THE LEBANESE GOVERNMENT'S FINANCIAL RECOVERY PLAN

— EXECUTIVE SUMMARY —

- *The Lebanese economy is in free fall. An international financial rescue package is urgently needed to backstop the recession and create the conditions for a rebound. In parallel, a quick delivery on long-awaited reform measures is critical to help restore confidence*

- *The international community will provide resources to Lebanon only if the authorities are able to propose and implement a comprehensive reform program that creates the necessary conditions to the rebound (structural reforms) and addresses all the imbalances accumulated over the past decades to eliminate their heavy burden on the economy*

- *The reform program aims at protecting the poorest segments of the population from the dire consequences of the crisis. Extensive social safety nets will be created with the assistance of development partners to provide income support, until Lebanon returns to solid growth and most of its population rises above poverty line*

- *The government budget will be rebalanced through better tax collection, recovery of stolen assets, tax reform aiming at targeting segments of the population with high income to reduce inequalities, enhanced spending efficiency and better public financial management. The quick implementation of the reform of Electricité du Liban (EDL) and other state-owned enterprises will alleviate the burden on the budget while supporting the recovery with more efficiently run utilities to back private entities' development*

- *The public debt will be restructured to restore the government's solvency and create the necessary buffers to protect public finances from future adverse shocks and secure a long period of economic growth*

- *Structural reforms will cover all sectors of the economy to unleash the growth potential, make it sustainable, and create jobs. The fight against corruption will lower the cost of doing business in Lebanon, bring decisive improvement in the business climate, and create favorable conditions for private sector development*

- *Competitiveness will be strongly improved by the adjustment of the Lebanese Pound to the market rate in the near future. The existing dual exchange rate is not suited for the long-term recovery of the Lebanese economy. The government plan is based on an estimation of a rate of 3500 US$/LBP. Mitigating measures will remain in place to protect the poorest segments of the population from inflationary pressures.*

- *The financial system, covering commercial banks and the central bank, will be restructured in a fair way. And since it is understood that external support will not be available to cover past losses, the reform program will be geared toward minimizing the remaining losses in the system in order to boost economic recovery*

- *The central bank balance sheet embeds large losses that have to be tackled quickly to rebuild a credible monetary system and secure confidence in the system*

- *The banking sector is faced with large losses on its credit portfolio, sovereign holdings and its very large exposure to BdL. Acknowledging these losses is a prerequisite for a long-term solution, while analyzing each bank's situation will help determine each one's needs*

- *The aggregate level of losses incurred by Lebanese entities that have to be addressed in the program amount to LBP241 trillion[1]:*

  - *LBP73 trillion related to the restructuring of the government's debt (losses generated by excessive fiscal deficits over a long period of time, and notably by very high interests paid to local banks and BdL)*
  - *LBP66 trillion related to BdL past accumulated losses (losses generated by loss making transactions aimed at preserving the peg and maintain a high dollar inflow, including the financial engineering since 2016)*
  - *LBP40 trillion related to banks' losses on their credit portfolio (losses related to non-performing loans generated by the recession)*
  - *LBP62 trillion of net losses on the balance sheets of BdL and the banks The losses will materialize in the balance sheets of the BdL and the banks based on an estimation of the Lebanese Pound at the rate of 3500 US$/LBP*
  - *LBP177 trillion aggregated losses in the BdL balance sheet*
  - *LBP64 trillion direct aggregated losses in the banks' balance sheets*

- *In addition, foreign holders are expected to face significant losses on their holdings of Eurobonds*

- *Losses can partly be mitigated using available resources:*

  - *BdL losses can partly be covered by (i) existing capital base of LBP6 trillion, (ii) netting against valuation adjustment on the liabilities side (assumed to constitute permanent reserves and to be denominated in US$ terms) of LBP36 trillion and (iii) a transitory negative equity position of LBP14 trillion, the equivalent of US$3.9 billion or 15% of the expected 2020 GDP (remaining losses of c. LBP121 trillion)*
  - *Banks' losses can partly be covered by the current capital base of LBP31 trillion (remaining losses of LBP33 trillion)*

- *Net remaining losses: LBP154 trillion. These are real losses that the financial system is faced with, Banque du Liban (BdL) and the banks' combined*

- *Lebanon is faced with few available options for dealing with these losses*

  - *Ignoring the losses would prevent Lebanon from benefiting from any meaningful international assistance, it would prevent it from negotiating a debt restructuring with foreign bondholders, it*

[1] The analysis is made based on proforma BDL and commercial banks balance sheets reflecting an exchange rate at LBP3,500 per USD. Appendix 2 provides the main assumptions and BdL's and commercial banks' respective revised balance sheets

would expose Lebanon to litigating creditors, and it would prevent any economic rebound as the banking sector would remain heavily crippled

- *A bail-out of BdL and the banks would require a financial package from foreign partners that is highly unlikely*

- *Stripping Lebanon of all of its remaining assets would not be fair on the vast majority of citizens, does not solve the solvability issue and jeopardizes Lebanon's future and its ability to rebound*

- *Remaining available options are limited. The Plan proposes to mitigate the remaining losses through:*

  - *Mobilization of resources by the government through (i) recovery of stolen assets thanks to forensic work initiated by the Government (ii)recovery of deposits evaded from Lebanon in breach of the capital controls (iii) excessive dividends paid abroad by the banks over the last 5 years (iv) financial engineering proceeds*

  - *Recover excessive interest income serviced by the banks to depositors*

  - *Using some of the state assets (land, real estate, state-owned enterprises, etc.). This option would raise serious issues in terms of inter-generational equity. However, a better management of some specific state assets could generate income that can partially be allocated to loss absorption*

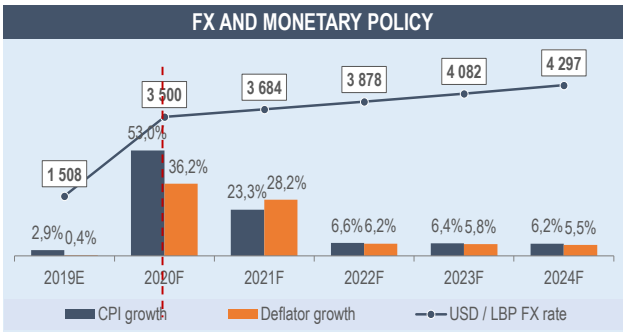
  - *Absorption of BdL losses by the bail-in of banks' deposits and CDs at BdL, and other means*

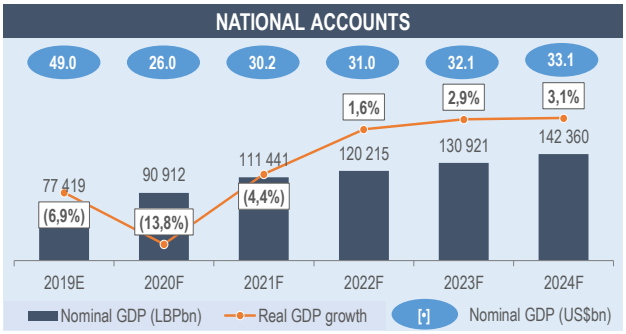
  - *Use real estate and land on banks' balance sheets at their market value, and use their existing foreign assets*

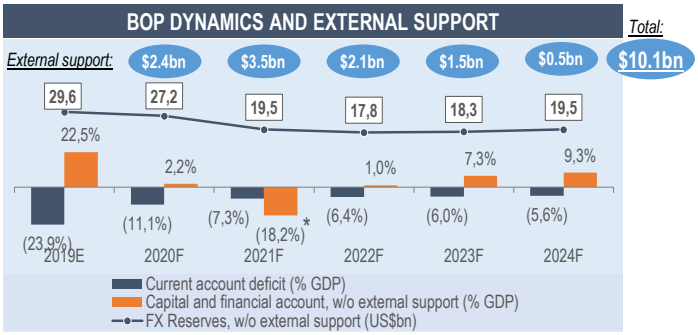
  - *Use real estate owned by BdL at market value*

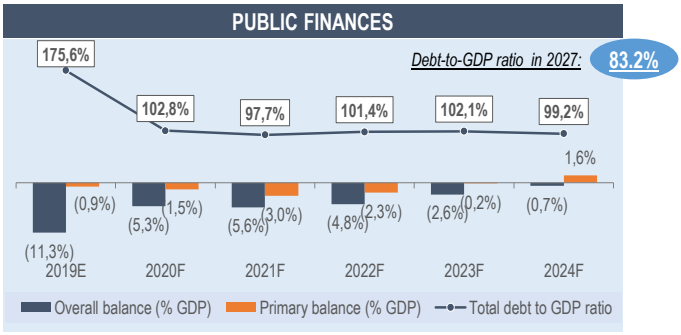
  - *Other options to be determined down the road*

Overview of the Revised Macro Framework









** Lifting of capital controls in 2021*

THE LEBANESE GOVERNMENT'S FINANCIAL RECOVERY PLAN

This memorandum highlights the Lebanese government's comprehensive macro-financial program aimed at resolving deep-seated macro-economic, financial and institutional problems, restoring confidence, boosting economic growth, promoting a healthy financial system and achieving debt and financial sustainability. The government is committed to strengthen Lebanon's cooperation with the international community and hopes for its financial and technical support to ease the impact of adjustment on the population and more specifically on the most vulnerable groups, and to achieve strong and sustainable growth as quickly as possible. The government is also committed to strongly improve the Lebanese system of governance, change its harmful practices, hold everybody in the public sphere accountable, and recover people's money from wrongdoers.

BACKGROUND AND RECENT DEVELOPMENTS

Lebanon is faced with an unprecedented economic crisis. Economic indicators point to an acceleration of the contraction of the economy and the coronavirus crisis currently affecting Lebanon and the whole world will only add-up to the already deeply deteriorated economic environment. Output is estimated to have contracted by 6.9% in 2019 following a contraction of 1.9% in 2018. It will further contract massively in 2020, worsened by the Covid-19 crisis, with dollar shortage putting a massive drag on nonfuel imports and consumer demand while driving up consumer prices and squeezing businesses. Unemployment and poverty are rising fast, inflicting unbearable pain on the Lebanese population. Average inflation has already accelerated sharply since the beginning of the year, creating the risk of an uncontrolled rise in prices fueled by continuous de facto depreciation of the Lebanese pound through the parallel market. The banking sector is paralyzed. Deposit inflows have dried up. In November 2019, banks imposed *de facto* capital controls to prevent further large deposit outflows. The budget deficit is projected to widen sharply as revenue collection is collapsing. Primary deficit is set to reach close to 4% in 2020. In order to stem the depletion of international reserves that have reached a worrying level, and in an attempt to contain the budget deficit, the government decided on March 7, 2020 to withhold the repayment of a Eurobond redemption maturity. Then, on March 23rd, Lebanon announced that it will withhold payments on all its foreign currency denominated Eurobonds.

The current severe economic and financial crisis has its roots in a long history of excessive reliance on large foreign currency inflows and failed attempts to execute credible economic policies. For years, Lebanon has received massive inflows of dollar deposits in the domestic banking sector, equal to multiple times GDP, which were not mainly recycled into the productive economy but fueled public sector deficits and high levels of consumption. Over the recent period, deeply rooted domestic political economy factors and institutional weaknesses have been exacerbated by a challenging external environment (deteriorating growth in the Middle East, war in Syria, impact of commodity prices on remittances, effects of strategic confrontation in the region) and led to a steady erosion of confidence.

Since 2011, Lebanon remains at the forefront of one of the worst humanitarian crises of our time and has shown exceptional commitment and solidarity to people displaced by the war in Syria, but hosting the most refugees per capita in the world (1.5 million displaced Syrians in addition to 0.5 million Palestinian refugees) has had a direct and significant impact on Lebanon's social conditions and economic growth: The mass influx worsened the already stretched public infrastructure (water and sanitation, solid waste, electricity,…) with demand exceeding the capacity of institutions to meet needs and placed a burden on Lebanon's public finance. The quality of essential services, including national health and education have been negatively impacted. A large number of Lebanese have become unemployed and have been pushed into poverty. This displacement crisis has cost Lebanon more than USD 25 billion, as per the recognition of international institutions.

A popular uprising erupted on October 17 that led to the resignation of the previous government. The large demonstrations across the country and across all walks of life demanded access to their deposits, an end to corruption, job creation for the youth, and better standards of living with equal opportunities for all. The government is fully in tune with the legitimate demands of the population and it promises to respond to their needs and aspirations as clearly mentioned in the government's inaugural statement to parliament.

Lebanon is faced with very large financial imbalances that have reached a level rarely seen in other countries faced with multi-pronged crisis. Expansionary fiscal policy and an overvalued exchange rate, on the back of massive foreign inflows, have contributed to a persistently wide external current account deficit, driven by high imports, while exports remained modest, and the deterioration of the net external position. The analysis of the aggregate balance sheet of the Lebanese financial sector – commercial banks and Banque du Liban (BdL) combined – points to a very large currency mismatch of c. US$63 billion, e.g. more than 120% of GDP (using official exchange rate). This foreign currency mismatch can no longer be mitigated by inflows of foreign deposits that dried-up over the past months and will realistically not recover in the foreseeable future.

In addition, years of large budget deficits and high interest rates pushed the stock of public debt to an unsustainably high level. Weak tax compliance in certain areas, a very generous pension system for specific groups, poor governance, very high interest burden and the chronically loss-making electricity sector have, among others, contributed to persistent large fiscal deficits. Consequently, the public debt increased to unsustainable levels, rising from 131% of GDP in 2012 to an estimate of 176% of GDP at end-2019. With interest payments alone accounting for c. 50% of government revenues in 2019, the fiscal accounts are stretched too thin to pursue productivity enhancing social and infrastructure investment.

This deep and multi-faceted crisis requires immediate action on several fronts at the same time. The Lebanese people is faced with several years of economic hardships. It is the historic responsibility of the government and parliament to swiftly implement the key reforms that were delayed for too long and to fully revamp the real economy and the financial sector to provide hope to the country and secure a strong new beginning.

However, this crisis cannot and should not be tackled by Lebanon alone. The country entered in a very serious danger zone requiring courageous, tough and painful measures – on top of strong solidarity among the Lebanese - that will bring the light at the end of the tunnel. Nevertheless, no reform agenda, as ambitious as it could be, can be implemented when the economy is in free fall. Stabilizing the economy is

an immediate priority that requires substantial foreign financial assistance, urgent reforms and the implementation without delay of a full-fledged fiscal, monetary, economic and social plan. The only way out is to regain the trust of the Lebanese people and the international community together, and to refuel and rebuild an economy living on productive and high added-value sectors, and not on capital inflows.

A. PROGRAM OBJECTIVES AND STRATEGY

In the face of the dire economic, social and financial situation, the government has designed a program that is credible, bold and comprehensive to restore confidence, gather urgent foreign support and put the country back on a long-term sustainable growth path. The program aims to address forcefully financial and fiscal imbalances, bring down the current account deficit, put the public debt on a firm downward path, restore the stability of the financial sector and restore confidence including by strengthening governance, fighting corruption and returning stolen assets, rebuild a sustainable and growing economy and provide reliable social safety nets**.** The government has every intention for the program to succeed while allocating fairly the cost of accumulated losses and sparing the most vulnerable groups from its burden.

