Lebanon: Government Recovery Plan Asks Too Much of Ordinary Lebanese, and Not Enough from Elites

→ Sami Halabi
In late April, Lebanese President Michel Aoun commended the government Financial Recovery Plan (FRP) as the country’s first economic reform package since independence in 1943. The timing of this rather underwhelming triumph comes as little surprise, given that Lebanon’s finances have become truly desperate.

When reading the FRP closely, one feels an overwhelming sense of deep, soul-crushing resignation. At its core, the FRP pushes the idea that “there is no alternative” to decades of devastating austerity measures that will halve Lebanon’s economy (when measured in USD) and prevent a return to the 2018 GDP level for at least 20-odd years. This effectively means the government expects all Lebanese to slash their standards of living without any prospect of foreseeable growth as a sacrificial atonement for the ruling class’ financial mismanagement, and the evasion of serious legal reform. These sacrifices are demanded without any real effort to pursue accountability and fair allocation of losses beyond some rhetoric of recovering assets that left the country. The Lebanese should not meekly accept this injustice.

It is essential to build into the recovery plan stronger measures for accountability and lay the basis for a fairer society by a better distribution of losses and the introduction of more progressive taxation. Despite the government’s stated promise to “protect the poorest segments of the population from the dire consequences of the crisis”, its plan is fundamentally about contracting government services. This will inevitably harm Lebanon’s poorest and its middle class, who are both already suffering because of the current economic crisis.

Instead, the sinners who created Lebanon’s mess – the financiers and politically favoured oligarchs – must soften the blow for Lebanon’s masses by, at least, paying their fair share. This accountability demands tough laws and enforcement mechanisms to recover any ill-gotten funds in the long run, but, as an immediate action, the authorities should claw back egregious profits made through questionable financial engineering (primarily through “haircuts” on certain deposits above certain thresholds), impose and enforce progressive taxes, and stamp out corruption. Nothing less will convince external lenders – not to mention the Lebanese themselves, who have angrily protested since last October – that more aid money should be thrown into Lebanon’s shadowy and broken system of
A selective laundry list instead of a fair plan

As a cry for help, it is hard to find fault with the FRP. In essence, the plan lays out almost every reform that international financial institutions (including the IMF and the World Bank) have touted for Lebanon since the civil war ended 30 years ago. Offering up these changes, as complemented by flashy presentations to international agencies at swanky meetings during early May, amounts to a government plea for assistance from any funder willing to pump in foreign currency and save Lebanon from imminent collapse.

This narrative of the obliging, servile supplicant is all too familiar to modern Lebanese statecraft. The country has become increasingly addicted to foreign aid since the 2006 war, a trend only enshrined since by the Syrian refugee crisis. The emergency funds have flowed even though the state remains devoid of real structural reform, despite hollow promises to the contrary. The FRP is the latest chapter in this sordid tradition: a laundry list of reforms that any observer knows full well are unachievable in the proposed three-year timeframe.

In fairness, the FRP does have several merits that should not be overlooked – for the first time, the Lebanese authorities publicly diagnose the foundations of the economic problems in the country, including the admission that the currency peg to the US Dollar is no longer tenable. The plan accepts a devaluation from the current official rate (1507.5 Lebanese Lira to the US Dollar) to a more realistic rate (ranging from 3500 to 4297 LL) over the next four years (see Figure). No doubt, surrendering the peg would decimate the savings of many Lebanese who converted deposits into lira, attracted by stratospheric interest rates of levels close to 15% and 20% before its collapse. This is regrettable, to put it mildly, but there was also a falsehood inherent in those rates.
Projected Value of Lebanese Pound according to the FRP

The FRP also acknowledges – albeit by omission – non-productive sectors like real estate cannot run the Lebanese economic engine as they have since the early 2000s. This shift of thinking is evident in the FRP’s newfound focus on productive industries such as agriculture, manufacturing, and tourism – even if these sections appear to be a cut and paste from previous promises to donors. It also reflects new market realities that undermine real estate. While some home loans may become more affordable after devaluation, most middle-class households will lose the bulk of their savings (in LL) that would otherwise have paid off mortgages. But the pivot away from real estate – which hoarded capital inflows and largely employed low skill labour from Syria and not Lebanon – is commendable. New support for productive sectors is also likely to be the government’s strongest selling point in the FRP because, now more than ever, Lebanon must rethink its economic model rather than rely on non-productive sectors that once threw up “easy wins”.

