



LIFE's Response to the Draft of the Lebanese Government's Reform Program

In the face of the economic meltdown unfolding in Lebanon, we herein publish our response to the widely circulated draft of the Lebanese government's reform plan. As the plan seems to have been met with widespread public criticism and thus runs the risk of being prematurely shelved, given the increasing cost of policy paralysis, we feel it is important not to be outright dismissive and articulate our views in a balanced manner below.

- We are **encouraged** by some aspects of the plan. Most notably:
 - It adopts a more **comprehensive** approach than previous attempts including “fiscal adjustments”.
 - It represents the first credible effort to **quantify** and recognize the sobering magnitude of the **macro-financial imbalances**.
 - It calls for a move to a long-needed “more **flexible exchange rate policy**”.
 - It justifiably calls for a **full independent audit** of the Banque du Liban's (“BdL”) financial position.
 - It recognizes the need for “substantial foreign financial assistance” presumably opening the door to the possibility of an **IMF program**.
 - It focuses on substantially strengthening the much-needed **social safety net** for the Lebanese population.
- We, however, **continue to be concerned** by the omission of some important elements that are much needed to decisively deal with Lebanon's accelerating economic crisis:
 - While the draft has correctly called for an audit of the BdL, we believe this **audit should be expanded to cover all government ministries, major agencies and public bodies** (including utilities and other major state-owned enterprises) that are ultimately responsible in the aggregate for the cumulative fiscal deficits and the resulting unsustainable debt load. Eventually, all past public tenders above a certain threshold will also have to be audited in order to ensure a path to recovering illicit payments.
 - We deem the proposed **fiscal reforms not comprehensive enough** to put Lebanon on a sustainable path. Particularly, EdL reforms must be accelerated according to a workable and transparent plan rather than relying on prior plans of questionable credibility. While recognising that “phased fiscal adjustment” steps are more feasible politically, past experiences and empirical evidence suggest that it would only prolong the economic paralysis.
 - Our assessment is that the plan's **estimates of inflation and currency exchange rate levels are not** credible and by our projections will reach worse levels, effectively creating a higher tax on all savers and consumers. The path for Lebanon to surmount this economic crisis needs to be honestly communicated to Lebanese citizens, and the resulting **unavoidable pain equitably shared**.
 - While we do believe that the restructuring of the banking sector ought to be part of any economic transformation plan, it is imperative that **small and medium size deposits**, including those of the NSSF and the syndicates, be **protected**. As we have already been calling for, **capital control legislation** should be adopted immediately in order to manage the remaining

liquidity among Lebanese citizens and the productive sectors in a fair and open manner. Unlawful bank conduct should be dealt with swiftly and firmly.

- While a **bail-in for the larger deposits could be adopted as a last resort**, it must be **properly legislated, conducted in an orderly and transparent manner, and only as a last line of defence** after the full shareholder's equity of the banks has been used to absorb losses. With respect to any preferential entitlements to government assets depositors may directly have, as mooted in the government plan, a **full legal review** will have to be undertaken to ascertain whether this would be practicable, equitable or even possible.
- A **restructuring of the banking sector and any related impact on deposits must go hand in hand with immediate, credible and wide ranging fiscal reforms** absent which, such restructuring will eventually prove futile further exposing depositors to a weakening sovereign credit and discouraging future recapitalisation of banks. Additionally, as mentioned in our previously published papers, Lebanon's rule of law, along with a **strong institutional framework** are a pre-requisite of any plan.
- While the plan cursorily mentions future state asset sales, we believe that, subject to all necessary safeguards to ensure sound governance and transparency, a **medium-term privatization program should become an important component of a more comprehensive fiscal adjustment and stabilisation plan**. We recognize that those necessary safeguards are absent today and any privatization should only be consummated once the governance and transparency frameworks are in place and when the economic environment is stabilized.
- While the plan does include proposed structural reforms, it does not articulate a sufficiently clear **vision for the country**. Such vision could be aligned with the economic vision articulated in the McKinsey report of 2017 from which a large number of reforms can be immediately initiated to kick start the path towards a **more sustainable and productive model for the Lebanese economy**.
- The plan does not go far enough to recognize that Lebanon has no alternative but to immediately start serious and **open negotiations with the IMF**. We estimate the amount of external support needed to be substantially higher than referenced in the plan and this amount will continue to increase as long as inaction prevails. We understand that, as is typically the case, other multilateral and government would come in behind the IMF and help close the funding gap, a support that is desperately needed and whose benefits would far outweigh the potentially challenging conditions imposed.

As many precedents and false starts sadly attest, this government might adopt the path of least resistance: kicking the increasingly rusty can down the road, and failing to execute. **Salvaging Lebanon's economy requires strong and comprehensive economic leadership** that no Lebanese government in the recent past has exhibited. As such, unless the steps raised above are adopted immediately, Lebanon's accelerating economic crisis, made worse by the COVID-19 lockdown, will quickly further impoverish Lebanese citizens, tear away at its social fabric and decimate what is left of its institutional framework.

We are out of time; people's lives and livelihoods are at risk.

LIFE

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