The Government's method for implementing the reforms will be to continuously define, promote and follow-up on the implementation of concepts, policies, procedures, measures, laws and actions leading on one hand to the sustainable creation of value and jobs and, on the other hand, to the sustainable reduction in the budget and the balance of payment deficits.

The program rests on nine central and interrelated pillars:

- Revamping the peg to lessen the strains on the balance of payments and improve competitiveness
- A comprehensive debt restructuring strategy that decisively addresses the debt overhang
- A comprehensive restructuring of the financial system to address decisively accumulated FX mismatches at the central bank and in the banking sector, reveal the embedded losses and re-focus a resized banking system on the distribution of credit to the private sector
- A strong phased fiscal adjustment, focused on improving tax compliance, streamlining expenditure and reforming the public sector, including reforming Electricité du Liban (EdL)
- Growth-enhancing reforms that include measures and laws that would adjust the socio-economic model that includes radical corrections in the distribution of GDP and the structure of the current account balance. Reforms will promote a productive economy, provide a conducive environment for business and investment, increase productivity and reduce costs, which in turn, would enhance the competitiveness of the Lebanese economy and participate in the reduction of the balance of payment deficit
- A social sector reform agenda to improve social indicators and strengthen or develop social safety nets to protect the most vulnerable segments of the population
- An ambitious national anti-corruption strategy, addressing the roots of a major impediment to growth and social justice and allowing for retrieving the largest possible part of the ill-gotten and stolen money
- An environmental reform and a national sustainable development strategy to preserve the environmental identity of the country and sustainably using it as a socio-economic engine
- International financial assistance at favorable terms to close the large external financing gap and finance the development of the infrastructures that are necessary to support the growth of the economy.

B. FOREIGN EXCHANGE POLICY AND BALANCE OF PAYMENTS DYNAMICS

1. EXCHANGE RATE AND MONETARY POLICY

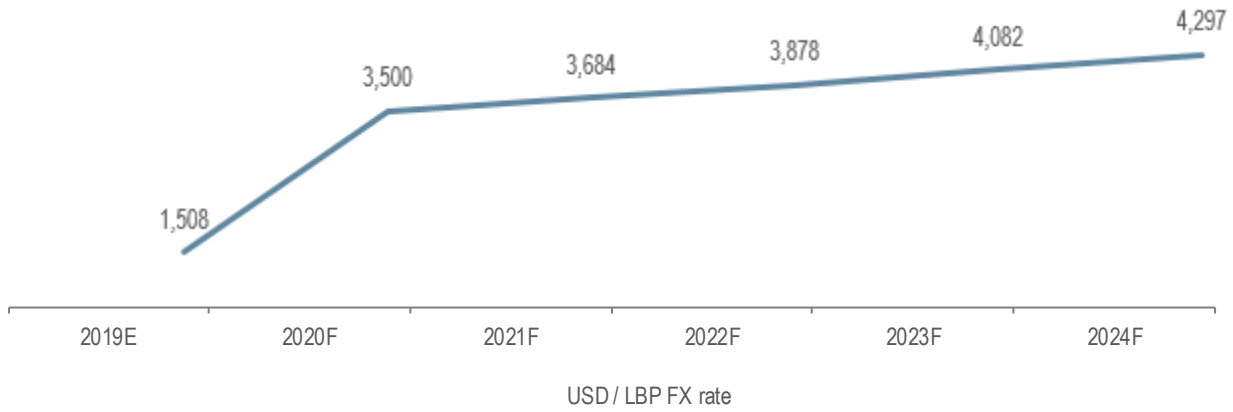
The current sudden-stop in inflows that used to finance large current account deficits in the past now exerts heavy pressure on BdL FX reserves. It forced the introduction of *de facto* capital controls and triggered a continuous depreciation of the pound in the parallel FX market. The signaling of massive money creation through a program of de-dollarisation of the economy by BdL recently exacerbated that trend. The peg to the U.S. dollar that has been maintained over decades is now impossible to restore and must be revamped as part of the Government program. This is all the more necessary because the peg resulted in the building-up of a large real overvaluation of the Lebanese pound that participated in the crowding-out of the industrial sector's development. For years, the lack of competitiveness of the Lebanese companies has prevented the emergence of a productive and diversified economic base in Lebanon and encouraged the consumption of imported goods through artificially inflated purchasing power.

The existing dual exchange rate is not suited for the long-term recovery of the Lebanese economy, because of its distortionary nature and the limited availability of FX resources in the parallel market. The widening gap fueled by recent BdL initiatives between the official rate and the parallel rate– currently around 4100 - is a source of social inequalities and could lead to the emergence of economic rents for accessing the dollar at the official rate, thus prolonging an already inefficient system. Besides, the *de facto* capital controls imposed by the banks are exacerbating the scarcity of FX, thus preventing the emergence of a functioning parallel market and are driving parallel rates to record highs. The parallel market doesn't allow for the development of a balance between FX demand & supply and would put a severe drag on the recovery. It is not suited to provide the sufficient FX resources the economy needs over time to rebound and grow again.

The Lebanese pound will be readjusted in the foreseeable future. It will enhance transparency and improve liquidity in the forex market and send a strong signal in support of the rebalancing of the economy. A depreciated exchange rate will reduce the current account deficit. Combined with structural reforms, it will improve competitiveness, which is essential for boosting production and exports. It will encourage the development of promising sectors, such as IT, manufacturing, agriculture, in addition to Lebanon's traditional sectors such as finance, tourism, and construction. The Government and BdL will continue to pay special attention to priority imports (wheat, medicine, gasoline) and take necessary action to protect the poorest segments of the population.

The exchange rate will be set at a level that will both ensure the return to sustainable current account deficits in the medium term, and the correction of real exchange rate misalignment. The level of the parallel rate is also an important indicator to monitor and will inform the policy decision, bearing in mind that the capital controls, the limited size of current parallel market and the resulting build-up of unmet demand ("backlog") is presumably driving the parallel higher than where it should normally be ("overshooting effect"). Existing studies suggest, depending of the methodology used, a real overvaluation of the Lebanese pound of c. 30% to 60%, the higher bound estimate being assessed as necessary to close the current gap of the balance of payments. With recent events pointing to an acceleration of the REER misalignment, we estimate in this paper that the rate used is reasonable. The government plan is based on this assumption.

Going forward, the government intends to move to a more flexible exchange rate. FX exchange rate will be set in a way to prevent renewed real appreciation and preserve competitiveness (e.g. managed float or crawling peg). BdL will implement an exchange rate policy that will ensure that adjustable FX rate will reflect inflation differential with major currencies. A gradual depreciation of the currency of c. 5% per annum is assumed during the forecasting period. Ultimately, the stability of the new exchange system will result from the successful correction in the current account deficit and structural shifts in the structure of the economy.



Source: Lebanese Authorities

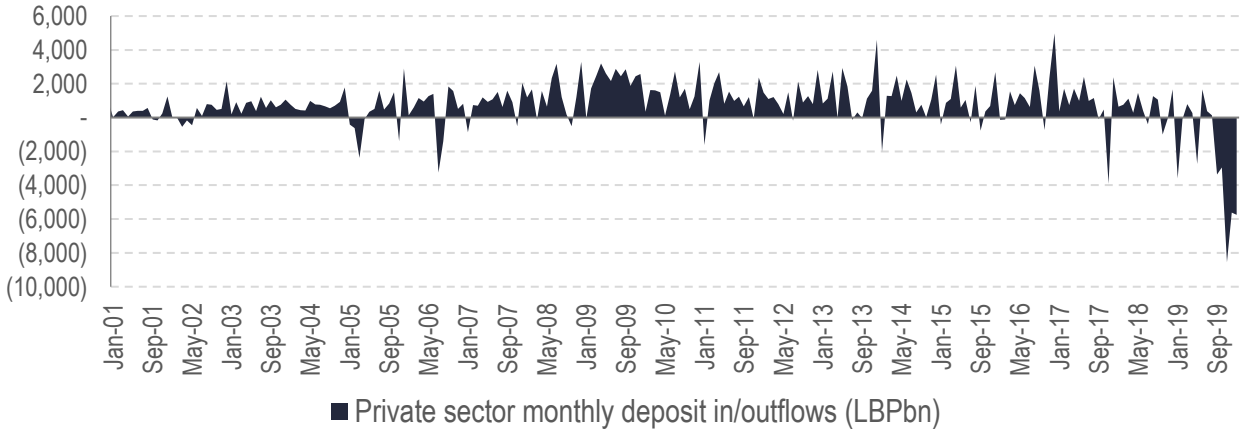
Another pressing issue is the continuation of capital controls. *De facto* capital controls implemented at the level of individual banks are source of unequal treatment of depositors as loopholes remain. The government will take action in the short term to ensure a fairer and more comprehensive implementation of capital controls. Capital controls will remain in place as long as financial stability remains at risk. They will be dismantled over time when the first positive signs of restored confidence will materialize as a result of the devaluation, the flotation of the pound, the restructuring of the financial sector, and the implementation of government's reforms. We assume a gradual lifting starting in 2021. The restoration of depositors' confidence will entail, for an interim period, the acceptance of net deposit outflows as the restoration of free movements of capital will be reaffirmed. It is expected, however, that net positive inflows will resume only over time, contributing to the stabilization of the pound and the re-accumulation of BdL international reserves. It is not expected, however, that deposit inflows will recover to their pre-crisis level as Lebanon will not replicate the failed banking model of the past and transit to a more sustainable structure of the balance of payment.

Finally, monetary policy will seek to control and gradually reduce inflation to lower single digits over the medium term. This will support real incomes and enhance external competitiveness. We expect average inflation to spike in 2020 due to the pass-through effects of the FX devaluation. Going forward, BdL will progressively phase out monetary financing to purchase T-Bills as the recovery takes place and foreign assistance will offer fresh resources to cover the remaining funding needs of the government. Once the economy has stabilized, a new monetary policy framework will be set-up by BdL to focus on monetary base targeting using indirect money market policy instruments. Reserve money will reflect BdL projections of market liquidity consistent with the chosen inflation path. Collaboration between the Ministry of Finance and BdL through the Higher Debt Committee will be strengthened to incorporate

public sector flows in the monetary program and develop capacity for analyzing and forecasting high frequency patterns for fiscal revenues, expenditures, and financing needs.

2. BALANCE OF PAYMENTS DYNAMICS AND EXTERNAL SUPPORT

The cash usable reserves at BdL have reached a worrying level and all indicators show that the depletion is not likely to reverse naturally as was the case in previous similar (though less pronounced) episodes of FX outflows. The size and duration of currently observed trend of deposit outflows is unique in comparison to previous episodes. With capital controls *de facto* in place since end of 2019, and the unprecedented dire situation of the country now widely acknowledged both domestically and abroad, it is difficult to imagine Lebanon coming out of such a deep crisis without the support of the international community at large. It is unrealistic to think that the trend of deposits flows will reverse and that the international markets will reopen for Lebanon, notwithstanding the Covid-19 crisis, without the strong commitment to a large scale and comprehensive recovery plan backed by internationally recognized experts.



Source: Banque du Liban

External support, in the form of financial commitments but also in support of the Government reform program, is urgently needed to limit the size of the economic contraction, secure basic imported goods, and restore confidence in Lebanon. The depth of the recession, exacerbated in the context of the Covid-19 crisis, will depend on the availability of dollars to finance the balance of payments in the quasi-absence of private capital inflows (except for remittances). An even more severe contraction of imports would have a devastating impact on the economic output, leading to a severe deterioration of social indicators and the risk of a protracted recession. It is urgent to break this vicious circle with the announcement of a massive external financial support to backstop the economy, made conditional upon the implementation of a comprehensive recovery plan able to restore confidence and reverse the current trends.

Net External financing needs over the next five years are projected at c. US$10 billion under an optimistic economic scenario of gradual economic recovery and the successful restructuring of the Government foreign currency debt. In this baseline scenario, which embeds a large and rapid international support, we assume a gradual contraction of the current account deficit to c. 5.6% by 2024

when taking it into account the impact of the public debt restructuring, allowing the economic recovery to materialize within a reasonable timeframe. We assume part of the international support in 2020 will take the form of emergency assistance provided by the IFIs to support spending relating to the COVID-19 crisis[2]. Gross cumulative external funding gap is projected at US$28 billion. However, we assume that the external debt default situation is cured in 2020 with a successful public debt restructuring, enabling considerable savings in the external debt service and a gradual return to international capital markets in 3 years' time. We finally assume that, after unavoidable initial deposits outflows in 2021 once the capital controls are progressively lifted; private FX inflows gradually resume with the full clean-up of the banking sector, including BdL.

Table 1: Balance of Payments (in US$m)

	Estimate	Projections				
	2019	**2020**	**2021**	**2022**	**2023**	**2024**
Current account	(11,724)	(3,555)	(2,835)	(2,579)	(2,457)	(2,362)
% of GDP	*(23.9%)*	*(13.7%)*	*(9.4%)*	*(8.3%)*	*(7.7%)*	*(7.1%)*
Goods balance	(13,365)	(7,614)	(7,431)	(8,121)	(8,877)	(9,632)
Services balance	198	1,406	1,950	2,450	2,900	3,350
Income balance	(1,438)	(64)	(381)	(237)	(100)	19
Current transfers	2,881	2,717	3,028	3,330	3,621	3,902
Capital account	994	668	668	668	668	668
Financial account	7,635	(3,896)	(9,483)	(3,524)	(959)	(75)
Direct investment	1,534	148	328	494	643	771
Portfolio investment	1,641	(1,062)	(944)	(878)	(709)	(633)
Other investment	4,460	(2,982)	(8,868)	(3,140)	(892)	(213)
Reserve assets (depletion)	2,390	6,782	11,650	5,435	2,748	1,768
External financing requirements (cumulative)		6,782	18,432	23,868	26,615	28,384

Sources: Banque du Liban, Lebanese Authorities

External support in the form of a program supported by international multilateral institutions is expected in such a situation and constitutes a realistic and efficient way of restoring confidence. Investors and observers are reminding the government that the IMF in particular has been created for the exact purpose of supporting its members going through severe balance of payments (BoP) crises, and they are expecting Lebanon to call on the IMF to tackle the current crisis, as numerous countries did in similar circumstances. In their view, this would immediately trigger a shock of confidence and send the right signal both domestically and abroad about the Lebanese government being committed to deal forcefully with all aspects of the current crisis. This would also provide strong backing to the difficult decisions that the government will have to take eventually and that could otherwise be back-loaded. The Government believes the present plan is a good basis in case of negotiations with the IMF, and it will keep striving to minimize the harm on the Lebanese population during the correction years.

The donor and lender communities are unanimously saying that a multilateral intervention in Lebanon would catalyze additional external financial support, in the framework of the *Conférence économique pour le développement par les réformes et avec les entreprises* (CEDRE) and beyond, and would also help achieve a successful public debt restructuring. The positive spillover effects of an

[2] On March 12, 2020, the World Bank has approved a reallocation of US$40 million under the current Health Resilience Project (US$120 million) to support Ministry of Health. IMF could lend as per the current mobilization of emergency finance schemes currently deployed all over the world in close coordination with other IFIs.

