyan requirement is much higher than in countries where it also exists, such as China, Indonesia, India and Russia.[14]

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[11] Encouragement of both National and Foreign Investment Law No. 9 of 2010.

[12] One of the main benefits included in the law is the provision of legislative protection against unlawful nationalisation and expropriation.

[13] The capital includes all investments made, including the real estate acquired. Meanwhile, foreign investors can still invest in Libya below this threshold, provided that their investment is not regulated by the provision of the 2010 Investment Law.

[14] The Investment Law also requires 30% of workers to be Libyan nationals and receive training. Foreign investors are still prevented from owning land and property in Libya and are allowed only the temporary use of real estate.

The 2010 Investment Law provides a series of *incentives*.[15] However, there many laws and institutions offering incentives to businesses, which weakens the level of transparency of the Libyan investment framework and in turn increases risks of bribery. The lack of consistency between the provisions of various investment-related laws sends conflicting and contradictory messages to investors.

The law contains a set of investment *guarantees* that meet international standards, although the vagueness of the drafting might lead to some legal insecurity. The law also gives access to investor-state dispute settlement (ISDS), which is an acute issue in Libya, given the large number of cases brought by foreign investors since 2011. Despite a de jure openness to international arbitration, there is an issue of recognition and enforcement by local Libyan courts of foreign arbitral awards that de facto undermines investor's access to ISDS mechanisms.

- Investment promotion and facilitation framework: Libya's Investment Promotion Agency (IPA), the Libya Privatization and Investment Board (LPIB), was created in the early 2000s to oversee and regulate foreign investment in the industrial sector. LPIB is mandated to promote inward investment, but it is also dealing with privatisation of companies – facing the privatisation of 111 state-owned enterprises. When it comes to investment promotion, LPIB essentially serves as a screening agency for foreign investors and its activity is limited to processing investment inquiries.[16]

  LPIB is operating without a budget since 2014 as a result of the country's political crisis. Not surprisingly, it has not been able to develop a national investment strategy, although it is mandated in the law. Also, LPIB is the only IPA in the MENA region whose board of directors does not include private sector representatives, although the composition of the board might be revised to include the chamber of commerce and industry.

- Attract remittances and investments from the diaspora**:** As a destination for foreign workers – both skilled and unskilled, mainly from the MENA region – Libya has been a net source of remittance outflows over the last 4 decades. There is no official data on remittances flows to Libya since 2006, when the value for personal remittances received amounted to USD 16 million – its highest value at the time – and when the stock of emigrants was estimated at 1.5% of the total Libyan population. In contrast, migrant workers in Libya sent out USD 914 million during the same year. Outflows peaked at USD 3 199 million in 2013 with the flight of people and capital during the country's civil unrest. Today, the total emigrant

[15] Such as tax and customs exemptions on equipment, a five-year income tax exemption, a tax exemption on re-invested profits and exemptions on production tax and export fees for goods produced for export markets. It also allows foreign investors to transfer net profits overseas, defer losses to future years, import necessary goods and hire foreign labour if local labour is unavailable. Foreign workers can acquire residency permits and entry/re-entry visas, renewable for five years, and transfer earnings overseas.

[16] LPIB also provides single window services, which were established in 2013, through four sub-national offices around the country. Single windows offer a range of services, such as issuing licenses for entities registered under Law No. 9, processing customs duty and tax exemptions, approving project supplies and supervising labour contracts, including worker visas and residency permits.

population is estimated to be just under 3% and highly concentrated in high-income countries – about 60% of migrants are in OECD countries.

To rebuild the country, Libya needs to attract remittances and investments from its growing diaspora. The Libyan government could develop a strategy to engage its migrants through a national marketing campaign for rebuilding infrastructure. Additionally, the placement of enabling financial services and money wiring options will make it easier for Libyan expatriates to send cash home.

- Support infrastructure projects: Libya's infrastructure was in a poor state even before the 2011 revolution, and it has been extremely damaged since then (OECD, 2016). In 2011, over 80% of Libyan firms reported suffering from recurrent power outages resulting in productivity losses (World Bank, 2011). Roads, airports and ports have all been subject to intense fighting and substantial damages, and the use of air transportation has worsened for both firms and individuals. SMEs surveyed in 2014 reported disruptions along their supply chains due to the closure of seaports or airports, which affected their access to imported goods, petrol and raw materials and their ability to export their products (Calice et al., 2015).

  Infrastructure projects in Libya will require to have a minimum of security conditions, but risk mitigation tools will be essential to attract foreign investment. Regional multilateral banks should be leveraged and innovative approaches developed in order to enable the necessary project financing. Solid governance mechanisms and transparent procedures will be needed. Large infrastructure projects should also look to link international investments with local firms.

- Enable the private sector to have a responsible business conduct: Libya has ratified 7 of 9 core international human rights instruments and is a signatory to one additional one (UN OHCHR, 2017 b-c).[17] Libya has also ratified 29 ILO Conventions, including the eight fundamental Conventions and two out of four priority Governance Conventions (ILO, 2017a). However, reliable information on RBC policies and initiatives is not readily available.

