Lebanon: Pathways to Economic Recovery

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I. Introduction: Between Stimuli, Reform, and Restructuring

A fallacy that politicians often commit is the belief that relaxed budget rules, stimulus capital packages, and bigger deficits along with corresponding higher levels of debt, will eventually eliminate the need for the painful and long-delayed reforms that highly indebted countries so desperately need. In a more intrusive sense, cases of weak economic growth, retarded development, fragile rule of law, poor economic diversification, undermined competitiveness, and feeble infrastructure need to be examined profoundly. If necessary, such diagnosis needs to be fundamental enough so as to address all these barriers, not merely through reform, but also through restructuring[i]. In this sense, structural reforms imply changes to the way the government and the whole system work in order to achieve sustainable socioeconomic recovery[ii].

In this talk, I will highlight some of the obtrusive aspects of the current economic and financial situations on the global, regional, and Lebanese scenes, which have contributed to the current socioeconomic situation in Lebanon. Then, I will present the role of Banque Du Liban (BDL) as the authority entrusted with the monetary policy and financial stability. Finally, I will conclude with mentioning some prospective policy restructurings and macroeconomic reforms that would serve Lebanon's economic recovery.

II. Global, Regional, and Lebanese Strains

On the general economic level, global growth is projected at 2.5 percent in 2020, just above the post-crisis low level registered last year. Amid current trade tensions, uncertainty has weakened trade and investment and turned the balance of risks to the downside. Emerging and developing economies have been witnessing a steep productivity growth slowdown since the global financial crisis, despite the fast accumulation of the largest and most broad-based debt since the 1970s[iii]. However, all of these estimates preceded the developments that the world is currently witnessing in light of fears of the consequences of the spread of the emerging Coronavirus on the global economy. Panic dominated the global financial markets, as Coronavirus panic wipes $6 trillion off world stocks this week[iv]. European stock markets fell by more than three percent before recording further decline, recording losses in their shares by 12-13 percent, the largest since the global financial crisis. After the recent deterioration of Wall Street (-4.42 percent for the Dow Jones and Standard & Poor's indices and -4.61 percent for the Nasdaq), decline appeared in Asian markets, where the Tokyo and Shanghai indices fell by four percent, while the Shenzhen index decreased by about five percent. Many analysts believe that the seriousness of the epidemic on the global economy outweighs its risk to health due to financial market losses and the cost of measures taken to contain it and the stumbling of the giant Chinese economy and its Silk Road project[v]. Breaking news today is that the IMF is poised to downgrade global growth estimates due to COVID–19's negative impact on economics.

According to IMF estimates, total global debt (public plus private) reached $188 trillion at the end of 2018, increasing by USD three trillion in comparison to 2017. This surge was confined to the emerging market economies and low-income developing countries and positioned the global average debt-to-GDP ratio (weighted by each country's GDP) at 226 percent in 2018. With the main increase coming from public debt, country-by-country data reveals rising vulnerabilities, suggesting that many countries may be ill-prepared for the next recession. In emerging markets, the average public debt ratio has risen to levels similar to those prevailing during the crises of the mid-1980s and 1990s. Public debt ratios surpassed 70 percent in almost a fifth of the countries. As for low-income developing countries, there has been a steady build-up of public debt, with two-fifths of them worldwide at high risk of, or in, debt distress[vi].

On the regional level, the ongoing political and security unrests and conflicts during the past decade reflect the regional turmoil that have consumed much of the region's financial resources and missed lots of its economic opportunities. The growth rate of the Arab economies is forecasted at 2.5 percent in 2019 due to the sluggish external demand and its adverse impact on oil and non-oil exports. On the inflation level, Arab countries are expected to witness a significant decrease to around 6.7 percent, affected by local fiscal reforms implemented in many Arab countries and measures adopted to mitigate their impact on consumers, in addition to changes in oil and basic commodities prices as well as exchange rate movements[vii]. This regional status is in dire need for regional integration efforts and bold monetary-financial initiatives. Such initiatives seem vital in light of the decline in foreign direct investments in the Middle East over the past few years. Moreover, the Middle East lags behind its peers in governance ratings, including the rule of law[viii].