IMF program are also numerous. Though the IMF would most probably not be able to provide by itself sufficient resources to cover all external financing needs of Lebanon for the next five years, even under a so-called "exceptional access", it will unlock other sizeable pockets of available funds from multilateral or bilateral partners that would be conditioned to the successful implementation of the IMF program. In addition, debt discussions with bondholders will be facilitated in the context of an IMF program (some of them insist they will simply not negotiate absent such a program), as it would provide an anchor for negotiations, with clear sustainability targets and a methodological framework to rely on. Investors will be far more willing to accept a facial reduction of their debt if they see credible recovery value in what they are left with.

A Lebanese recovery plan outside of an IMF program that would not tackle fully all the imbalances inherited from the past would fall short of the main objective of giving a fresh start to the Lebanese economy while putting it on a viable long-term trajectory (see appendix 1 for a detailed discussion). This is mainly due to the unwillingness of the international community to commit the extensive support needed, while at the same time the very large accumulated losses in the Lebanese financial system would not be restructured and while no international framework would be put in place to monitor reform implementation over the medium term (foreign donors are well aware that previous experiences have shown a lack of capacity from Lebanese governments to conduct reforms as planned in the context of international support packages).

In the here-after described macroeconomic scenario, external support from various sources are projected to total c. US$10 billion over 5 years (in addition to CEDRE funds) and will be complemented as needed with contributions from bondholders in the context of the debt restructuring and a strategy of returning to the international capital markets in the medium run. Total contractual debt payments to Eurobond holders were projected at c. US$19-20 billion over the next five years before the default[3]. Regardless of the nominal discount, the negotiation of a 5-year grace period on principal and the reduction of coupon to a minimum level during that same period would fill an additional US$15-18 billion of the projected US$28 billion BoP financing requirements. The rest of the gap – besides external support– will be covered by a strategy of gradual re-access to the market as the Lebanese economy recovers and the credit rating improves, as well as the rise in FDI that should be fueled by the emergence of a new Lebanese economy. The overall amount of external support could be higher in case of stricter benchmarks in terms of net foreign assets accumulation by the central bank (reconstitution of higher international reserves).

[3] This amount combines debt payments to foreign holders of Eurobonds as well as local banks. However, as per the BoP methodology, payments made to local holders in FX generate capital outflows in the financial account on top of the outflows related to payments to foreign holders. All others things being equal, they translate into reduced international reserves.

C. MEDIUM-TERM MACROECONOMIC FRAMEWORK

The macroeconomic scenario that is described hereafter makes the assumptions that (1) Lebanon will benefit promptly from the required external financial support to serve as a backstop to the recession, and (2) Lebanon will successfully implement the comprehensive package of reforms and decisive actions that are described in this document, be it related to the fiscal consolidation, debt trajectory, structural reforms, financial system restructuring, the reform of the FX system, the social safety net, the growth of the economy or the related infrastructure rehabilitation and development. The macroeconomic scenario depicted hereafter relies on realistic but rather favorable developments, and one should keep in mind that any deviation from this plan could result in far worse outturn of imports contractions, real GDP growth, inflation rate, and budget performance for 2020 onwards.

Following a preliminary projection of real output contractions of -13.8% in 2020 and -4.4% in 2021, the economy will then gradually recover and reach 3.1% real growth by 2024 before stabilizing at an estimated 3% growth potential in the longer run. The recovery will be driven by external support to limit the contraction in imports and domestic consumption, a public investment push in the context of the unlocking of the CEDRE committed financing and the implementation of a well prioritized investment plan that would back private sector development and focus on key areas, the implementation of a comprehensive pro-growth reform agenda, and competitive gains achieved through the devaluation of the currency. The private sector is also expected to gradually adjust to the new environment by reducing costs and reorienting production towards the external sector and import substitution. The average inflation is expected to spike at 53% in 2020 due to the pass-through effects of the exchange rate depreciation. Inflationary pressures will gradually decline to 6.2% by 2024.

Fiscal policy will be driven by an ambitious, albeit necessary, fiscal consolidation plan spread out over 5 years. Primary budget balance will be improved from -0.9% in 2019 to 1.6% in 2024, reflecting a "domestic primary surplus" of 3.8% excluding the portion of capital expenditures that will be self-financed externally with the unlocking of the CEDRE external financing commitments, therefore reflecting a much tighter primary surplus objective. These ambitious fiscal consolidation efforts, together with the sharp reduction of the public debt interest bill that will be achieved through debt restructuring, will aim at putting the debt-to-GDP ratio on a clear downward trajectory with a minimal harm on the most fragile.

Overall government deficit is projected to narrow from 11.3% of GDP in 2019 to 5.3% in 2020 and further to 0.7% by 2024, under a set of illustrative debt restructuring assumptions (as further described in section D.2). Neutralizing the effect of the disbursement of CEDRE financing would reflect a balanced overall budget as early as 2024. Under this set of assumptions, the debt-to-GDP will decline steadily from an estimated 176% in 2019 to 99.2% by 2024 and further to 83.2% by 2027. Fiscal consolidation measures will be underpinned by core structural reforms—fiscal responsibility legislation, central treasury management, and public bodies and employment reforms—that entrench fiscal discipline.

Weak domestic demand as well as the currency depreciation will reduce imports of goods and services substantially. While exports of financial and other business services are expected to be severely affected by developments in the banking sector, political stability and improvement in infrastructure could boost tourism receipts beyond 2020 when travel bans imposed in the context of Covid-19 are lifted. Lebanon's economy has shown a good track record in recovering if sound policies are implemented, and potential for higher growth starting in 2022 is significant.

Table 2: Medium-Term Outlook under the Government's Macro-Economic Framework*						
	Estimate	**Projections**				
	2019	**2020**	**2021**	**2022**	**2023**	**2024**
Brent Price, USD/bbl**	64.3	31.8	35.9	39.7	42.9	45.4
USD/LBP Exchange Rate	1,508	3,500	3,684	3,878	4,082	4,297
Depreciation	*4.7%*	*56.9%*	*59.1%*	*61.1%*	*63.1%*	*64.9%*
Real GDP Growth, %	(6.9%)	(13.8%)	(4.4%)	1.6%	2.9%	3.1%
Nominal GDP (LBP billion)	77,419	90,912	111,441	120,215	130,921	142,360
Nominal GDP (US$ billion)	49.0	26.0	30.2	31.0	32.1	33.1
CPI Inflation, %	2.9%	53.0%	23.3%	6.6%	6.4%	6.2%
GDP Deflator, %	0.4%	36.2%	28.2%	6.2%	5.8%	5.5%
Budget Primary Balance, % GDP	(0.9%)	(1.5%)	(3.0%)	(2.3%)	(0.2%)	1.6%
Overall Budget Balance, % GDP	(11.3%)	(5.3%)	(5.6%)	(4.8%)	(2.6%)	(0.7%)
General Government Debt, % GDP	175.6%	102.8%	97.7%	101.4%	102.1%	99.2%
Current Account Balance, % GDP	(23.9%)	(13.7%)	(9.4%)	(8.3%)	(7.7%)	(7.1%)

Sources: Lebanese Authorities, Bloomberg
**All figures taking into consideration the impact of externally financed capital expenditure achieved through CEDRE as well as the public debt restructuring (as described in section D.2)*
***Source: Bloomberg as at 22 April 2020*

D. ECONOMIC POLICIES

1. FISCAL POLICY

The fiscal component of the reform package should aim at reaching a primary budget surplus of c. 1.6% 2024, equivalent to c. 3.8% surplus without taking into consideration the impact of externally financed capital expenditure achieved through CEDRE. This requires, in addition to reducing the electricity transfers, rationalizing the wage bill and cutting all inefficient current spending, increasing budgetary revenues by curbing tax fraud and evasion, fighting smuggling across all points of entry, increasing the compliance rate, and revamping the entire tax system to make it fairer and heavier for rent income. In order to preserve the most vulnerable segments of the population, a comprehensive safety net package will be implemented, with cash transfers to the poorest, and education and health adequate measures.

The government intends to introduce a supplementary 2020 budget in the next few months to put public finances on a sustainable path. In this context, the government is committed to substantially reducing the overall primary deficit through a combination of corrective revenue and spending measures. The combination of the rapidly deteriorating and unstable economic environment, leading to a sharp fall in the compliance rate, and the drop in taxes on interest income are expected to drive the tax to GDP ratio from 16.2% of GDP in 2019 to 13.6% in 2020. Beyond this year, we expect tax revenues to increase steadily to reach 15.2% of GDP by 2024. The government's primary spending, excluding interest on debt, is expected to shrink from about 22.4% of GDP in 2019 to 17.1% by 2024, supported by a decline in the wage bill and the gradual removal of electricity transfers.

Table 3: Medium-Term Government's Fiscal Consolidation Path

	Estimate	Projections				
	2019	**2020**	**2021**	**2022**	**2023**	**2024**
Total revenues, % of GDP	21.5%	17.9%	17.5%	18.4%	18.7%	18.7%
o/w tax receipts, % of GDP	16.2%	13.6%	13.5%	14.5%	15.0%	15.2%
Total primary expenditure, % of GDP	22.4%	19.4%	20.4%	20.6%	18.9%	17.1%
o/w wage bill, % of GDP	*13.1%*	*11.1%*	*10.4%*	*10.4%*	*9.7%*	*9.1%*
o/w transfers to EdL, % of GDP	*2.9%*	*2.0%*	*1.9%*	*1.4%*	*0.7%*	*0.0%*
o/w CEDRE spendings, US$ billion	-	-	*0.3*	*0.6*	*0.6*	*0.7*
Total primary expenditure (excl. CEDRE), % of GDP	22.4%	19.4%	19.3%	18.4%	16.6%	14.8%
Primary balance, % of GDP	(0.9%)	(1.5%)	(3.0%)	(2.3%)	(0.2%)	1.6%
Primary balance (excl. CEDRE), % of GDP	(0.9%)	(1.5%)	(1.9%)	(0.1%)	2.0%	3.8%

Source: Lebanese Authorities

This medium-term fiscal strategy (MTFS) will be adopted by the government and approved by Parliament by end-June 2020. It will include the following revenue and expenditure measures with a view to distributing fairly the burden of adjustment and to avoiding to the extent possible any additional impact on wage earners and the poor.

a. Expenditure Reduction Measures:

Expenditure measures are expected to yield 4.5% of GDP by 2024, while an average US$500 million per year, or approximately 1.5% of GDP, will be spent for safety nets in view of limiting the negative impact of fiscal consolidation on the most vulnerable parts of the population. The following measures will be implemented:

- **Electricity sector reform:** budgetary transfers to EdL amounted to US$1.5 billion in 2019, equivalent to 2.9% of GDP thus representing a heavy burden on the budget
    - The government plans to eliminate EDL subsidies as soon as the EDL plan approved in April 2019 is implemented and electricity is provided 24/24 hours per day. Tariff will increase gradually with the generation. The government will continue to implement the measures aiming at improving efficiency, expanding capacity, and reducing waste and theft

- **Measures targeted at the wage bill reduction:** The government is committed to rationalizing public sector employment with a view to improving efficiency and reducing cost. The objective is to bring total personnel costs to 9.1% of GDP by 2024 through the following measures:
    - Freezing of headcount of military personnel and promotion of military personnel conditioned to empty positions
    - Reduction of the number of contractuals (5% p.a. over 5 years)
    - Freezing on the new hiring of public employees: a freeze on public sector hiring will be imposed and the size of the public sector will shrink due to attrition. As several thousand public sector employees are expected to retire in the coming years, only those who are in critical positions will be replaced, yielding important savings.
    - Revision of the package of benefits
    - Revisiting the number of economic and military attaches
    - Introduce a cap on compensations, and eliminate double dipping
    - In order to mitigate the impact of high inflation on the purchasing power of civil employees, the government also intend to compensate for the real depreciation by one-off increases of nominal salaries to be determined on an annual basis based on previous year inflation estimate figures

In addition to the above-mentioned measures, the government will complete a census of all government and public enterprises positions, compensation, and description of function, and create and maintain a comprehensive database of employment and compensation in the public sector, updating on a regular basis the census information. This should allow further reduction of the wage bill costs in the medium run through a reduction of ghost workers, rationalization of salaries and benefits, and removal of non-essential positions.

- **Pension Reform**: The fiscal cost of the pension system in Lebanon, especially for the armed forces, is very high by regional and international standards and is likely to increase sharply over the medium

and long term. This reform is a priority because of its social, economic, and fiscal impact. In 2019, pension related expenses represented 36.1% of total personnel costs or 4.7% of GDP. The objective will be to reduce it gradually to 2.2% of GDP by 2024. The following measures are contemplated:

- Revision and proper implementation of measure "number 3" related to military retirement. Calculation rules for military retirement will be aligned on other regimes for fairness and cost effectiveness
- Abolishment of the early retirement scheme
- Revision of the reversionary pension rules to widows and children
- Revision of the rules for transfer of familial allowances after death, treating girls & boys the same way

In addition, the Government will initiate a comprehensive review of the pension law, and on introducing **universal health coverage to all citizens**.

- **Reduction of transfers to other SOEs and public bodies**
  - Rationalization, strengthening and reform of Lebanon's public entities (e.g. railways & public transportation, LPA, universities…): The government will perform the review of 73 public entities and devise a plan aimed at merging entities when feasible, to bolster efficiencies, rein in salaries and benefits, and rationalize operational costs, while closing other obsolete entities and eliminate redundancies when deemed relevant
  - Re-negotiation with NSSF of the arrears clearance schedule and interest charge: current reimbursement schedule over 10 years and prohibitive interest rate of c. 6 to 7% will be renegotiated for longer period and reduced interest rate

- **Reduction in domestically financed capital spending**
  - Domestically financed capital expenditure will be progressively replaced with foreign financed capital expenditures – in particular through the unlocking of CEDRE resulting from the authorities' implementing this ambitious reform agenda and defining clear priorities – and Private Public Partnership projects and BOT projects when appropriate. This will allow a further reduction of the LBP-denominated budget primary deficit and therefore of the inflationary monetary financing by BdL without reducing the much needed capital expenditure and investment to restart growth

- **Other expenditure reduction measures:**
  - Review of school allowances and of allowances for all public sector employees (provided that revised allowances are no less than the cooperative benefits of government employees that should not be affected)
  - Rationalizing of other current expenditures to limit waste
  - Reforming the public expenditure management with the establishment of a central treasury management system (CTMS) to bring responsibility for treasury management functions under one agency, and the creation of a Treasury Single Account (TSA) to improve cash management and consolidate all general government cash resources

The fiscal reform package will be accompanied by social safety net (SSN) measures to protect the most vulnerable groups. The poverty rate is already high, estimated at about 48% of the population and is susceptible to an increase as the country adopts measures to come out of the crisis. Financing an SSN program could be taken up by donors including the World Bank in the context of a full-fledged adjustment program. The Bank and other donors have already provided support to build a poverty targeting system in Lebanon that could be immediately deployed to fund the SSN program. Monthly cash transfers will be considered for approximately 200,000 poor households to cover basic needs and offset the impact of the increase in some prices including fuel.