  Libya could adhere to the OECD Guidelines for Multinational Enterprises, which are recommendations addressed by governments to multinational enterprises. Given Libya's hydrocarbon resources, the government cdould adopt tools that enable a responsible business conduct by foreign and local companies. To address the challenges raised when engaging with stakeholders, the OECD has developed a guidance for practitioners in the mining, oil and gas industries: OECD Due Diligence Guidance for Meaningful Stakeholder Engagement in the Extractive Sector. The guidance provides a practical framework for identifying and managing risks with regard to stakeholder engagement activities to ensure companies play a role in avoiding and addressing adverse impacts as defined in the OECD Guidelines for Multinational Enterprises.

  The Libyan government could also benefit from initiatives that enable transparency in the management of its hydrocarbon resources. The Extractive Industries Transparency Initiative (EITI) is the global standard to promote the open and accountable management of oil, gas and mineral resources.

[17] Libya is a signatory to the Convention on the Rights of Persons with Disabilities; however, no action has been taken on the Convention for the Protection of all Persons from Enforced Disappearance.

- **Support SMEs and entrepreneurs:** Stimulating growth of the domestic private sector will help to diversify the economy, improve macroeconomic stability, and reduce pressure on the state for wealth and income, thus diminishing political instability, and the risk of violence. A revitalised domestic private sector could also provide jobs and economic opportunities for former combatants, and provide an alternative source of opportunity for people engaged in the parallel migration-related economy, reducing the incentives to be involved in illegal smuggling activities.
    - Improve the legal and institutional framework for SME policies: SME and entrepreneurship policies in Libya are relatively new. Since 2006 Economic Development Strategy included SME promotion as an objective to diversify the economy, several developments have taken place including the creation of an SME agency, Libya Enterprise, and several attempts – although unsuccessful – to develop an SME strategy. In 2017, a Short-term Action Plan for SME Policies was endorsed by 18 institutions as a mechanism to coordinate and share information among local and international organisations. However, much remains to be done.

      One of the most critical aspects is the virtual freeze of public institutions in charge critical administrative procedures. Since 2011, the one-stop shops for firm registration were closed, as well as the land cadastre and property transfers, or the issuing of construction licenses. This makes it technically impossible for firms to fully comply with regulation and to be "formal". In the short-term, these institutions and agencies should be reactivated and measures will be needed to address activity occurred since 2011 – for instance, legalising constructions taking place since then.
    - Provide alternatives sources of access to finance: With one of the least developed financial markets in the world, Libya is affected by a severe cash crisis that constrains everyday activities to all citizens, let alone entrepreneurs or businesses, who cannot even freely disposed of their own deposits. Stringent limits to cash withdrawals, limited access to international financial markets, and reduced use of credit cards, makes speaking of access to credit is a strong understatement. Unless the macro-level issues affecting the financial system are dealt with, there will continue to be little finance available for firms and start-ups.

      At the meso/micro level, much can be done building on to support SMEs access to finance. Among other ongoing initiatives, a new microfinance facility was recently created, and the National Guarantee Fund is being reactivated to encourage the banks to issue loans to SMEs.[18] These efforts should be scaled up in order to have a meaningful impact.

      In the medium-term, institutional and regulatory reforms will be necessary to provide an enabling framework for SME finance in Libya, including establishing a credit registry or bureau to share information, adopting legislation on secured transactions – in accordance with the existing laws including the Islamic banking law –, and eventually establishing a collateral registry for moveable assets.
    - Make access to public procurement opportunities easier for SMEs: In the prospect of large reconstruction projects, an effort must be done to allow SMEs to reap some opportunities. This will not be an easy task given the lack of competitive local

[18] Both initiatives are implemented by Expertise France under the EU-funded project Support to Libya for Economic Integration, Diversification and Sustainable Development (SLEiDSE).

firms, but some support can be provided. On one hand, the legal framework should be reviewed to make sure that SMEs do not face regulatory hurdles. Specific skills upgrading programmes can be developed targeting the sectors that could offer the most potential.

- **Addressing the war economy system**: The lack of control of the state has led to the collapse of whatever formal economic activities and institutions existed. Illicit and informal activities are the norm, with a system of incentives that will be very difficult to address.

    - Reduce illicit activities**:** Human and fuel smuggling are prevalent in Libya, especially in the South and in the West, where the state has less control over the territory. Fuel subsidies makes oil smuggling highly lucrative- the business is estimated to be worth up to USD 2 billion per year (Gazzini, 2017). Due to a de facto open border with Niger, the South-West region is the entry point for the majority of sub-Saharan African migrants. Since 2013, Libya has witnessed a significant increase in smuggling and trafficking of migrants, which could amount to almost USD 1 billion (Eaton, 2018).

      Reducing illicit activities will require addressing the existing system of incentives, especially given that they tend to concentrate in areas with few alternative economic opportunities. Measures need to engage local leaders to obtain their buy-in and take into account the dynamic underlying the current war economy in place.