The Lebanese front has been facing escalating tensions for several months now. This unprecedented escalation is the cumulative outcome of Lebanon's geopolitical, sociopolitical, and economic environment, being surrounded by multiple sources of challenges and threats. Such sources of challenges and threats include: 1) geopolitical aspects, being surrounded by Israeli threats and repercussions of the Syrian war; 2) macroeconomic inefficiencies and governance weaknesses, causing shortages in capitalizing on Lebanon's strategic sectors and potentials; 3) internal socioeconomic-political deadlocks and turbulences, having hosted around 1.5 million Syrian displaced people and witnessing ongoing social mobility for socioeconomic structural reforms[ix]. As a result, main economic indicators such as foreign investment, tourism, and real estate, marked their lowest levels since 2011. GDP growth stood at around 0.3 percent, while the inflation rate reached approximately six percent. As fiscal deficit was optimistically estimated to be around eight percent in 2019, public debt is projected to increase to 155 percent of GDP for the same year[x]. Moreover, a contraction of 3.8 percent is estimated in 2019; the fiscal deficit is estimated to have widened to 11.6 percent of GDP[xi]; layoffs and forced wage decreases have spiked[1].

These adverse situations on all fronts emphasize the need to pursue essential structural reforms in socio-macroeconomic policy space for the purpose of enhancing resilience to adverse shocks and promoting sustainable growth and development.

III. Role of BDL: Resilience amid Mine Lands

According to the Code of Money and Credit, under which BDL was established, the mission of BDL is to safeguard currency as a fundamental guarantee for sustainable economic and social development. This mission includes, in particular:

- Safeguarding the safety of the Lebanese currency;
- Maintaining economic stability;
- Maintaining the safety of the banking system;
- Developing the monetary and financial market;
- Organizing and developing payment systems and methods;
- Developing and organizing cash transfers;
- Developing and organizing clearing and settlement operations related to various means of payment and financial instruments.

BDL has strived, since the mid-nineties, to preserve the resilience of the Lebanese financial/banking system against the imminent mines and shocks, facing an aggressive internal and external environment, the manifestations of which can be ascertained through the following indicators:

- Debt-to-GDP ratio has exceeded 150 percent, placing Lebanon in the fifth highest rank globally. Budget deficit reached 11 percent of GDP in 2018 and is projected to exceed the eight-percent-of-GDP target of the 2019 budget due to the substantial decrease in public revenues after the uprising[xii].
- Lebanon is ranked 143 among 190 economies in the ease of doing business, according to the World Bank 2020 Doing Business report[xiii].
- Lebanon is ranked 88 among 141 economies according to the 2019 Global Competitiveness Index[xiv].
- Lebanon is ranked 95 among 157 economies, and tenth among Arab states, according to the Global Index of Economic Openness for the year 2019[xv].
- Lebanon is ranked 154 among 180 economies, and 12 out of 14 in the MENA region, according to the Index of Economic Freedom for the year 2019[xvi].

[1] According to a survey conducted by INFOPRO Research (2020): 33% of businesses laid off 60% of their employees while 12% of businesses laid off all their employees; 51% of businesses reduced salaries of employees; 94% of businesses witnessed a 69% decrease in sales.

- Lebanon is ranked 89 among 126 economies, and sixth out of eight in the MENA region, according to the Rule of Law Index for the year 2019, issued by the World Justice Project[xvii].
- Lebanon is ranked 137 among 180 economies, and 12 among 21 Arab states, according to the Corruption Perceptions Index for the year 2019, issued by Transparency International[xviii].
- Lebanon ranks tenth out of 14 Arabs in terms of digitization, according to the Digital Index of the Arab Advisors Group for the year 2018[xix].
- Lebanon is ranked 106 among 115 economies, and last among Arab states, according to the Energy Transition Index for the year 2019, issued by World Economic Forum[xx].
- The net foreign assets of the Lebanese financial sector (as an indicator of the balance of payments) decreased by USD 3.5 billion between January and November, 2019[xxi].

Countering these adversities, BDL aimed at maintaining a balance between securing the financial system from systemic risks through regulatory macroprudential policy on one hand, and avoiding any disruptive implications on output and monetary/price stability through conventional and unconventional monetary policy on the other. Accordingly, BDL has been persistent in complementing and supporting the fiscal policy and public finance dynamics in Lebanon through implementing the following essential practices:

- Attaining exchange rate stability that comprises the key in maintaining financial and price stability as a solid pillar of economic growth, resilience, and macroeconomic reform;
- Maintaining low rates of inflation over the past twenty years;
- Ensuring a gradual decrease in interest rates;
- Building robust foreign reserves;
- Providing cost-effective financing for the public sector through securing optimal interest rates for the public debt;
- Stimulating the economy through stimulus packages that comprise credit incentives targeting numerous segments of the Lebanese economy and availed through the banking sector;
- Boosting knowledge economy through equity financing, thus capitalizing upon both Lebanon's strategic human capital and its financial markets;
- Establishing a reliable banking system in strict compliance with international banking and accounting standards, particularly with respect to capital adequacy, corporate governance, profitability, and combating money laundering;
- Enhancing financial inclusion and financial consumer protection practices; and

- Developing modern financial regulatory laws and platforms, particularly in relation to payment systems and electronic finance.