The Government will discuss with international partners additional social policy measures in response to the deteriorating social conditions in the country. The objective is to enhance and implement additional social safety nets to protect marginalized families, fight poverty in poor areas, and propose community plans to improve their conditions and provide the basic services to them from education, health, and social services with a special focus for areas that witnessed conflicts. Expected budget amount to US$1bn in 2020, US$1.5bn in 2021, US$1.3bn in 2022 and US$1bn in 2023 and US$0.75bn in 2024. The Government will also invest in the recent programs, IMPACT and the new SSNP PMT data collection in order to build a reliable database and continuously update it and verify it as a key element to develop focused and effective programs with a better understanding of the needs and more focused targets to act upon (2020+). It will encourage sustainable investments through micro-credit and partnerships between the public and private sectors, municipalities, donors and NGOs (continuous); Establish a coordination structure between stakeholders to accelerate the return of displaced Syrian refugees in order to alleviate the social and economic weight on host communities and on the government (see Appendix 3 for more details). The estimated annual cost of refugees is around an average of USD 4.5 billion since 2011.

Finally, the financing of the measures aiming at supporting the economy through the crisis will also be discussed with international partners as part of the international support package. Over the period 2020-2024, preliminary Government estimates point to: (i) cumulative US$1.1bn expenses in support of incubators, industrial zone, knowledge economy, tourism and other sectors; (ii) the mobilization of US$6.7 subsidized loans for industry, agriculture and tourism; (iii) US$2.8bn foreign currency liquidity lines for imports of raw materials. These measures will be financed through grants and loans provided by the international partners when available. On top of these contributions, additional tax measures would be contemplated to mobilize resources from the richest segments of the population.

b. Revenue-Enhancing Measures:

Revenue-enhancing measures are expected to yield up to 3.7% of GDP by 2024

- **Broadening the tax base**: In the early years of the fiscal consolidation plan, the government will focus its efforts on measures aimed at broadening the tax base, improving compliance rate (focus on areas where tax compliance is significantly below benchmarks) and tax collection. We intend to implement the following measures:
    - Improving customs collection (improving procedures at legal crossings, closing illegal crossings and fighting smuggling through greater control with the deployment of military personnel, introduction of scanners, on-line data for imported goods…) and extension of customs fees on imported goods
    - Improvement in the collection of VAT
    - Normalization of tax compliance levels
    - Collection of new environmental fiscal instruments to create good incentives and penalize polluters
    - Removal of certain VAT exemptions and reduce the VAT floor to zero
    - Review of other tax exemptions & incentives (such as in the real estate, education, transportation and financial services sectors)
    - Strengthening the tax revenue administration
    - Encourage electronic payments to fight tax evasion
    - Implement other e-government initiatives

Fiscal adjustment efforts will also be supported by institutional reforms. In the context of a comprehensive program of revenue administration reform, the government will increase tax audits, boost tax-related debt collection, and prosecute tax offenders. Addressing tax compliance problems will improve fairness by ensuring that the tax burden is well distributed.

- **Increasing tax**: in a second stage, the government will implement a large overhaul of the tax system aimed at making it fairer and more efficient. It will include the following measures:
    - Progressive increase in corporate tax rate (gradually from 17% to 20%)
    - Increase from 10% to 20% of the tax on interest income on deposits above US$1 million and introduce a progressive taxation scheme
    - Increase of income tax for high salaries (from 25% to 30% for the bracket above LBP255 million)
    - Increase of income tax on capital gains from 10% to 15%
    - Increase of VAT on luxury goods from 11% to 15% and more
    - Set a 25,000 LL floor price on gasoline and remove the 30,000 LL cap; examine possibility to transition towards a more targeted public assistance to public transportation and people in real need

- Introduction of 1000 LL excise on gas oil
- Increase nominal value of fines after devaluation

- **Other revenue increase measures will include**:
  - Introduction of a global income tax framework
  - Introduction (or enforcement) of licensing fees on quarries and crushers, and a special rate for income tax on all taxpayers benefiting from special rights granted by the government
  - Retroactive enforcement on the quarrying sector based on volumetric extraction, Extended producer responsibility (EPR), Enforcement of the United Nations General Assembly recognized compensation to Lebanon following the 2006 oil slick on the Lebanese shores
  - Transfer of traffic penalties to the treasury
  - Vehicle inspection fees in a view of promoting the use of eco-friendly vehicles an penalize old cars and vehicles that consume more gasoline
  - Port of Beirut (deposit port revenues into Treasury account at BdL)
  - Enforcing fines on illegally built Maritime and Wild and river properties (full application of law 64/2017 to recover maritime property after revising the appraisals, draft law on encroachment on river properties and land properties)
  - Recovery of stolen assets based on the forensic analysis initiated by the Government. Preliminary objective is to recover at least US$10 billion over the coming 5 years. Draft law to be prepared to provide details on implementation mechanisms

Table 4: Impact of the fiscal consolidation measures (Summary)

as a % of GDP, unless otherwise stated	**Estimate**	**Projections**				
	2019	**2020**	**2021**	**2022**	**2023**	**2024**
Total Revenues (without measures)	21.5%	17.2%	15.8%	16.90%	15.2%	15.0%
Impact of Revenues Measures (p.p.)	-	0.7	1.7	2.4	3.5	3.7
Total Revenues (with measures)	21.5%	17.9%	17.5%	18.4%	18.7%	18.7%
Total Primary Expenditures (without measures)	22.4%	18.7%	18.6%	19.1%	18.7%	18.4%
Impact of Expenditures Measures (p.p.)	-	0.4	1.5	2.4	3.4	4.5
Impact of SSN package (p.p.)	-	(1.2)	(2.3)	(1.9)	(1.6)	(1.2)
Impact of CEDRE (p.p.)	-	-	(1.0)	(2.0)	(2.0)	(2.0)
Total Primary Expenditures (with measures)	22.4%	19.4%	20.4%	20.6%	18.9%	17.1%
Primary Balance (without measures, baseline)	(0.9%)	(1.5%)	(2.9%)	(3.2%)	(3.6%)	(3.4%)
Primary Balance (with measures, fiscal consolidation scenario)	(0.9%)	(1.5%)	(1.9%)	(0.1%)	2.0%	3.8%

Source: Lebanese Authorities

A tight fiscal policy will not only improve the budgetary situation but also the external position. Limiting domestic demand through cutting government spending and reducing wages and benefits will have an impact on private consumption and investment and thus will reduce the demand for imports. As such, this will bring down partially the external current account deficit, and hence the overall balance of payments, which has been a drag on foreign reserves.

Fiscal consolidation will also reduce the monetary financing from BdL thus addressing inflationary pressures. The reduction in primary deficit, coupled with the renegotiation of domestic debt financial conditions will sharply reduce the government budget deficit and therefore the required issuance of T-bills by the government. In the Lebanese context where BdL has been the main buyer of T-bills through monetary financing, this should help alleviate the inflationary pressure that the country is currently facing in the context of the *de facto* depreciation of the LBP. We expect inflation rate to abate from a forecasted 53% in 2020 to 7% in 2021 and further to 6% by 2024.

2. PUBLIC DEBT RESTRUCTURING

Lebanon's overall public debt restructuring cannot be avoided because the needed fiscal adjustment is just too large. With public debt interest payment currently representing more than 10% of GDP, the required fiscal consolidation to achieve a near zero overall budget balance would be to too much of a burden for the Lebanese people especially in time of recession. Moreover, currency devaluation will further raise the public debt to GDP ratio (as c. 35% of the government debt is denominated in foreign currency) making it less sustainable.

Table 5: General Government Debt (as of December 2019)

	US$ billion	LBP billion	as a % of GDP
LBP-denominated debt	56.8	85,701	110.7%
Multilateral and bilateral debt	2.0	3,017	3.9%
Eurobonds	31.3	47,206	61.0%
Total	**90.2**	**135.9**	**175.6%**

Sources: Lebanese Authorities, Bloomberg

The overall debt restructuring strategy of the government contemplates a three-pronged approach:

(i) Suspending principal and interest payments on Eurobonds to prevent further depletion of the official FX reserves and engage good faith discussions with Eurobonds holders;

(ii) The rollover of domestic debt principal maturities and the ongoing payment of interest due (except to BdL), albeit at a reduced rate, until a negotiated solution is achieved. The parameters of the Eurobond restructuring, the macroeconomic and fiscal framework (including inflation trajectory), as well as the assessment of the impact of a domestic debt restructuring on the banking sector and on depositors will inform the government decision on domestic debt restructuring. A principal discount on the domestic debt will be required to restore the overall stock of public debt to a sustainable level;

(iii) Remaining current on debt service payments to multilateral partners and bilateral partners. This stock of debt is limited (c. US$2 billion, of which c. US$600 million of bilateral loans), and debt service in 2020 is affordable (US$257 million). Multilateral institutions benefiting from a preferred creditor status will be fully serviced. The Republic will also maintain payments to other multilateral institutions and bilateral partners.

The objective of the government is to restore a clear downward debt trajectory over the short to medium run while returning to a debt to GDP ratio of c. 83% by 2027. This objective is achieved under an illustrative scenario of principal discounts on domestic debt[4] and on international bond debt, with a reduction of interest rates to 3% p.a.

[4] In the illustrative scenario, all holders of T-bills are impacted by the restructuring. This approach will need to be further refined to exclude certain categories of holders (e.g. social security funds)

Public Debt Dynamics

While the total public debt will immediately decrease because of the debt restructuring exercise, Lebanon's public debt to GDP ratio will remain fairly stable over the period 2020-2024[5] as a consequence of:

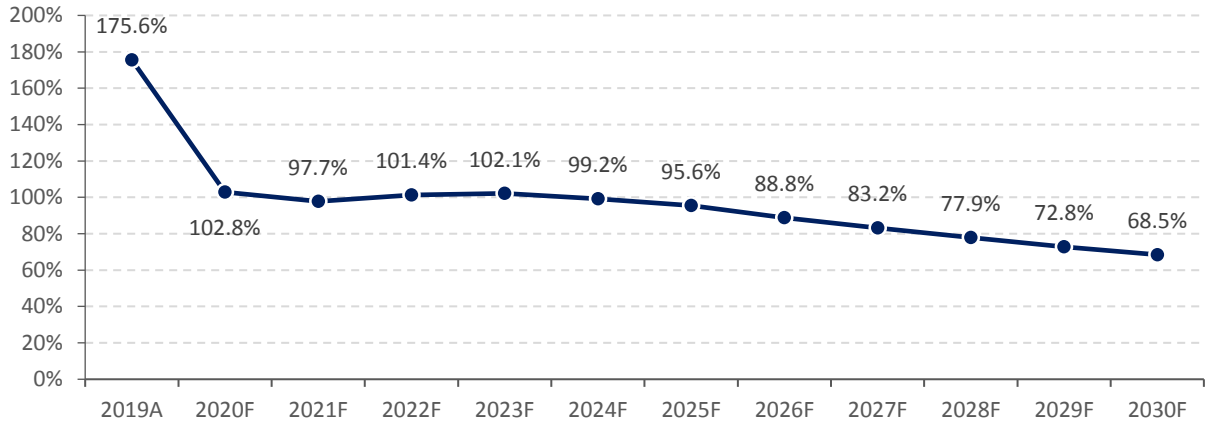
(i) The currency depreciation that will mechanically increase the ratio of USD denominated public debt to GDP, even in the absence of new hard currency debt

(ii) The ongoing budget deficit that will persist over the fiscal consolidation period, therefore requiring the government to incur new debt, and

(iii) (as a result of ii) The large amounts of external funding that Lebanon is expected to benefit from in the context of the unlocking of CEDRE-related financing and a likely IMF program, or alternatively the support from other multilateral/bilateral partners.

Given the above, the target public debt to GDP ratio is set in 2027.

Evolution of the debt-to-GDP ratio (%) in a scenario including discounts on T-Bills and Eurobonds



Source: Lebanese Authorities

[5] Total debt figure may be underestimated as it only takes into account the part of the external support that is meant for budgetary support, thus excluding c. US$6.3 billion of pure BoP support from the total debt stock. The methodological approach will need to be further assessed.

3. FINANCIAL SECTOR RESTRUCTURING

a. Overall Strategy and Objectives

In the financial sector, the priority is given to fully restoring financial system soundness. The reversal of capital inflows from abroad is creating unsustainable pressures on the financial sector as a whole – including BdL – that is unable to meet its financial obligations in FX. In front of massive balance sheet imbalances – representing more than 100% of GDP – complacency or partial solutions are not an option. The Lebanese economy needs a healthy and dynamic banking sector and a strong central bank to grow again. All accumulated losses have to be identified and addressed forcefully. Also, the restructuring of the public debt and the recession will incur further heavy losses on banks' capital position to be added to an already worrying situation.

A full bail-out of the financial sector is not an option. All around the world since the 2008 financial crisis, international practice has shifted away from the idea that a failed financial system should be supported by public/taxpayers money. No foreign assistance will be available to cover the losses from a home-made financial collapse. Bail-out is not an option also because of the size of the losses accumulated in the financial sector. No government would take the responsibility to ask future generations to cover such heavy losses from the past.

The government has elaborated a multi-pronged strategy aiming at fully restoring financial sector stability over the medium term. This will be followed in the coming weeks by a more granular and detailed plan which will take into consideration the situation of each of the largest banks. The program focuses on (i) a full assessment of the financial position of the Banque du Liban and the identification of potential measures aiming at addressing foreign currency mismatches accumulated in its balance sheet, including an appropriate contribution from the banking sector to this restructuring ; (ii) strengthening the governance of financial sector supervision and control, including BdL to prevent any new build-up of financial risks; (iii) a phased restructuring of the banks' balance sheets, including the management of impaired assets, the associated contribution of shareholders and various other means to rebalance assets and liabilities ; (iv) the introduction of the necessary support elements of the bank restructuring strategy into the legal framework; and (v) the design and implementation of a strategy for an orderly consolidation of the banking sector and its recapitalization.

b. Restructuring of BdL

Recognizing and allocating past losses accumulated over the years by BdL as well as immediate expected losses resulting from government debt restructuring is the very first step in the comprehensive overhaul of the Lebanese financial system. Indeed, the further assessment of the domestic banks' net capital position requires the prior valuation of large assets held by Lebanese banks at BdL, essentially deposits and CDs.

