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Policy Brief

Industrial Manufacturing

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This policy brief is part of a series of nine sectoral studies developed by the Lebanese Center for Policy Studies (LCPS). The lead author of this series is Senior Economic Researcher Lina Maddah, with the contribution of Executive Magazine. The aim of this series of briefs is to examine the impact of Lebanon's economic crises on key economic sectors and present recommendations that can assist with private sector recovery. This series was developed with the support and contribution of the Lebanese Private Sector Network (LPSN) and in collaboration with Executive Magazine.

Sector Overview

In 2015, the Industrial Manufacturing sector generated $8.8 billion in total revenue or roughly 17 percent of Lebanon's GDP. But the story starts around a century and a half earlier. The origins of industrial manufacturers in Lebanon reach back to the mid-19th century. Involving linkages with European manufacturing supply chains for luxury fabrics, the industrial spinning of silk constituted a move towards a more developed industrial economy when compared with the previous, low-scale farming and processing of Mulberry trees and silkworms in the supply chain of French producers of silk and luxury fabrics. In those days, Lebanon's move from a small agricultural producer country into silk processing also provided decisive transformation impulses towards a more productive national economy, in the form of maritime shipping houses, organized financial intermediaries (money dealers) and banks.

Using machinery and know-how imported from Europe, manufacturing expanded and intensified in the first half of the 20th century. However, the grand political shifts of the age, which on the Lebanese stage included but were not limited to World War I and II, were not conducive to imperial European – quasi-colonial but industry-supportive – infrastructure projects such as penetrating the Eastern Mediterranean region with railways from Istanbul. As the economically virgin territories around the Arabian Gulf in the days of the Cold War were increasingly attracting industrial ventures with their energy resources and embryonic markets, Lebanese industrialists proved a strong ability to set up in those markets, aided by cultural affinities and language. For a period, Beirut was a true singular hub in the economic and industrial development of the Arab West Asia region.

In the second half of the 20th century and the first decades of the 21st, Lebanon's orientation towards the growth of its services economy was for local manufacturers a detriment to the industrial sector. Lack of governmental support in areas such as provision of affordable electricity to their establishments were frequently cited by manufacturers as crippling disadvantages, along with, in regional comparison, high labor costs, slow transportation, cumbersome customs requirements, and insufficient legal protections of manufacturing industries. The insight that historically no high-performing services economy has been able to thrive in absence of a strong manufacturing industry, seemed lost on Lebanon's policy makers, at least in the country's post-conflict reconstruction and development years, which favored construction, banking, and other avenues of rentier in-come generation.

Lebanon entered the third decade of the 21st century with significant geographical, sectoral, and financial concentration of industrial market power. Agro-industrial food processors and manufacturers are the strongest sub sector in manufacturing (see figure 1). Five percent of the manufacturing firms generate 71 percent of the total industrial revenues. Geo-graphically, the religiously and communally diverse yet majority Christian Mount Lebanon governorate (which embraces the urban Beirut governorate from all sides but the sea) is home to three out of five manufacturing establishments with notable strengths in the sectors of agro-food and paper and packaging materials.[1] On the other hand, diverse ownership with a dual-ity of family-owned and small-to-micro businesses, and high complexity of manufacturing gave resilience to the country's economic fabric.

1 ALI Industrial Indicators, March 2017, https://ali.org.lb/indicators/ ali-indicators-march-2017/

2 ALI Industrial Indicators, March 2017, https://ali.org.lb/indicators/ ali-indicators-march-2017/

In 2015, 4 percent of the Lebanese labor force was employed in the manufacturing sector with an average individual annual income equal to $10,400 (higher than the 2015 average $7,800 GDP per capita).[2]

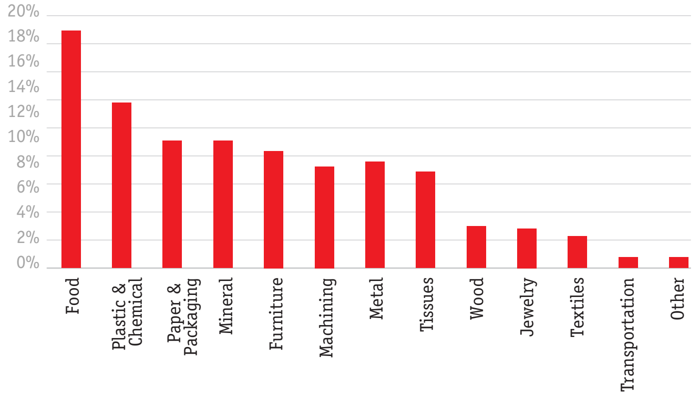
However, the industrial contribution to GDP has been given as significantly differing figures in different studies at different times. According to the government agency Investment Development Authority of Lebanon's (IDAL) report from 2019, the industrial sector contributed about 8 percent of the GDP ($4.2 billion), and employed about 318,000 people, or about 20 percent of the labor force. These figures above anything else cannot but lessen confidence in data if one notes that the 2015 data cited above differ from the 2019 IDAL report by a whopping eight percentage points in terms of GDP contribution. This data – which suggests a more than 50 percent lower cumulative revenue of the manufacturing industry in 2018 when compared with 2015 – stands opposed to a $5 billion reported increase in Lebanon's GDP (to nearly $55 billion).