      ODA, and whole-of-government approaches, could also help tackle illicit financial flows targeting the laundering process. Interpol and Europol believe that laundering often takes place in Europe, with smugglers purchasing legal enterprises such as car dealerships, grocery shops, restaurants and transport companies, and then using these businesses to launder illicit funds, which are in turn invested in real estate, high value goods and legal businesses. Focusing on recovering some of these illicitly obtained assets and using the recovered funds to invest in the Libyan domestic private sector could be useful.

    - Tackle informality: Another critical issue hampering the economy is the prevalence of informality, which hinders productivity and growth of informal operations, and poses unfair competition to those who try to comply with regulations. The prevalence of informality in Libya is closely related to the low capacity of the government, as firms cannot expect to receive much in terms of services. At the same time, there is a critical issue of rule of law: the government is not only unable to enforce regulations, but in some cases it does not even have its licensing or registration instances operating.

      Tackling informality will require reactivating administrative services, launching a formalisation campaign and raising awareness among business of the potential benefits/sanctions.

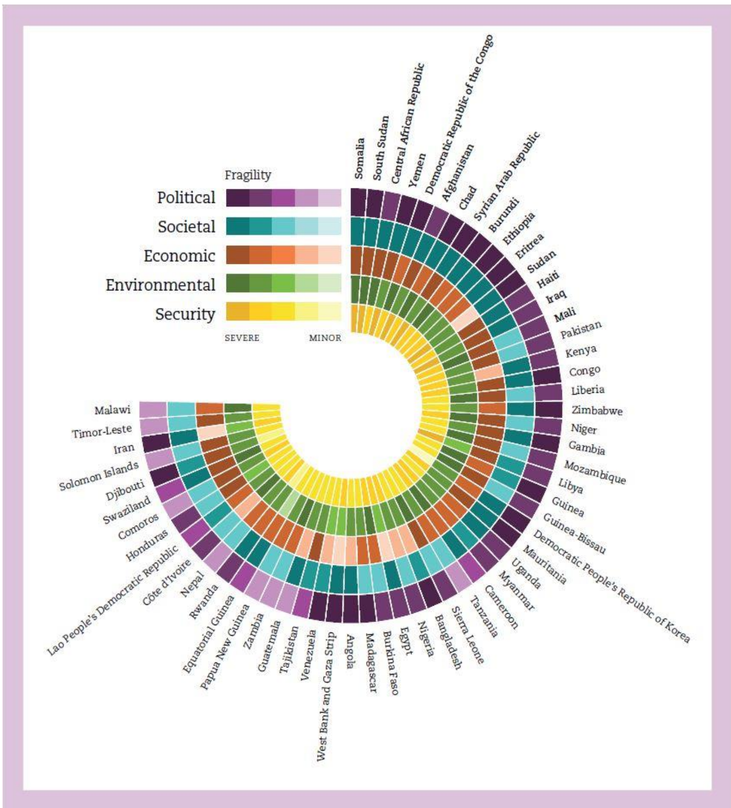
Table 3. Summary of policy tools – Libya

Objective	Policy area	Policy tools
Building a new social contract and ensuring inclusion	• Set the foundations for inclusive dialogue	• Establish the basis for social dialogue • Create a platform for PPD
	• Address the needs of vulnerable sectors and groups	• Reduce regional disparities • Address the needs of demobilised militia members • Empower women economically
Ensuring sound fiscal and macro-economic conditions	• Address the cash-crisis and avert a deep macroeconomic crisis	• Protect institutions critical to macroeconomic and financial management • Unlock and enable management of the sovereign wealth fund
	• Increase domestic revenues and improve domestic spending	• Support tax collection capacity • Plan a gradual transformation of the subsidies system
	• Better target official development assistance	• Use ODA for transfer of know-how and as catalytic for reforms
Promoting private sector development	• Improve the framework conditions to attract international investment	• Improve the Investment legislation • Investment promotion and facilitation framework • Attract remittances and investments from the diaspora • Support infrastructure projects • Enable the private sector to have a responsible business conduct
	• Support SMEs and entrepreneurs	• Improve the legal and institutional framework for SME policies • Provide alternatives sources of access to finance • Make access to public procurement opportunities easier for SMEs
	• Addressing the war economy system	• Reduce illicit activities • Tackle informality

Annex – States of Fragility 2018 list of countries

Fragile
Pakistan
Kenya
Congo
Liberia
Zimbabwe
Niger
Gambia
Mozambique
Libya
Guinea
Guinea-Bissau
Democratic People's Republic of Korea
Mauritania
Uganda
Myanmar
Cameroon
Tanzania
Sierra Leone
Bangladesh
Nigeria
Egypt
Burkina Faso
Madagascar
Angola
West Bank and Gaza Strip
Venezuela
Tajikistan
Guatemala
Zambia
Papua New Guinea
Equatorial Guinea
Rwanda
Nepal
Côte D'Ivoire
Lao People's Democratic Republic
Honduras
Comoros
Swaziland
Djibouti
Solomon Islands
Iran
Timor-Leste
Malawi

Extremely fragile
Somalia
South Sudan
Central African Republic
Yemen
Democratic Republic of the Congo
Afghanistan
Chad
Syrian Arab Republic
Burundi
Ethiopia
Eritrea
Sudan
Haiti
Iraq
Mali



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