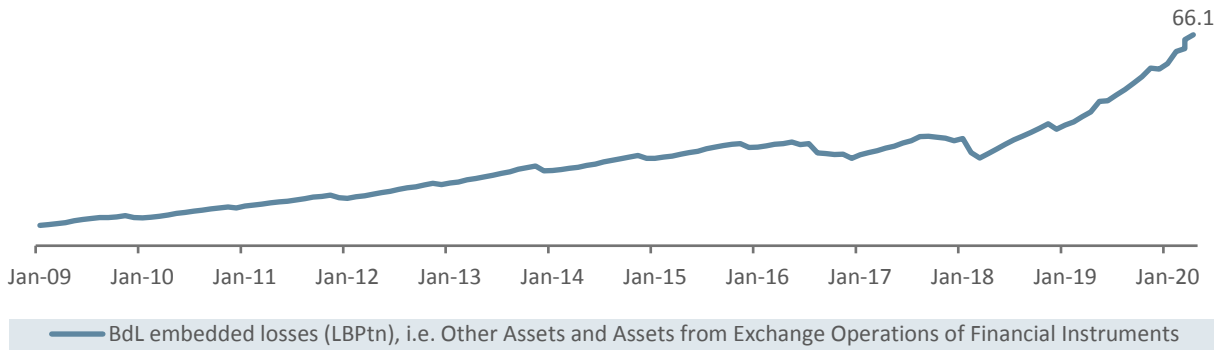
The BdL balance sheet faces three distinct issues: a large imbalance due to accumulated losses from the past, a negative FX position that will increase the losses in case of a devaluation of the Lebanese Pound and a liquidity gap. The council of ministers has decided to task internationally recognized professionals to conduct a full audit of BdL accounts, a full review of BdL's financial operations over the last 5 years and a fair valuation of bank exposures to the central bank. This valuation exercise will consider a full restructuring of BdL balance sheet, including the write-off of embedded losses

accumulated in the past (as identified by the audit) and the impact of government debt restructuring on BdL holdings of Eurobonds and T-Bills.

Where are BdL embedded losses coming from?

The BdL balance sheet includes embedded losses carried forward against future seignorage revenues and accumulated over the last 15 to 20 years. This accounting practice is commonly used by central banks around the world to deal with temporary losses incurred during a crisis. However, BdL has been using this accounting practice over a much longer period of time, so that total embedded losses now represent more than LBP66 trillion, a significant portion of total reported BdL assets and a very large amount (above 100% of GDP at official exchange rate) that compares to no other case in the world.

These embedded losses result from years of loss-making financial transactions operated by BdL (aiming at accumulating FX reserves to defend the peg and cover the balance of payment funding gap, on top of other sources of losses) **and accumulation accelerated in the context of the "financial engineering" that started in 2016**. These transactions were conducted in the view of replenishing the FX international reserves by attracting FX resources from the banks against costly associated financial transactions in FX and LBP. Ultimately, these transactions proved unsustainable and very risky as they couldn't address the core imbalances that generated the regular fall in FX reserves (a very large current account deficit) and they transferred to BdL a large exposure to FX risk.



Source: Banque du Liban as of 15 April 2020

BdL has argued publicly that it does not consider these amounts as losses but rather as an amount carried forward and amortized against future revenues. However, this amount has increased by LBP three trillion in the second half of March and LBP two trillion in the first half of April. The graph above clearly indicates that BdL has not been on a path of amortizing this amount for the last several years.

BdL's embedded losses, or "amounts carried forward", should be restructured and BdL's profitability must be restored. The uncontrolled accumulation of losses threatens the viability of BdL, which is the anchor of financial stability, the credibility of the national currency and depositors' confidence in the entire Lebanese financial system. Moreover, accumulated losses represent large amounts of debt transferred to future generations that will put an unbearable burden on Lebanon's future capacity to grow.

Based on the conclusions of the audit, the evaluation of the impact of the devaluation on BdL accounts, and depending on the objectives in terms of remaining BdL net capital position and net international reserves position, the government will evaluate options for the restructuring of BdL's

liabilities. Transferring all bank related liabilities to the State to restore BdL's balance sheet would not be a viable option. It would result in increased losses for banks and depositors given the overriding necessity for the State to reduce its debt to a sustainable level.

The plan currently envisages a contribution from banks' deposits and holdings of CDs to cover losses that cannot be covered by the existing BdL capital base. The remaining bank deposits on the BdL balance sheet will be re-profiled to help bridge the liquidity gap. In order to reduce the social cost of such a brutal immediate adjustment, the government will consider:

(i) Assigning to BdL the profits of stakes in a newly created Public Asset Management Company (PAMC - see below) to help strengthen its financial position after restructuring. Revenues generated by the PAMC will provide the necessary resources to BdL to repay its remaining liabilities to the banks over time;

(ii) leaving BdL with a moderate negative net capital position that would be covered over time by future BdL seignorage revenues generated after the full restructuring of the balance sheet.

Creation of a Public Asset Management Company to fully restore BdL's financial strength

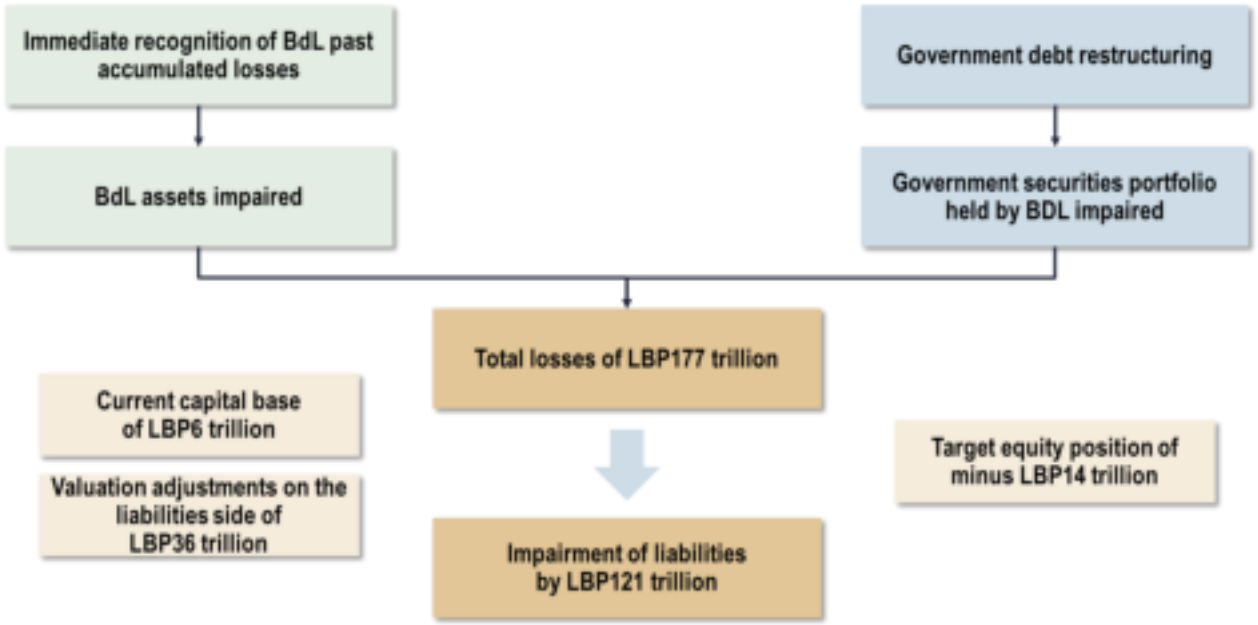
The Public Asset Management Company (PAMC) will be created by law to hold key government assets (excluding Oil & Gas assets): (i) equity stakes in the main state-owned enterprises and (ii) real estate assets.

The government will assign the profits of the PAMC to fund capital increases of BdL allowing it to face its remaining obligations to the banks. The PAMC will be tasked with the restructuring of public companies in its portfolio and their future use over a 10-year period. Real estate assets will be properly managed over the same period of time. The PAMC will be run in full coherence with the authorities' overall growth promotion strategy.

PAMC will adopt a best-in-class governance model, with a management board comprising top-level professionals and a supervisory board representing the shareholders including BdL, civil society, international financial institutions and independent experts. The Government will rely on international expertise for the creation & management of the PAMC and will build-upon lessons learnt from international precedents. It is understood that state-owned enterprises will keep their autonomy throughout the process.

The below chart illustrates the expected assessment of losses to be transferred to the domestic banking sector as a result of BdL restructuring exercise. It relies on the illustrative assumption of a remaining net capital position of minus US$3.9 billion (LBP14 trillion) or c. 15% of GDP[6], on the assumption that the Valuation Adjustments on the liabilities side of the balance sheet constitute permanent reserves and are indexed on the US$ (US$10.4bn) and on assumptions made on the parameters of government debt restructuring. Pending the audit of BdL, the resulting losses, net of BdL current capital base, amount to c. LBP121 trillion. The impairment of liabilities will affect CDs and deposits held by the banking sector.

[6] 15% of GDP for central bank losses carried forward is a metric that has been accepted by IMF in the case of the program currently implemented by Barbados



Note: Figures as of 15 April 2020
Sources: Lebanese Authorities, Banque du Liban

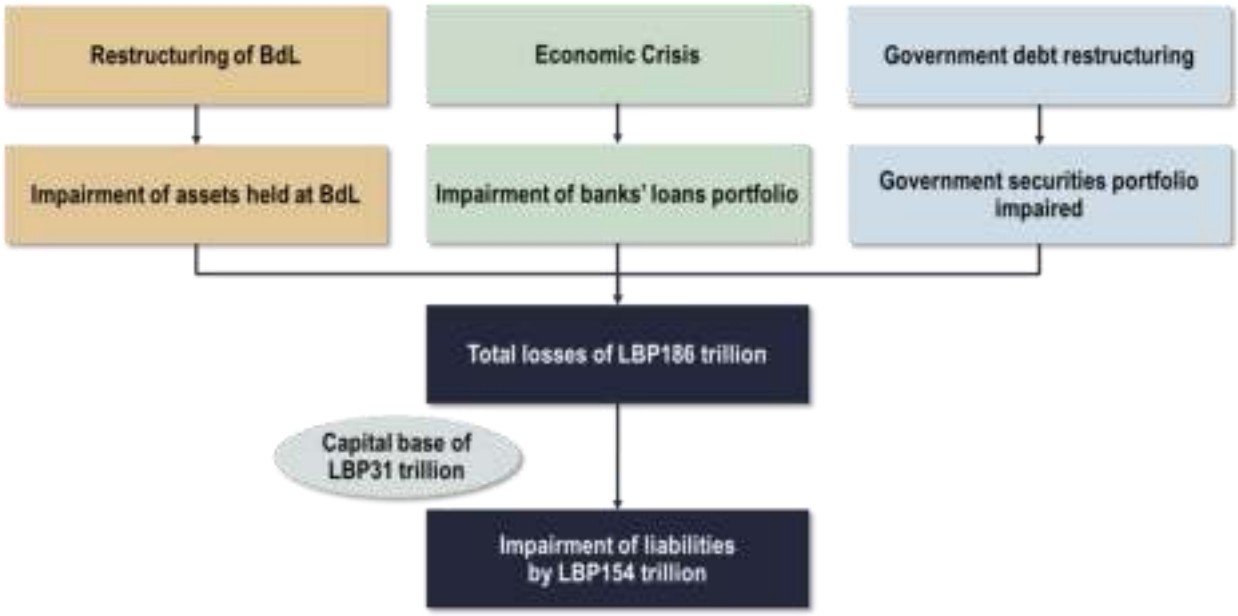
The contemplated restructuring of the BdL balance sheet could entail to cover even larger losses. First, the exact amount of embedded losses currently accounted in the balance sheet remains uncertain and could be revised upward, based on the result of the audit decided by the council of ministers and simply as time passes (as the accumulation of losses increases day by day). Second, the exact allocation of losses will have to take into account the need to restore a positive Net International Reserve position at BdL. The required level of FX liabilities after the restructuring would be adjusted even lower if BdL was to rebuild an appropriate positive net FX position in line with international standards. Finally, the permanent character of the "Valuation Adjustments" amount on the liabilities side of the balance sheet needs to be confirmed.

Finally, following its restructuring, BdL will have to rebuild profitability. Even downsized, BdL's balance sheet would remain sizeable after the contemplated restructuring and largely above the standard size of the balance sheet of a central bank focusing only on core monetary & exchange rate policy activities. It will be exposed to FX risk in the context of a crawling peg or managed float regime. Depending on the PAMC's profitability and of a detailed evaluation of the appropriate level of net international reserve (NIR) position and absent additional restructuring, additional foreign support may be required to replenish BdL net reserves at adequate level. In the context of the reform of legal provisions related to its responsibilities and management, BdL will elaborate a financial & risk management plan aiming at aligning its accounting practices with international practice, enhancing transparency, reducing its role in the financing of the government and restoring its long-term profitability.

c. Banking Sector Restructuring

In addition to indirect losses incurred as a result of BdL restructuring exercise, the domestic banking system will also incur direct losses in the context of the crisis and of the public debt restructuring. An Asset Quality Review (AQR) will be conducted by an internationally recognized

institution to evaluate expected private loans portfolio impairment. In addition, the authorities will evaluate the total impact of the restructuring of the public debt on the holdings of Eurobonds and T-bills in the banks. Based on illustrative parameters of government debt restructuring and the impairment by 30% of banks' portfolio[7] of claims on residents and non-residents, total direct losses are expected to amount to more than the banks' current capital base.



Note: Figures as of 28 February 2020, excluding banks' recapitalization requirements
Source: Lebanese Authorities, Banque du Liban

The authorities will elaborate a comprehensive strategy for the restructuring of banks' balance sheets in due course. In the first instance, it is essential to estimate the losses on a global basis to assess the impact of the financial sector losses on the overall program. Obviously, the exposure of each bank to Government debt or BdL varies greatly. Also, the quality of the loan portfolio of each bank can differ significantly from the average metrics retained in this analysis. As a result, the impact of the losses and the recapitalization needs will necessarily require to be appreciated on a bank by bank basis when the more granular plan is drawn. The full valuation of (direct and indirect) losses incurred by the Lebanese banks in their portfolios of assets could reach a total **LBP186 trillion** as per preliminary estimates covering both USD and LBP assets**.**

First, the plan will implement a full bail-in of existing shareholders and preferred shareholders (i.e. a LBP31 trillion capital write-off). Second, other liabilities excluding deposits, if any (e.g. market instrument issued by the banks), will be written off.

Tackling the remaining very large financial sector losses of c. LBP154 trillion is unavoidable to allow the economy to recover. The Lebanese economy will not grow in the future absent a fully restructured & recapitalized banking sector. The government is determined to allocate the burden sharing of this considerable effort in a way that is economically efficient and socially fair.

[7] The necessary impairment of commercial banks' portfolio will be assessed after a proper AQR has been performed and may prove higher considering the impact of the recession

The authorities are determined to protect the vast majority of depositors, if not all of them if possible. In addition, the assets of the *Caisse Nationale de Sécurité Sociale* and professional organizations (*ordres professionnels, universities, foundations and associations of public benefit…)* will be equally preserved.

In addition, the authorities are convinced that law-abiding citizens should not be affected unless all potential remedies have been exhausted. To that effect:

- The authorities intend to claw back sums which have unlawfully escaped the country and apply those sums against the banks' losses. Sums that will not be captured in a timely manner will be assigned to the Recovery Fund
- Illegally obtained funds and assets, in all fields, and in particular from PEPs, will be used to compensate for the losses
- Finally, bank owners will be required to re-inject an amount equivalent to the dividends received over the period 2016-2020 if they intend to play a role in the recapitalization of their banks.