Contextualized with pre-crisis economic developments, the shocking data divergence suggests the presence of either substantial changes in parameters and methodologies used in data evaluation or massive deficiencies in data col-lection. In the important area of employment data, the sup-posed data on the manufacturing headcount as share of the labor force vary by 16 percentage points between the two cited data sets.

In other numbers, around 4,700 industrial manufacturers were registered in 2019, among which 26 percent are agro-food processing firms, followed by construction materials (12 per-cent) and chemical products (8 percent). In 2015, the manufacturing sector's output was split between domestic consumption, which accounted for 83% of the total, and exports, which accounted for 17 percent of the total.[3]

3 Atallah, S. Ezzeddine, N. and Mourad J. (2019). Lebanon must develop an export strategy to create jobs. LCPS Policy Brief, https://www.lcps-leba-non.org / articles/details/2169/lebanon-must-develop-an-export-strategy-to-create-jobs

Figure 1 **The distribution of Lebanese manufacturers by the number of firms per specialty**



Source: Maddah, Maddah & Gharios (2023)[4], data adapted from ALI

4 https://api.lcps-lebanon.org/content/uploads/files/Policy-Brief-76-eng.pdf

This figure shows the distribution of Lebanese manufacturers on different specialties. The food and beverage industry has the largest number of firms followed by the chemical and plastic industries. The paper and packaging industry, the mineral, and the furniture industries come in at around 11 percent each. There is a significant drop when it comes to wood, jewelry, textiles, and transportation industries with the latter having the least, with only 2 percent of total Lebanese firms.

Challenges

Challenges confronting manufacturers seem in part rooted in policies that limited expansion of manufacturing when compared with the services economy over the past 50 years. This first occurred through disruptions of the flow of goods and lack of internal security, and then by policies that factually disincentivized industrial investments, by absence of capital markets and by disallowing competitive alignment of the currency with conditions governing export markets. In the crisis context of the early 2020s, the sector is being severely impacted by previously unseen problems, including a lack of liquidity, severe disruption of all financial trans-actions, constrained domestic purchase power and decreased consumption, worsened barriers to export, and crumbling infrastructures. The exacerbated set of challenges entails:

- Complicated licensing and permit processes (involving different ministries) limit the ease of doing business[5] and hinder the industrial sector's growth.
- Slow and costly customs procedures and logistical obstacles hamper industrial imports and exports.
- By comparison with most producer countries in the MENA region, the labor market pool is small and the cost of labor is high.
- The high cost of tapping into reliable energy sources surges manufacturing costs. Due to collapses and unpredictability in state electricity supply,

5 Lebanon's rank in the 2020 Ease of Doing Business report was 143 out of 190 countries

manufacturers have to allocate scarce resources to diesel generators (on which they relied previously as auxiliary sources of electricity) or/and solar energy installations that require high initial investment while still awaiting regulations under the Decentralized Renewable Energy Law that would optimally support decentralized power generation.

- The manufacturing sector is marked by high reliance on imported inputs, from machinery to raw materials. Price inflation in global markets, fluctuating cost of shipping, supply chain disruptions, and political sanctions or market closures pose outsized challenges.
- The liquidity crisis of 2019 and the protracted banking crisis of the following years has created particular challenges in external financing and increased transaction costs of industrial producers. Loss in export financing options and blocking of credit lines impacted all manufacturers, especially MSMEs. The cost of funding for imported inputs has also increased.
- Domestic pricing faces challenges of consumers' purchase power erosion on the back of currency depreciation and explosive inflation of Lebanese pound prices, inventory imbalances, and inefficiencies in local supply chains.
- Mismatches between training of youth for labor markets and needs of employers have worsened further in the crisis into labor shortages due to the emigration of skilled workers.
- Reduced efficiencies, living-cost related absences, and electricity-disruption related reductions in operating hours at various ministries and public administration units are disrupting business for industrialists on top of their production and labor challenges.
- Unequal passing of social obligations and sudden increases of tax and non-tax burdens on industrial producers by the state have boosted informality of work and enterprises, which distorts the economic playing field to the disadvantage of law-abiding manufacturers.