In spite of the strains hampering its progress, the banking sector's status remained healthy, recording an annual growth of 5.35 percent in total assets of banks which reached USD 260 billion in November 2019. Bank deposits stood at USD 172 billion in November 2019, with an annual decrease of 5.78 percent. In parallel, bank loans to the private sector stood at USD 54.7 billion in November 2019, as compared to 61.7 at end 2018. On the other hand, bank loans to public sector reached USD 31 billion, as compared to USD 34.4 billion at end 2018. The dollarization of deposits increased to 74.7 percent, up from 70.62 percent at end 2018, while the loan dollarization ratio witnessed a slight increase of less than one percent since December 2018, registering 69.6 percent by November 2019.

The general conclusions of the consultations of the IMF mission to Lebanon dated October 2019 commended BDL for "maintaining financial stability while emphasizing the need to rebuild its financial strength". They acknowledged that "BDL has been the linchpin of financial stability and protecting the peg, but at the cost of intensifying sovereign-bank linkages", emphasizing that "structural reforms are essential to revive growth and enable external adjustment". It is noted that the IMF considered reducing the credit rating of Lebanon by rating agencies (most recently Moody's) as a reflection of the current challenges in its public finances. Moreover, these conclusions focused on structural reforms to stimulate growth and competitive advantage in the economy, especially in the electricity sector and public administration[xxii].

IV. Policy Restructurings and Macroeconomic Reforms

The real flaw in the Lebanese economy according to the above-mentioned indicators is not merely the crisis of its high indebtedness and the deficit in its budget, but it is what prevents the reduction of deficit and debt, which is the growing structural weakness that afflicted the Lebanese economy since the end of the civil war particularly in its productive sectors, public institutions, public services, rule of law, competitive environment, comparative advantages, and infrastructure. This is demonstrated in a World Bank report, which stated that Lebanon loses nine percent of its GDP annually since the end of the civil war as a result of the performance of its "confessional governance", which represents half of the cumulative value of its current GDP[xxiii]. Even the economic elements of openness and freedom that Lebanon has long been distinguished in its surroundings have become semi-neutralized. This does not deny the fact that Lebanon has potentials and comparative advantages that can be capitalized upon. On the contrary, these gaps cause many lost opportunities and wasted potentials that Lebanon possesses, particularly in the areas of its human capital, financial sector, and expatriate energies, not to mention the potential oil and gas resources.

Based on all the aforementioned, I can deduce the prospective policy restructurings and macroeconomic reforms that would have substantial effects in meeting the accumulating challenges towards Lebanon's economic recovery.

First, *monetary policy and financial stability* perspective:

With the challenging circumstances that led to the recent hike in demand for dollar banknotes, BDL is still deploying its efforts to protect monetary and financial stability. However, BDL has always stressed the significance of securing political will for implementing economic structural reforms that would curb the embedded weaknesses of the Lebanese economy, thus securing a robust economic basis for monetary/exchange-rate stability[xxiv]. The most prominent aspects behind a potential tailoring of the monetary policy and financial stability according to the forthcoming status could be the following:

- Enhancing the balance between macroprudential policy that targets financial stability on one hand, and monetary policy that aims at providing effective transmission mechanisms on the other;
- Augmenting the integrative collaboration between monetary and fiscal policies;
- Promoting the functional roles of interest rates and foreign exchange rates for securing sustainable growth, as the macroeconomic and public finance situations permit;
- Seeking sustainable and strict liquidity and capital adequacy parameters for the banking system, which BDL has directed through its circulars;
- Keeping the balance between central bank independence and transparency, so as to reinforce the legitimacy of the central bank's monetary and regulatory mandate;
- Emphasizing the developmental role of the banking sector and financial markets for launching the aspired productive economy and reduce rentier trends;
- Heightening the policies that enhance the adoption of the national currency and diminish dollarization;
- Enforcing the standards that secure the satisfaction of the needs of the financial consumers and the protection of their interests;
- Optimizing the performance of the banking sector through executing necessary mergers and recapitalization;
- Combatting malign financial practices that hold speculative tendencies towards the national currency;
- Intensifying control and supervision over external banking endeavors;

- Applying uniformity and equity concerning any capital-control measures to avoid capital flight[xxv] while endorsing an as-needed basis approach.