Restructuring of banks' balance sheets will be implemented based on a comprehensive plan. The plan will be elaborated with the assistance of professional experts who will assess the amount of losses for each bank and their recapitalization needs.

On that basis, and subject to all steps described above, any further measures related to banks deposits will be determined. On a bank by bank basis, large depositors could be offered voluntarily:

- A conversion of part of their deposits into their bank's capital, following precedents implemented in other jurisdictions. New legal provisions will be needed
- A conversion into tradable equity stakes in a newly established special Recovery Fund that will receive the proceeds of the ill-gotten assets tracking and recovery program that will be put in place by the relevant authorities with the help of our international partners
- A conversion into a long dated, subordinated bank obligation with no or a limited interest

The Deposits Recovery Fund

Private sector deposits targeted for bail-in will be transferred to a dedicated deposit recovery fund. The deposits which would be transferred to the fund would be selected based on a framework to be established by the Authorities: small deposits would remain in banks, large deposits could provide a contribution on the basis of their high interest revenue, with an option given for medium and large deposits to be transferred to the recovery fund. This will automatically size down the commercial banks' balance sheets. The selected depositors would be offered by the fund potential long-term recovery, making them entitled to receive revenues over time, up to a limit to be determined. The revenue streams of the fund would come from funds collected through the anti-corruption strategy (stolen funds in particular) and potential other future proceeds from state assets.

Additional options will be also considered in an effort to preserve all deposits as much as possible.

It is understood that the DRF will benefit from the recovery of stolen assets.

Conducting a full restructuring of the banking sector will require new legal powers for the government and the relevant supervisory bodies. The Authorities, with the assistance of relevant international institutions, will identify and adopt any changes needed in the legal framework to make sure

the government and/or relevant supervisory bodies will be in a position to implement any action required to restore financial stability, including the bail-in of existing shareholders as well as all other necessary measures.

The full recapitalization of the banking sector will only be possible after a well-devised consolidation aiming at restoring its solvency and viability, reinforcing its resilience and regain public confidence. One of the key elements of structural reforms is to achieve a smaller, more robust banking sector that serves better the needs of the Lebanese economy. The authorities will rely on the full range of options used by other governments in similar banking crises including the creation of a dedicated government owned bank recapitalization fund able to provide new resources. In this context, the banking system restructuring strategy will probably involve mergers of banks.

Banks will be asked to propose to the authorities and relevant supervisory bodies business plans and restructuring / recapitalization plans including mergers with or acquisitions by other domestic or foreign banks to address their structural funding issues and generate synergies. The government and supervisors will welcome new foreign players in the domestic banking sector to promote competition and transparency. The new capital base will be rebuilt via capital raising in the market or a conversion of remaining deposits into shares.

Fresh liquidity will be provided to the reorganized banking sector. BdL will develop the necessary instrument to ensure that liquidity flows in LBP meet adequate levels to support credit distribution in the restructured banking sector. A gradual de-dollarization strategy will be devised by the Ministry of Finance and BdL to reduce the share of credit distribution in FX. Interbank lending will be resumed to cover liquidity needs in FX.

In order to help the economy to restart quickly, the Government will contemplate the issuance of five new commercial banking licenses subject to having an equity of at least 200 m$, 50% of which should be fresh money. These banks will dedicate their resources to finance almost exclusively the real economy. A development bank and, potentially, specialized funds, will be considered.

4. REFORMS TO PROMOTE A NEW ECONOMIC GROWTH MODEL

Our overall economic approach is based on leveraging all resources and means at the disposal of the Government to regenerate the productive economy and promote a new integrated, sustainable and inclusive growth model that will break with the unsustainable model of the past. The Government will rely on:

- A reformed legal & fiscal environment and the modernized infrastructure environment to rebuild the investors' confidence in Lebanon and in their ability to ensure an adequate return on investment;
- The investments that will be made through CEDRE and other similar programs and infrastructure investments;
- The Lebanese Diaspora's commitment to Lebanon through contributions in productive investments, donations and sponsorships, knowledge, relations, lobbying and market access as well as providing remote job opportunities in the international knowledge economy;
- Partnerships with / assistance and knowhow transfer from international friendly countries, multilateral agencies and partners will be of paramount importance to foster the growth of the economy;

Noting that it should be updated every other year starting in 2021 to keep it up-to-date, measure improvements made and factor in any changes in the environment.

As part of its development strategy, the Government will implement a comprehensive program of structural reforms. The objective is to unlock Lebanon's growth potential, in an environmentally sustainable manner, tackle long-lasting impediments to growth (corruption, inefficiencies), increase exports, develop a diversified production base as well as create adequate and well-paid jobs to reduce unemployment and attract talented Lebanese back into the country. It is the government's ambition to significantly improve Lebanon's rating in Doing Business and Global Competitiveness, where Lebanon's rank has declined in recent years (122 out of 190 in 2016, 143 in 2020). The authorities will pay special attention giving a strong priority allocation of FX resources provided by development partners to the development of the productive economy.

Current list of reform measures ready for adoption

The reform measures we are implementing aim at creating a competitive business environment, attracting investment and increasing productivity to provide fertile ground for private sector activity. Parliament will approve the backlog of laws and regulations prepared in the context of the 2018 CEDRE Conference and implementation decrees will be adopted:

(i) Public procurement law to modernize Lebanon's outdated procurement law and strengthen the procurement administration (to be studied by a dedicated subcommittee at parliament)
(ii) Competition law and consumer protection law (currently elaborated by Ministry of Economy and Trade)
(iii) Labor law (Ministry of Labor)
(iv) Implementing decrees for the e-transaction law adopted by parliament in October 2018 (to be finalized before June 2020)
(v) Laws related to 1) facilitation of secured lending, 2) institutionalization of judiciary mediation, 3) revision of the insolvency law, 4) establishment of a legal framework for insolvency practitioners, 5) insolvency law (currently at Parliament)
(vi) Implementation decrees for the law on judicial intermediation (to be adopted by Cabinet)

- **(vii)** Customs strategy and law including e-single window and on-line access to value at origin (end 2020)
- **(viii)** Publication of PPP regulations (Q1 2021)
- **(ix)** Law for independence of the Judiciary Body (at Parliament)
- **(x)** Integrated solid waste management law (awaiting implementation decrees and decisions)
- **(xi)** Amendment to law 462, appointment of the Electricity Regulatory Authority and of the EDL Board of Directors
- **(xii)** Conduct a credible 2021 budget exercise within the legal deadlines, with a multi-year approach (end 2020)
- **(xiii)** Private equity funds (awaiting higher council)
- **(xiv)** Water code law revision (at Parliament)
- **(xv)** Air quality law (awaiting implementation decrees and decisions)
- **(xvi)** Protected areas law (awaiting implementation decrees and decisions)
- **(xvii)** *Schema d'Aménagement du Territoire Libanais* SDATL decree 2366/2009 (awaiting full implementation)
- **(xviii)** Draft law on organizing the quarrying sector (awaiting finalization)
- **(xix)** Paris agreement on climate change (awaiting full implementation)
- **(xx)** Environmental prosecution law (awaiting full implementation)
- **(xxi)** Chemical management and sustainable consumption and production (awaiting development of the legislation framework)

To enhance transparency and accountability, the authorities will set up a website that tracks the status of legislation and the status of reforms.

Short term action plan to support the economy in the context of the COVID-19 crisis

Short-term economic measures will be implemented to provide businesses with immediate assistance in the context of the recession and the COVID-19 crisis. Public funds as well as foreign assistance will be mobilized to alleviate the burden created by the scarcity of FX on local businesses, support exporters, support micro-credit, ease delivery conditions and support the liquidity position of SMEs. Namely:

1. Allocate US$200 million from the Government as cash collateral through local banks for imports of raw material specifically for industries that export goods with assignment of proceeds of the related revenues, thus bringing additional foreign currency to the country;
2. Once the Cedar Oxygen Fund is established, the above US$200 million can be used to pay CNSS fees in LBP as a way of subsidizing SMEs that commit not to dismiss employees. This will help the cash flow of companies, avoid dismissals, and increase the reserves of the Central Bank in USD hence allowing the Central Bank to place US$200 million in the Cedar Oxygen Fund instead of US$100 million;
3. Allocate US$200 million at parallel market rate as cash collateral through local banks for imports of raw material for industries that do not export enough goods to reimburse the loan with fresh funds with assignment of proceeds of the related revenues to bring back any additional foreign currency to the country – this point needs further study with BdL;
4. Implement the mechanism for Export Promotion included in the 2020 budget (i.e. for a given company that exports more in 2020 than in 2019, it gets a 5% subsidy on the difference);
5. Establish a special program of LBP75 billion at low interest rate through micro-credit companies and NGOs to assist the most vulnerable (poor households and mostly focused on women) in developing a

microenterprise and reducing our subsidy expenditures (max LBP10 million per loan) while making sure that such funds are not utilized as end of month facilities;

6. Negotiate US$200 to 300 million emergency foreign line of credit or guarantees with IFC, EIB, AFD, EBRD, etc. for letters of guarantees and letters of credits (cash facilities will require the guarantee of the Lebanese Republic):
   - Mainly for SMEs
   - For imports of raw material, intermediate goods, essential goods that cannot be locally substituted and working capital without a need for them to put up cash collateral
   - Prioritizing: exporters (since they will bring in foreign currency), then producers (manufacturers and farmers) then Traders;

   Securing such funding from international organizations is critical to enable growth;
7. Start to open progressively the economy while monitoring closely the Covid-19 evolution;
8. Pay a significant part of the dues to the private sector asap (contractors, consultants, hospitals, etc.) to inject liquidity in the market and support companies during this critical time;
9. Cash flow support by:
   - Deferring NSSF payments for at least six months in order to reduce layoffs and enhance cash flow of companies. This will be done with the proper financing provided to NSSF through various means;
   - Accepting temporary reductions in salaries until the end of the year and reflecting such reductions on the NSSF contribution except for end of service pension that remains the same;
   - Provide a 6 months grace period for loan principal repayments with the related IFRS9 accounting forbearance for the banks;
10. Reduce interest rates further to Libor on USD deposits and Libor plus 3% on LBP deposits and set a maximum margin over the BRR of 2% for businesses and 4% for individuals for existing and new loans;
11. Debt moratorium or grace periods for all taxes and utilities fees until the end of the third quarter and waive any penalty fees at least for businesses.
12. Encourage investments, employment, and growth through:
    - 10-year income tax exemption for new investments in newly established companies in the sectors that are supported by our long-term vision;
    - Government owned land to be rented for new industrial investments at below market prices;
    - Allocate Municipal, State and Wakf plots of land to be used by farmers;
    - Reduced NSSF fees for newly employed persons under 30 years.
13. Simplify / relax government administrative procedures for export and import and waiving certain forms and documentation in certain procedures, at least reduce the requirements for quietuses from NSSF for a given period of time.

Transversal reforms

With regards to combating corruption, the government will take credible and visible immediate measures to fight corrupt practices, recoup stolen assets and strengthen the anti-corruption legal infrastructure. Corruption affects citizens and businesses alike, generates large losses for the public finances and tackling this major problem that Lebanon faces is thus a priority for the Government. The Government will conduct an immediate crackdown on corruption in the public sector and appoint well-renowned international forensic specialists to retrieve the stolen funds. It would indeed be unethical to ask the Lebanese to sacrifice so much without doing the utmost to recover their rights. Cracking down on corruption has multiple wide-ranging benefits. First, government bodies will be cleaned-up from individuals who have been engaged in embezzlement of public funds or other forms of corruption. This

will reduce our over-sized and inefficient public sector, while promoting honest hard-working public employees. This in its turn should increase productivity and facilitate any reforms that will be set in motion at a later stage. Second, it sends a strong message that there is accountability which will act as a deterrent for any potential corruption in the future and increase the credibility of the current administration. Third and most importantly, the government will be seen as working towards the same goals of fairness, transparency, and equality, which matter to the people. And finally, it will contribute in quickly funding the deposit recovery mechanism mentioned here above. Overall, this approach is a win-win situation, leading to a positive economic outcome but also satisfying the primary–and very legitimate–demands of the population.

The government will promote inter-ministerial work to secure efficiency and cost control. It will also improve its public investment management framework in accordance with international best practices. The government will quickly put in place a follow-up mechanism for CEDRE that will secure the most effective control on the use of funds, the highest levels of transparency, and the rationalization of the implementation of projects.

Parliament adopted a legislation for the establishment of a National Anti-Corruption Commission. A national anti-corruption strategy has been completed that outlines four main strategic objectives: 1) enshrining transparency; 2) activating accountability; 3) limiting discretion in public administration; and 4) ending impunity; and actions required for their achievement. A plan for its implementation has been devised with assistance from UNDP and the national strategy and implementation plan will be submitted to the Cabinet soon.

The Government will promote measures to secure the smooth implementation of the national social and environmental safeguards and strengthen enforcement of legislation include, but are not limited to: (1) setting strict deadlines for parliamentary, executive and judiciary authorities for feedback and approvals; (2) establishing an ombudsman for quality controlling/ quality assuring the provisions of the laws, enhancing accountability and reinstating the culture of service; (3) standardizing and digitizing procedures, automating the administrations and securing e-services all across; (4) dedicating staff for securing proper access to data and citizen satisfaction through data/ website management, complaint management and application of the public participation principle; (5) optimizing the technical and budgetary capabilities across the public institutions; (6) promoting public-private-academia-civil society partnership and Corporate Social Responsibility in addressing sustainable development issues; and (7) encouraging responsible media.

The Ministry of Finance has prepared the modernization of the land administration system, to be implemented with the support of the World Bank. The project represents the first phase of a 10-year Land Administration Modernization Program. The project's development objective is to improve access to land use and value data, property rights data, and geospatial information through the Land Registry and Cadaster system modernization. It includes completing the surveying/ delineation of the Lebanese territory as an essential tool for proper urban planning. On top of that, immediate and effective measures will be taken to tackle corruption through the standardization of procedures and a broad investigation with regards to previous operations.

Land and basin management. The objective is to achieve Land Degradation Neutrality, and in line with the SDATL, prepare and adopt the masterplan for the protection of environmentally sensitive areas (mountains; protected areas; green surfaces; agricultural terrains; and coastal zone), and complete/revise land use plans with the pre-requisite SEA studies. Adopt a comprehensive environmental management approach to prevent pollution at the basin level.

The Ministry of Finance has laid out a comprehensive strategy for Customs reforms. The strategy is focused on: (i) simplifying procedures; (ii) updating the existing ASYCUDA-based system to support e-payments; (iii) enhancing electronic data entry and developing an electronic registration module, including an e-single window focusing on coordination among all of government's border agencies; (iv) strengthening risk management; and (v) introducing a full-fledged Authorized Economic Operator (AEO) program, which will enable proven low-risk traders to avoid overly-burdensome inspection procedures.

Digital transformation of the Government. A comprehensive strategy for government digital transformation has been developed. The strategy has been reviewed by the World Bank. OMSAR has developed a program for the implementation of the strategy, to be adopted by Cabinet soon.