But the FRP falls short by ignoring how these new strategic sectors will develop in a country riddled with corruption. Lebanon currently lacks any anti-trust legislation, much less a competition regulator, to ensure that growing industries can escape cynical monopolization. A third of Lebanese markets were oligopolistic in 2003 – today it is likely to be much worse. These compromised fields include lucrative local industries like pharmaceuticals, petroleum-based products, gas, and cement. For foreign products needed to drive these industries, import agencies can still register exclusive commercial representation agreements and
become the sole importers of specific goods. What is more, ministers and parliamentarians across the political spectrum have business stakes in many of the aforementioned industries. In this context, it is little wonder that conflict of interest legislation does not appear on the FRP’s selective laundry list of reforms. Yet without proper regulation, the targeted productive sectors will fall prey to market concentration, conflicts of interest, and artificially inflated prices – and the kleptocracy will continue.

The absence of accountability

In a similar vein, the FRP makes no serious effort to hold those who caused Lebanon’s economic meltdown accountable for their actions. The document pays lip service to the faulty ‘financial engineering’ of the Banque du Liban (BDL) and the commercial banks, but it does not condemn or hold them accountable for building the regulated Ponzi scheme that has crippled Lebanon. For years before the collapse, the BDL ran stimulus plans (equivalent to USD1 billion in Lebanese Lira) that propped up the commercial banks’ loan portfolios – 90% of which are exposed to the real estate sector. The BDL and the banks used the proceeds from this unproductive stimulus to sell the health of the Lebanese banking system to those who would inject foreign currency into the BDL’s ‘financial engineering’ schemes, under which large investors enjoyed ludicrous interest rates in US Dollars. The BDL then purchased these dollars at an overvalue, before lending the money to the state and fuelling the public debt. This charade, like all Ponzi schemes, disintegrated once investors stopped pumping in fresh money.

The FRP ignores these obvious targets for reparation. Instead, it makes the outrageous assertion that all deposits are considered equal for bank recapitalization when it states that “law-abiding citizens should not be affected unless all potential remedies have been exhausted.” The FRP’s approach is lacking in moral justice, precisely because it does not distinguish between ordinary depositors and those who profited from the Lebanese Ponzi scheme.

Craftily, the plan diverts attention from this reality by focusing on a relative red herring: capital flight. The FRP calls for the recovery of “sums which have unlawfully escaped the country and [application of] those sums against the banks’
losses.” This proposal conveniently ignores the fact that there was – and there is still - no legal basis for imposing capital controls in Lebanon. Only the Association of Banks in Lebanon, a private association of commercial entities, has been restricting dealings with bank deposits – and it has no legislative authority to do so. For its part, the judiciary has declined to rule on the legality of these unofficial capital controls, citing “exceptional circumstances.” By focusing on the purportedly unlawful exit of capital since last October, the FRP attempts to create a smokescreen for skirting around liability for Lebanon’s (not particularly talented) financial engineers.

But fear not! The FRP promises that “illegally obtained funds and assets…and in particular PEPs (politically exposed persons) will be used to compensate for losses,” without offering any further details beyond “the authorities intend to claw back sums which have unlawfully escaped the country and apply those sums against the banks’ losses.” In other words, Lebanon’s political elites would have the international community – not to mention the long-suffering Lebanese people – believe that the government will chase down the unjustly enriched, prosecute them in Lebanon’s hitherto paralysed court system, and then engage in a long and costly pursuit of these misappropriated funds. According to the FRP’s logic, this recovery of “stolen assets” will bring in “at least USD10 billion over the coming five years.” The Lebanese could be forgiven for refusing to suspend their disbelief any further; no government official has faced prosecution under the illicit wealth law since its enactment in 1999, not least because any plaintiff whose case is thrown out faces fines up to USD13,000 (at the official rate) and possible jail time. We should not hold our breath.

There is an alternative: time to look at the social contract

The Lebanese should look through the FRP’s smokescreens and fanciful promises and see the plan for what it really is: an unequivocal surrender to the IMF, from which negotiations can proceed. The government’s reward would be emergency liquidity loans from the IMF, which would pave the way for the World Bank and other international donors to fund the USD11 billion reform plan through pledges
made at the CEDRE conference in April 2018. Of course, emergency funding deals always come with strings attached, including regressive taxation, slashing of the public sector, and privatization. The government plan prescribes draconian austerity measures foreseeing spending on general public services dropping from an existing 21% of GDP to 17.1% of GDP by 2024.\footnote{Lebanon: Government Recovery Plan Asks Too Much of Ordinary Lebanese, and Not Enough from Elites} And, of course, IMF and World Bank contributions will be in the form of loans – albeit at below-market interest rates – which the heavily indebted government must pay back.