Second, *fiscal policy and public finance* perspective:

- Promoting government expenditures that are oriented towards investments in infrastructure;
- Implementing reforms to the taxation system towards achieving a more equitable, direct, and progressive system;
- Eliminating deep-seated and inefficient spending rigidities[xxvi];
- Fighting trafficking and tax evasion and enhancing tax collection through removing exemptions and preferential treatment, and enhancing e-government and incentive-based noncompliance penalties for companies[xxvii]. It is noted that the Association of Banks in Lebanon estimated the value of annual tax evasion at four billion dollars[xxviii];
- Public debt restructuring through lengthening the maturity of government debt while reducing interest rates that are correlated with inflation levels, whereby the burden weight of the restructuring should be allocated on interest-benefit-basis[xxix];
- Imposing fair fines for the occupation of marine, river, and municipal properties and seeking to restore them;
- Focusing on borrowing in Lebanese pounds to keep the public debt under sovereign control.

Third, *macroeconomic policy* perspective:

- Launching plans for transforming the Lebanese economy from a rentier-based to a productive economy through improving economic diversification, developing measures/laws for protecting competition, and enhancing prominent productive sectors in accordance to Lebanon's comparative advantage (e.g. knowledge economy, vocational sector, agro-industry, medical industry…).
- Emphasizing public-private-partnership, aiming at increasing investment, reducing government debt, and improving efficiency[xxx]. This would be optimally accomplished through bringing in citizens, strategic investors, and the government within an accurately - balanced scheme.
- Strengthening the balance of payments through creating an attractive investment environment for diaspora remittance-inflows and FDIs on one hand, and enhancing the trade balance through increasing exports and diminishing the reliance on imports on the other.

Fourth, *good governance and corruption* perspective:

The formation of a more comprehensive and profound vision on the issue of corruption requires an approach that takes into consideration two factors that constitute sources of corruption, particularly in our Arab region. The first factor that is economic in nature is the rentier culture, and the other that is social in nature is the factional culture. The rentier economy generates corruption in the economy by relying on rent instead of productive effort to obtain wealth. The explanation for this is that reliance on rent implies the absence of effort and risk tolerance, and thus the factors that stimulate accountability are absent, which in turn encourages corrupt practices. This imbalance results in structural distortions in the system of government with regard to the relationship between the citizen and the government, the concentration of wealth, the widening of social gaps, and the nurturing of the ruling class. On the other hand, factional rule provides a framework for sharing or monopolizing power away from the mechanisms of democratic participation. Consequently, this governance results in the exclusion of the mechanisms of transparency and accountability in economic policies and the rule of law, which results in the distribution of rent, especially to the groups close to the government, to ensure the sustainability of the system. Eventually, this leads to systematic impoverishment and corruption. The reciprocal relationship is complete, as corruption, in turn, feeds the rentier economy and factional governance. Ultimately, this trilogy of rentier economy, factional governance, and corruption practices is an integrated system in which each element nurtures the other. Therefore, fighting corruption comprehensively and effectively is only possible with an approach that addresses all of these elements[xxxi].

From the Lebanese perspective, fighting corruption entails the following:

- Empowering the anti-corruption bodies and mechanisms necessary for implementing measures that enforce the good-governance practices of transparency and accountability (government expenditures and tenders; bank secrecy and immunities for politicians and public sector employees…).
- Enacting a law that preserves the independence of the judicial system.

Fifth, *social safety net* perspective:

Implementing reforms to the National Social Security Fund and expanding the social safety net program so as to encompass measures for supporting ageing and unemployed factions.

Sixth, *infrastructure* perspective:

Reforming the Electricity Company of Lebanon is the utmost priority in this context that would decrease the budget deficit by around USD two billion. Moreover, launching efficient and competitive telecommunication projects, establishing effective public transportation networks including railways, and capitalizing on national water resources are crucial infrastructure elements.

V. Conclusion

Given the prevailing traumatic environment in Lebanon and the region, these are times when all vital forces and capabilities of the nation should act decisively towards integrating their resources for true structural reforms. These reforms must follow a strategic approach to policy design to bring consistency between pressing vital socioeconomic changes and longer term development objectives, between stability and growth, and between efficient productivity and social welfare in the widest developmental sense[xxxii].

Thank you.

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