Sectoral strategies

Financial Services. Areas of development focus on increasing non-banking assets and position Lebanon as on off-shore investment management hub targeting mid-high net worth individuals. Key areas of excellence will be developed such as investment research, digital analytics and actuarial studies. The financial sector will be refocused on the country's sustainable development agenda. Project finance capabilities will be developed to capitalize on Syria & Iraq reconstruction efforts.

Knowledge economy. Higher university programs will be designed as to accompany the knowledge economy's requirements and will build on graduates' skills to develop this part of the economy.

Sectoral reforms

Sectoral Reforms. The government is committed to undertake the required sectoral reforms that are needed to advance the sectors, making them more efficient and sustainable, in line with the basic framework of recommendations suggested by the World Bank. The reform initiatives currently underway, and those planned for short to medium term are presented below.

The judiciary system's governance will be modernized, in particular through amending the law to ensure that judges are elected by judges to key positions, and that a firewall is installed between judges and political and administrative positions. The required texts will be amended to allow any high-level politician involved in the misuse of public funds to be prosecuted and indicted by the relevant control bodies and courts. Only political accusations will be judged by the parliamentarian court for presidents and ministers. The draft law is currently at Parliament.

Environmental prosecution. Dedicated prosecutors and investigation judges will be assigned as per the provisions of law 251/2014. An interim measure (in lieu of the Environmental police established by virtue of law 444/2002 and decree 3989/2016) is to be taken between the concerned ministries (Environment, Interior and Municipalities and Justice) to secure a dedicated team for enforcement of environmental legislation. Capacity building in investigating environmental crimes to be built/ developed accordingly. The set-up is to be assessed periodically and the need to take the environmental prosecution set-up at a higher level (cassation), as per the original version of the draft law (leading to law 251/2014), taken accordingly.

Quarrying. In addition to the planned law organizing the quarrying sector, finalize and adopt the draft quarrying masterplan to drive a sustainable supply of construction raw materials with focus on local market, and enforce it strictly. Parallel to that, initiate and complete the needed study to determine

extracted volumes so far (based on the 1,300 identified quarry sites) as well as identify land ownership. Enforce accordingly the relevant legislation for the purpose of collecting the due compensation to the national treasury (3-fold compensation: (1) governance: working without a permit and/or violating the permit conditions; (2) financial: settling the difference in volume based fees; and (3) environmental: cost of environmental degradation and cost of rehabilitation).

Oil and gas. A sovereign wealth fund will be established to manage the oil and gas assets. It will be geared toward protecting the rights of future generations. Assets will be invested outside Lebanon and proceeds will be partly used as government revenue, thus keeping Lebanon away from Dutch disease symptoms. The fund will act as a stabilization body during its first five years. A pre-determined share of the Sovereign Wealth Fund is to be channeled for environmental protection and rehabilitation activities through the Ministry of Environment until the by-laws of the National Environment Fund (NEF) established by law 444/2002 are issued.

Electricity. Electricity tariffs will be adjusted with a view to reducing EdL's losses. One of the fundamental reforms that remains to be implemented in the electricity sector is establishing the regulatory authority to regulate the sector, as per article 7 of Law no. 462/2002 entitled "Regulation of the Electricity Sector". The aforementioned law still requires approval of parliament. A key reform is the corporatization of Electricité du Liban so that it becomes a well-established company with an assigned Board. The Board must overview EdL's functions based on commercial foundations and create the necessary framework for activities related to generation, transmission and distribution. In addition to that, the status of the contracted employees within EdL will be settled in order to secure EdL's operation and sustainability. The transportation infrastructure will be restructured for the optimal transportation of gas and fuel to the power plants. In addition to that, the transmission network infrastructure will be improved to secure the vital requirements for the efficient and successful operation of the distribution service providers. A Strategic Environmental Assessment for the Electricity/ Energy sector (Electricity; Renewable; Oil & Gas) is to be carried out and its recommendations integrated in the revised Electricity Policy Paper.

Telecommunication. The Government intends to develop and adopt a telecom policy aimed at liberalizing the sector and opening it further to private sector investment and utilization. This entails a revision of the telecom law (Law 431). The Government also intends to appoint the telecom regulatory authority, and appoint the board of Liban Telecom, therefore leading to its corporatization. The investment program of OGERO, the state-owned telecommunications operator of the fixed line, includes projects to upgrade the fixed-line network (built in the 1990s as part of the Government's post-war recovery program) and deploy a nationwide fiber-optics based broadband network. The investment program of the 2 mobile companies (Alpha and Touch), both state-owned but privately operated, includes projects aimed at finalizing a nationwide deployment of 3G and 4.5G network with high coverage and quality of service. A significant part of the investments in the sector is financed from revenue generated by the sector.

Capital markets reforms. The government plans to address the long-standing issue of underdeveloped capital markets and asset management activities outside the banks as part of a broader strategy to modernize the non-bank financial sector, position Lebanon as a financial hub in the region and stimulate investment and growth. Apart from its growth-enhancing effects, capital markets development will help diversify risk and increase financial resilience in the face of shocks. The role of the stock market is also instrumental in the coming period, as it will help attract long-term financing and provide the private sector with working capital. The Capital Market Authority is currently implementing a market development plan with support from the World Bank. It aims at: (i) transforming the Beirut Stock Exchange into a joint stock company, as a first step prior to privatization (a Government decree was

issued for this purpose in August 2017); (ii) launching of an electronic trading platform, which would also include SMEs and start-ups, and provide for access to trading by the Lebanese Diaspora.

Solid waste. Responsibility for solid waste management will be decentralized to municipalities. A Framework Law setting forth the mechanism for developing solid waste strategies and plans will be adopted by Parliament. The proposed law 1) establishes an integrated management of solid waste while taking into consideration scientific advancements in this field, 2) adopts "waste-to-energy" principles, and 3) identifies the role of municipalities within the framework of administrative decentralization of waste management. The subsidiarity principle will be applied in solid waste management as per the provisions of law 80/2018 governing the solid waste sector – including hazardous waste. 4 integrated objectives will be sought: (1) environmental: rationalizing waste generation, driving economic and responsible recovery, and ensuring safe and sustainable disposal (by stopping open dumping and burning, and minimizing landfilling to the lowest limit possible); (2) administrative: adoption of the National Solid Waste Agency bylaws; (3) financial: setting a gradual and proportional system for cost recovery; (4) economic: enhancing private sector engagement and investment.

Air quality. In addition to developing and adopting the application decrees and decisions, sustain the operation and maintenance of the Air Quality Monitoring Stations (AQMS) network based on a public-private-academia partnership approach, and display air quality data and management reports periodically. Enhance and protect ambient air quality according to results.

Water. A national strategy for the water sector was approved by the Cabinet in 2012. The strategy aims to 1) maximize potential of surface water resources and improve management and protection of ground water resources, 2) ensure proper and continuous access to high quality water supply through increased network coverage, 3) provide adequate quantities and quality of irrigation water, 4) increased coverage of waste water collection networks and treatment capacities, 5) introduce and implement a new tariffs strategy, and 6) enhance the legal set up to support the implementation of the national water sector strategy. The Ministry of Energy and Water plans to revise and update the strategy, while taking into consideration the recommendations of the 2015 Strategic Environmental Assessment (SEA) study carried out for this sector and updating it in line with the strategy updating. It will identify achievements to date as well as prepare a work plan for the remaining measures and projects that are yet to be implemented in line with the strategy approved by Cabinet in 2012. The Water Code Law, which is to cement the process of international agreements in the field of water and promote an integrated water resource management and provides for delegation of management to the private sector, is currently in Parliament. More specifically, the law 1) confines authority over this sector to a single entity entrusted with the integrated management of the sector, including waste water and irrigation, 2) regulates management and usage of wells, 3) identifies a system to regulate, rationalize, develop and exploit water resources, 4) increases the efficiency of the systems for transport, distribution and operation of water facilities, in order to ensure sustainable management of water resources, and 5) adopts a "polluter pays" principle.

Biodiversity & Climate change. Conserve Lebanon's natural endowment based on the 2016-2030 National Biodiversity Strategy and Action Plan. Increase the number of protected areas and transform them into rural socio-economic engines. Catalyze efforts to meet Lebanon's Climate Change Nationally Determined Contributions (NDC), mainstream climate change into other policies and plans. Complete the Low Emission Development Strategy and mainstream it into the planned National Sustainable Development Strategy. Launch the Green Investment Facility and optimize the use of this instrument.

Chemical management. Develop the legal framework for rationalizing and regulating the use of chemicals in industrial and agricultural activities. Support environmental compliance across all sectors.

Appendix

<u>Appendix 1:</u> Discussion on alternative scenario with lower external support

A homegrown recovery plan outside of a program supported by the multilateral institutions would fall short of the main objective of giving a fresh start to the Lebanese economy while putting it on a viable long-term trajectory. The only credible alternative scenario to multilateral intervention is the unconditional support of a bilateral friend, similar to what Egypt unsuccessfully tried to do back in 2014 with Saudi Arabia and the UAE to avoid the currency devaluation the IMF was asking for as a pre-condition to its intervention. It would entail a sizeable bilateral support from a friend to help financing the current account deficit and rebuild reserves for a few years, outside of any comprehensive package to bring long-term remedies to the crisis. The immediate visible costs to the Lebanese people would be smaller, with only a modest fiscal consolidation, the rescheduling of domestic debt without a discount, a protracted default situation on external debt, and the postponement of banking sector restructuring, leaving the burden of past-accumulated losses to the next generations. Under such scenario, the CEDRE funds would not be disbursed, leaving the budget with no investment capacity whatsoever and the economy will undoubtedly be surviving for a few years, with capital controls in place and a distorting parallel FX market, before being faced with the exact same (or even worse) situation as today, a few years down the road.

Under such scenario also, privatizing public assets or using public sector companies as a resource to cover the massive losses accumulated in the financial sector would fall very short of the needed amounts. In a context where the economy would not have credible chances of recovery and where the government would obtain no support from abroad for the implementation of reforms, the authorities would not be able to attract foreign investors and to restructure public entities to restore profitability. In addition, the size of the losses accumulated over time in the financial sector represent multiple times GDP and Lebanon possesses too few public assets to monetize.

By failing to tackle the core imbalances of the Lebanese economy, the scenario of no or very limited external support would considerably increase the risks of a complete collapse. Trying to escape from a full-fledged IMF program usually does not bode well for the future of a country. The import contraction that would be necessary in the absence or quasi-absence of external financial commitments would not only lead to an even more severe economic contraction and the rise of poverty, but could also trigger a spiraling recession with the inevitable shortage of basic goods and the explosion of the parallel FX rate as Venezuela has been experiencing for some time now. Continued high level of monetary financing from BdL would inevitably lead to the acceleration of inflation and the total loss of confidence in the Lebanese pound. Depositors and investors in local currency would lose the value of their holdings over time, while foreign currency depositors would have no chance to recover any assets.

Although it comes at a cost, the scenario that is described in the rest of the document offers far better perspectives to restart the Lebanese economy. It entails immediate and sizeable support from the international community in various forms. The objective of the government will be to secure exceptional external funding and its rapid disbursement to immediately stop the bleeding of the economy and allocate fiscal space to alleviate the effect of the recession in the form of a social safety net package. The government will also ensure that all commitments made at the CEDRE conference are included in its

program, to ensure the disbursement of the committed funds over time to invest in the infrastructure of the country.

Appendix 2: Impact simulation of a devaluation of the Lebanese Pound at a USD/LBP rate of 3,500 on BdL and banks' balance sheets down the road

The impact on balance sheets of BdL and commercial banks from a devaluation of the foreign exchange to 3,500 USD/LBP is shown in the below tables. Entries assumed to be denominated in foreign currency are highlighted in green. BdL's and commercial banks' balance sheets are as per BdL's publication on its website.

BANQUE DU LIBAN

in LBPbn

ASSETS	15-Apr-20	Devaluation @ 3,500	PF Deval.
GOLD	23,812	31,472	55,284
FC ASSETS	52,273	69,090	121,363
o/w Eurobonds	*7,583*	10,022	*17,605*
SECURITIES	57,903	-	57,903
o/w T-bills	*50,717*	-	*50,717*
OTHER ASSETS	66,466	-	66,466
LOANS TO BANKS	22,253	-	22,253
TOTAL ASSETS	222,705	100,562	323,268

LIABILITIES	15-Apr-20	Devaluation @ 3,500	PF Deval.
CURRENCY IN CIRCULATION	15,164	-	15,164
COMMERCIAL BANKS' DEPOSITS @ BDL	169,639	157,408	327,047
o/w in FCY	*119,093*	157,408	*276,500*
PUBLIC SECTOR DEPOSITS	7,430	-	7,430
VALUATION ADJUSTMENT	15,709	20,764	36,473
OTHER LIABILITIES	9,156	-	9,156
CAPITAL	5,607	(77,609)	(72,001)
TOTAL LIABILITIES	222,705	100,562	323,268

COMMERCIAL BANKS

in LBPbn

ASSETS	29-Feb-20	Devaluation @ 3,500	PF Deval.
RESERVES / DEPOSITS @ BDL	178,044	157,408	335,451
o/w in FCY	*118,093*	157,408	*276,500*
CLAIMS ON PRIVATE SECTOR	61,715	54,619	116,334
o/w in FCY	*41,324*	54,619	*95,942*
CLAIMS ON PUBLIC SECTOR	39,422	23,177	62,599
o/w in FCY	*17,535*	23,177	*40,712*
FOREIGN ASSETS	24,241	32,040	56,280
OTHER ASSETS	13,662	-	13,662
TOTAL ASSETS	317,083	267,242	584,325

LIABILITIES	29-Feb-20	Devaluation @ 3,500	PF Deval.
PRIVATE SECTOR DEPOSITS	183,030	179,861	362,891
o/w in FCY	*136,081*	179,861	*315,941*
PUBLIC SECTOR DEPOSITS	7,286	-	7,286
DEPOSITS OF NON-RESIDENTS	45,675	54,793	100,469
o/w in FCY	*41,456*	54,793	*96,249*
LIABILITIES TO NR BANKS	12,469	16,480	28,949
OTHER LIABILITIES	37,328	590	37,918
o/w in FCY	*447*	590	*1,037*
CAPITAL	31,295	15,518	46,812
TOTAL LIABILITIES	317,083	267,242	584,325

Appendix 3: Economic Plan 2020-2025

A. *SECTORIAL STRATEGIES*

As Lebanon has and will have no means by itself in any foreseeable future to seriously boost the economy, our overall economic approach is based on leveraging:

- A new era attracting the Lebanese to invest in a productive economy as the rentier economic business model of Lebanon fueled by high interest rates and higher return than any productive economy is past history;
- The reformed legal, fiscal, environment and the modernized infrastructure environment to rebuild the investors' confidence in Lebanon and in their ability to ensure an adequate return on investment;
- The investments that will be made through CEDRE and other similar programs and infrastructure investments;
- The Lebanese Diaspora's commitment to Lebanon through contributions in productive investments, donations and sponsorships, knowledge, relations, lobbying and market access as well as providing remote job opportunities in the international knowledge economy;
- Partnerships with / assistance and knowhow transfer from international friendly countries, multilateral agencies and partners will be of paramount importance to foster the growth of the economy;
- The McKenzie study as:
  - An investor reference providing insights on the best investment opportunities and sectors;
  - Along with CEDRE reform program, a reference for reforms to be performed and infrastructure investments to be executed;

  Noting that it should be updated every other year starting in 2021 to keep it up-to-date, measure improvements made and factor in any changes the environment.