Lebanon undoubtedly needs immediate liquidity, which will have to come from international donors. Beyond that initial jump-start, however, the government can find plenty of funding from within the country. To harness this potential, Lebanon must introduce a fairer and more progressive approach to public finances and restructure the burden that the shattered banking sector has brought. As a first step, the government should apply a progressive haircut to, at the minimum, the profits that originated from the financial engineering saga. This would avert the unjust scenario in which Lebanon’s poor and middle class bear an oversized share of the burden of repaying debts incurred by corrupt elites.

Beyond reparations, the government needs a serious plan for introducing fairer, more equitable taxation policies – not a series of bullet points outlined in the FRP. While the government plan cites better tax collection and tax reforms, in practice a lack of details coupled with timid increases in progressive taxation mean the government can hardly be serious about “tax reform aiming at targeting segments of the population with high income to reduce inequalities.” For one, a raft of regressive taxes which hammer the poorest already feature prominently in the FRP. These include a price floor on gasoline (used for transport) and gas oil (used for generators) in a country where there is no reliable transport or electricity, particularly for the poor.

To its credit the FRP does not propose a devastating blanket increase in VAT, and also proposes some interesting tax measures, including a global income “framework”, which would, supposedly, tax all income sources whatever their nature. While it is true that the plan singles out interest income and capital gains for increases (which the FRP’ admits will flounder due to the crisis), the lack of any mention of how it will deal with foreign sources of income or with hiding behind Lebanon’s long-standing and almost sacred banking secrecy laws, means the
proposition is likely to be no more than lip service.\textsuperscript{13}

In a country where the richest 10\% command around 70\% of the country’s wealth, redistribution – not blanket austerity – must be the priority.\textsuperscript{14} Lebanese think tank Triangle (full disclosure: partially owned by the author) has used conservative estimates to calculate that merely reaching the average tax potential of similar middle-income countries could generate an additional USD3.5 billion per year.\textsuperscript{15} What’s more, instead of the increase on top marginal income tax rate from 25\% to 30\% proposed by the FRP, raising the rate on top income-earners to the OECD standard of 40\% would generate an extra USD6.82 billion a year, according to the same study.

This means that, together with collecting existing taxes, the public revenue could garner an extra USD10.3 billion a year. If more funds are needed, imposing a 1\% wealth tax on high net worth individuals (over USD10 million) would garner an additional 2 billion annually. To be clear, these numbers are conservative estimates based partially on data from a few years ago, and no one knows the extent to which the current crisis will hammer incomes and lower tax revenues. Yet, even if only half of the tax revenue materializes, each year those new revenue streams would still amount to more than half of Lebanon’s requested IMF loan, or half the total value of the CEDRE infrastructure programme – both of which are meant to be spread out over several years. With that kind of fiscal space, one might wonder how Lebanon could need anything more than immediate liquidity to recapitalize the banks and pay that back once the tax revenue rolls in.

If the international community is serious about funding genuine economic recovery, it will place strict loan conditions tied to genuine anti-corruption and judicial reforms – not the bullet points that the government has proposed as second fiddle to funding for sectors and infrastructure. Chief among these are laws and enforcement mechanisms, including the judicial independence bill, amendments to the illicit wealth law as well as anti-trust and conflict of interest legislation, to allow a recovering market to function for the public, not serve narrow private interests.

Times of crisis are also times of opportunity, and there has arguably not been a moment since independence when the Lebanese have so radically considered
their social contract. That means, for once, not settling for the usual, disingenuous reform promises, austerity, and reliance on debt that successive Lebanese governments have imposed on the Lebanese – the latest of which are contained in the FRP. The Lebanese should not be content with the modus operandi of the past three decades, whereby the state begs and borrows from foreign benefactors instead of progressively placing the burden of public finances on those who can afford to pay for it. Instead, a new social contract and political transition are needed to dig Lebanon out of the economic hole the country is in, albeit with just a little bit (less) help from its friends.
Endnotes

1. A full copy of the FRP is available here: https://bit.ly/2yXHLz


4. The magnitude of housing loans is unknown due to the lack of transparency around how stimulus packages were funded. See: http://www.thinktriangle.net/wp-content/uploads/2018/12/20181217_A_New_Deal_For_Lebanon_300dpi.pdf


7. Legislative decree no. 34 of August 5, 1967.


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