Opportunities

- Industrial production combines enormous potential for job growth with potentials to gradually improve the long-standing imbalance of external trade that is to the severe detriment of Lebanon.[6] The manufacturing industry, with its cumulative labor force of 195,000 (according to the most cited calculations), its job preservation achievements and contributions to GDP of recent years, has a pivotal role in shaping the future of the real economy. This has been highlighted during the economic crisis. Success stories of manufacturers and agro-industries in the 2020s have already been written in prevailing against pandemic-related international supply-chain shocks, conflict-induced wheat shortages, and domestic liquidity and financing problems. Industry can be a job creation motor for other sectors of the economy[7]. It can

6
USAID Lebanon Trade and Investment Facilitation (TIF) Activity: Sector Selection and Prioritization, October 2020 PA00X97M.pdf (usaid.gov)

7
'each job created in the industrial sector creates 2.5 jobs in other sectors' Industry: Its role and perspective in Lebanon's economic growth - Executive Magazine (executive-magazine.com)

leverage its recent successes by firming up commitments to digitization and creation of sustainable jobs in a digitized economy; it can commit to gender equity, Environmental, Social and Governance (ESG) standards, future-proof climate goals and today has a wide-open window for changing the narrative of the Lebanese economy.

- Industrialists have billions of dollars of untapped ex-porting potential in each of several industrial sectors, such as agro-food, pharmaceuticals, jewelry, clothes, furniture, leather, and electrical and industrial equipment.
- Young firms and startups are engines of job creation in Lebanon. Reflecting on a 2010 data report from the World Bank, micro startups – firms between 0 to 4 years of activity and with less than 4 workers – generated about 66,000 jobs in Lebanon between 2005 and 2010.[8] Due to emergence of important gaps in entrepreneurship ecosystems and dis-continuation of various acceleration programs, industry as a broad sector and through focuses on important verticals such as agro-industrial food processing, today has an opportunity to invest intangible resources (and tangible ones) and leverage untapped entrepreneurial potentials of startup entrepreneurs and young firms.

8 Chapter II in the complete 2014 World Bank Regional Report: 'Jobs or Privilege: Unleashing the Employment Potential of the Middle East and North Africa'

Policy Recommendations

1. Create a unified advocacy group in manufacturing to push for overdue legislation aligning with Sustainable Development Goals and global ESG practices. Develop an SDG-compliant vision and national strategy for the manufacturing industry, lobbying with the government to review and renegotiate trade agreements to protect Lebanese manufacturers. Incentivize eco-friendly practices with soft loans for adopting green energy, ensuring fair treatment of compliant manufacturers through equitable enforcement of regulations.
2. Attract investment in the manufacturing sector by pro-viding tax incentives, fast track licensing and permit processing, streamlining regulations and creating a one-stop shop for investors.
3. Develop comprehensive export strategies and provide market intelligence to help industrial manufacturers identify opportunities and overcome export barriers. Strengthen trade promotion agencies and provide targeted assistance to manufacturers to explore new markets, participate in trade fairs, and engage in export-oriented activities.
4. Assure governmental commitments to the creation of Special Economic Zones (SEZ) for industries and present SEZ projects that meet climate mitigation goals and financial standards promoted by, among others, the World Bank, International Finance Corporation, and the Bank for International Settlements, and/or that qualify for funding under programs such as the UN Green Climate Fund.

5. Improve and expand transportation networks, ports, and other logistics to enhance and facilitate the movement of goods.
6. Make efforts to recover or further increase support from the community of global donor countries and UN Organizations for development projects in promising industrial verticals and deserving locations such as design and crafting of furniture in North Lebanon.
7. As the industrial sector and as individual companies, pledge to the creation of a new, fairer and socially just economy in Lebanon in fulfillment of corporate responsibilities and in correction of structural weaknesses. Acknowledge and invest in new technologies and innovations, pursue proven benefits of a digital transition of industrial producers.
8. Partner with the public sector in a non-sectarian and merit-based, transparent public procurement culture, and facilitate collaborations between universities and industrialists in research, knowledge transfer, matching education and training programs with the needs of the sector, the achievement of higher education graduates' greater employability, protection of labor and human rights, and fair rewards in increasingly inclusive corporate cultures.

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About the Policy Brief
A Policy Brief is a short piece regularly published by LCPS that analyzes key political, economic, and social issues and provides policy recommendations to a wide audience of decision makers and the public at large.

About LCPS
Founded in 1989, the Lebanese Center for Policy Studies is an independently managed, non-partisan, non-profit, non-governmental think tank whose mission is to produce and advocate for policies that improve governance in Lebanon and the Arab region. LCPS's current research agenda focuses on: enhancing governance, informing the process of economic growth and sustainable development, promoting inclusive and effective social policies, and informing the development of policies for a sustainable environment. Four themes cut across the above areas of focus, including gender, youth, conflict resolution, and technology.

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