B. *OUR ECONOMIC VISION*

To continuously define, promote and follow-up on the implementation of concepts, policies, procedures, measures, laws and actions leading on one hand to the sustainable creation of value and jobs and, on the other hand, to the sustainable reduction in the Budget and the Balance of Payment deficits.

C. *SHORT TERM PLAN*

In order to jump start the economy, the below short-term plan will start to be implemented immediately:

14. Encourage investments, employment, and growth through:
    - 10-year income tax exemption for new investments in newly established companies in the sectors that are supported by our long-term vision;
    - Government owned land to be rented for new industrial investments at below market prices;
    - Allocate Municipal, State and Wakf plots of land to be used by farmers;
    - Reduced NSSF fees for newly employed persons under 30 years;
15. Simplify / relax government administrative procedures for export and import and waiving certain forms and documentation in certain procedures, at least reduce the requirements for quietuses from NSSF for a given period of time;
16. Enact a simplified form of capital control mainly to ensure the freedom in transacting for fresh money, to ensure that fresh money will not be subject to any bail-in and/or tax on deposits of any sort, if it takes place and to request repatriation of funds above 50.000$ transferred after October 17th 2020 by Politically Exposed Persons (PEPs) and shareholders with a participation in excess of 5% in banks;
17. There needs to be a complete review of headcount in the public sector starting with / at least those who were recruited the last 2 years after the decree that froze hiring and which are considered illegal in addition to a yearly 20% reduction of contractual head count for 5 years. Since the economic plan

includes the revival of the industrial and agriculture sectors, the laid off workforce will be recycled after government sponsored training programs;

18. We should start reducing the Budget deficit by increasing progressively the fuel and gasoline prices;
19. Start closing down unnecessary institutions as per the Ministerial Declaration;
20. Start the process to install scanners at the borders and ports.

D. INDUSTRIAL SECTOR

I. Overview:

Now that the rentier economy is behind us, the Lebanese industry could benefit from a high level of skills among the university graduates and large amounts of savings coming among others from the Lebanese diaspora.

Nevertheless, it is hampered by the size of the local market, high costs (e.g. energy, land), inexistence of efficient industrial zones, weak infrastructure, lack of technical vocational competencies, geopolitical issues with often substandard quality while focusing on packaging and/or transformation and/or assembling v/s producing high quality / high value-added products.

In addition, most industrialists have been unable lately to purchase raw material from abroad to the lack of hard currency.

II. Our Vision:

Become a niche regional leader in creative and high-value industries and a hub for regional processing creating sustainable value and jobs with a sustainable reduction in the Balance of Payment deficit.

I. Our Strategy:

- Focus on high growth and value-added niche markets geared towards reducing imports and increasing exports;
- Initially avoid high energy / utility consuming industries;
- Identify and focus investments on the import replacement industries
- Develop high level of quality standards and quality control;
- Leverage:
  - The financial strength and knowhow of the Lebanese diaspora and the local investors;
  - The availability of highly skilled labor;
  - The agricultural sector production;
    - The regional market and reconstruction need.
    - Excellence in the Knowledge and Technology Industry

II. Action Plan:

- Establish and promote a brand for quality products “Proudly Made in Lebanon” up to European standards with an annual budget of $2M (2021+);
- Develop multiple industrial zones offering world-class infrastructure and services ($130M over a three-year period);
  - Based on developing existing plans (Tripoli Special Economic Zone, three industrial zones proposed by Ministry of Industry / UNIDO);

  - Other zones across Lebanon, among others by renting Municipal and State land for non-polluting industries at below market prices based on agreed upon quality production geared towards export;
- Make government lands available to support the Agroindustry.
- Increase export potential by:
  - Adopting, enforcing, supporting and enforcing compliance with industry state of the art quality standards;
  - Waiving taxes on any produce for the quantity exported (2020+);
  - Leveraging the Commerce Attaché and Lebanese diaspora to open up new markets (2021+);
- Provide a 10-year tax break on profits as fiscal incentives for new investments in the in the industrial sector (starting in 2021);
- Provide a 3-year 50% reduction on NSSF fees for graduated employees under 25 that are employed for the first time by the in the industrial sector (starting in 2021);
- Provide subsidized loans ($3.55B over the period of the plan) to promote investment in target industries (e.g. generic medication, food processing, prefab, recycling, etc.).
- Guarantee the funds, liquidity, and investments as outlined for loan guarantees ($300M), knowledge and Technology Industry ($100M) direct loans and support of raw material ($750M), SME enterprise ($300M), rural and craft industries ($100M), incubators ($60M), labs ($20M), etc.

III. Enablers:

- Implement the broad economic environment reforms (e.g. ease of doing business, infrastructure, power generation, etc.);
- Develop a high quality technical and vocational education.

E. KNOWLEDGE ECONOMY

I. Overview:

The knowledge economy, which is broadly defined as the production of goods and services based on knowledge-intensive activities, is by definition, definitely the economy of the future for a country like Lebanon.

Lebanon has indeed the key ingredients for success and for becoming a regional creative hub based on:
- A greater reliance on intellectual capabilities than on physical inputs or natural resources;
- The quality university infrastructure (although declining in the last years and under financial stress due to the on-going crises);
- The Lebanese innovation capacity and business and marketing talent which is well proven worldwide;
- Deep knowledge regional knowledge and understanding of culture and language;
- Competitive costs further improved by the recent devaluation of the Lebanese Pound.

Nevertheless, Lebanon is suffering from serious issues hampering its development:
- Continuous (and accelerating) emigration of its best talents and its young generation;
- Sub-par physical and virtual infrastructure with low broadband speeds and high connectivity costs
- Weak regulatory and legal frameworks;

- Lack of incentives and seed projects from the Government (e.g. fiscal incentives, R&D on drones for the Lebanese Armed Forces or for the development of the agriculture, etc.);
- Underdeveloped capital markets and current financial crisis making access to local capital challenging;
- Poor acceptance / understanding of the Venture Capital (VC) approach by local investors and no established relations with VC structures and investors abroad.

II. Our Vision:

Leverage talent, technology, infrastructure and regulations to build a sustainable and leading knowledge economy and become a knowledge-driven digital nation, at the forefront of innovation, acting as a talent hub for technology, business services and outsourcing, creative industries and education.

III. Our Goal:

Become a globally recognized regional service provider and a "Silicon Valley" generating an inflow of equity and of revenues from cross-border services with several companies having a valuation in hundreds of millions of dollars.

IV. Our Strategy:

Learn to walk before we try to run…
A successful knowledge economy company needs to have mastered the relevant technology and/or creative skills, management skills, international business development and/or marketing skills, etc. Currently, Lebanon's knowledge sector companies have these skills only at a basic level. We cannot jump from where we are to Silicon Valley as we have been trying to do since 2010.

Therefore, we should:

- Subsidize the development of our capabilities by providing local companies with opportunities adapted to their capabilities and such subsidies should benefit Lebanon, and be commensurate with this benefit, e.g.:
  - Increasing potential exports and/or import substitution;
  - Hiring high talent employees;
  - Developing Lebanon's knowledge capabilities;
  - Giving the sector a positive image abroad i.e. boosting the "Lebanon" brand and opening markets up for each other
- Accelerate the digitization of the government and public institutions including healthcare, education, etc.;
- Establish bridges and partnerships for knowledge economy companies with the Lebanese diaspora and the VC community to attract cross border business and Foreign Direct Investments (FDIs);
- Not penalize companies that are copying a successful business model from abroad rather than innovating as we need to master some of these models first before we can start to innovate.
- Provide the conducive environment (physical, fiscal, technological, etc.) for private local and international investments.
- Continuously improve our educational hub, attracting regional students across the board, and international students for specific niches.

V. Action Plan:

- Establish in the Ministry of Economy and Trade a team dedicated to the development of the knowledge economy and the coordination between all related public and private entities (2020/2021) along with a National knowledge Economy Council composed of key selected senior stakeholders from both the private and the public sectors;
- Analyze the results of BDL's scheme (circular 331) for VC and update and develop it to make it more efficient and productive (2020);
- Adopt digitization as the key driver of sector productivity across all sectors and digital as the unique delivery means of government and private sector services (2020+) by:
  - Giving preference Lebanese companies;
  - Splitting big tenders into smaller ones wherever it makes sense, in order to allow a more Lebanese bidders to be among the winners;

  Thus, they can grow their capabilities as the government's needs grow.;
- Allocate a 2 m$ per year budget to establish a trademark for its knowledge economy and promote it through the Commerce Attaches and our international partners to build a network of investors and businesses ready to cooperate with local knowledge economy companies (starting in 2021);
- Partner with academic institutions, businesses and government entities to improve the support for innovation and provide physical and human resources as well as knowhow;
- Launch incubators and accelerators within the Lebanese University's branches throughout Lebanon, the space being provided by the Lebanese University, while the incubators / accelerators would be operated / managed through private sector initiatives;
- Promote Lebanese Universities to attract foreign students (already in the tourism sector plan) and promote partnerships between local and international universities;
- Establish one stop shop / full service Knowledge Economy Zones (Digital Hubs) in greater Beirut and in rural areas with low rent (e.g. on municipal or state land like Rashid Karame Fair) and low telecom costs;
- Provide a 10-year tax break on profits as fiscal incentives for new investments in the knowledge economy sector (starting in 2021);
- Provide a 3-year 50% reduction on NSSF fees for graduated employees under 25 that are employed for the first time by the touristic sector (starting in 2021);
- Provide an unemployment allowance for a certain amount of time, for people who take the risk of creating or working in a start-up, in case that start-up fails;
- Allocate an annual budget of 50 m$ R&D budget for capacity development of the Lebanese Armed Forces to be invested in the knowledge economy under the supervision of CNRS (starting in 2021);
- Leverage the Commerce Attaches' and our international partners to build a network of investors and businesses ready to cooperate with local knowledge economy companies (starting in 2021);
- Provide a tax break for individuals and companies that invest equity in the knowledge economy allowing them to deduct 10% of their investment from taxes due for a period of 5 years (starting in 2021).

VI. Enablers:

- Enact, review and modernize all articles of law and regulations necessary for the Knowledge Economy sector, mainly bankruptcy, competition, IP & Data Protection, Electronic Signature (2020 / 2021) and part timers;
- Implement the Fiber strategy (see investment plans).

F. AGRICULTURE SECTOR

I. Overview:

Lebanon benefits from a large biodiversity due to its geography, allowing it to produce a very large variety of crops with a serious potential to feed the Middle East and Europe with a high-value crops breadbasket.

Nevertheless, the agriculture sector suffers from low productivity due to small holding sizes or outdated techniques, low quality standards, ineffective cooperative systems, choice of low value-added crops sometimes cultivated at a loss (tobacco or wheat), lack of Government support leading to high production costs. In addition, exports have been hampered by the geopolitical instability for practically the last 10 years.

II. Our Vision:

Focus on high-value high-quality produce geared towards export generating sustainable wealth for farmers and rural communities and participating in the reduction of the balance of payment deficit through a coordinated effort by all stakeholders.

III. Our Strategy:

- Shift from low-value low-quality crops towards high-value high-quality crops (e.g. avocado, bio, etc.) with a focus on crops that have revealed comparative advantage for Lebanon to boost exports (e.g. potatoes, lettuce, thyme);
- Increase productivity per acre of land to be in line with global averages through improved techniques and modern technologies;
- Render local markets more efficient by strengthening the cooperative system;
- Reap the benefits of the recent legalization of cannabis for medical use.
-

IV. Action Plan:

- Establish and promote a brand for quality products "Proudly Made in Lebanon" up to European standards with an annual budget of $2 m (2021+);
- Incentivize the shift to high-value crops and provide the necessary support for 2 years to:
  - Facilitate the introduction of latest methodologies to improve yield and quality by offering training and workshops to farmers, and raise awareness regarding the overuse of fertilizers and pesticides (2021+);
  - Facilitate access to financing in the form of subsidized loans (2021+);
  - Provide fiscal incentive for investments in the Agriculture sector;
- Increase export potential by:
  - Improving quality standards;
  - Strengthening quality control mechanisms (overuse of pesticides, irrigation using contaminated water, etc.) (2021+);
  - Waive taxes on any produce for the quantity exported (2020+);
  - ISO 17020 certification for food inspection (2021+);
  - Provide training to move away from harmful harvest and post-harvest techniques (2020+);
  - Facilitate expansion & improvement of post-harvest infrastructure (e.g. cold storage & packaging facilities) (2021+);
  - Leveraging the Commerce Attache and Lebanese diaspora to open up new markets (2021+);
- Improve productivity (for e.g. for potatoes Lebanon 25.2 t/ha Turkey 32.4 t/ha):

  - By using Information Technology and IT, we can select better crop, fertilizer, and pesticide (2021+);
  - Strengthen the credit cooperative sector (access to financing) as the use of improved varieties of seeds, fertilizers, pesticides, agricultural machinery, require funds that the farmer cannot easily access (2021+);
  - Train the ministry's technical staff to help farmers better identify insects, pests, and diseases to quickly eliminate them (2021+);
  - Educate farmers in the methods of sowing, maturing and irrigating the new high-yielding varieties of seeds (2021+);
- Reinforce and support cooperatives to:
  - Compensate the small average holding size and strengthen the negotiating power of the farmers v/s the distributors (2021+);
  - Have the critical size for digitization and automation;
- Progressively stop the subsidies for wheat and tobacco and use the proceeds more efficiently to develop the sector;
- Rent Municipal and State land to farmers at below market prices based on agreed upon quality production geared towards export;
- Solicit the support of multilateral agencies and donors to for financing.

V. Enablers:

- Review and modernize all articles of law related to the Agricultural sector (2020 / 2021);
- Increase investment into enabling infrastructure, both hard (roads, energy, etc.) and soft (e.g. ICT).
- Integration of ICT not only in the agricultural sector e.g. e-commerce, automatic milking, but also in other sectors e.g. online land registration and land valuation…

G. TRADE & INVESTMENT RELATIONS

A key challenge that Lebanon is facing relates to the existing trade and investments relations with its key partners increasing the large imbalance between imports and exports. To that effect, specific attention will be given to enhanced trade & investment agreements able to generate large economic benefits, namely:

- The EU Association Agreement and the EFTA Free Trade Agreement need to be renegotiated;
- The World Trade Organization, MERCOSUR Free Trade Agreements (Argentina, Brazil, Paraguay, Uruguay, etc.) and Agadir Agreement (Egypt, Jordan, Morocco, Tunisia) negotiations should continue and be signed after extremely careful review;

among other things, to address the issues the private sector is facing with both technical and non-technical measures with a focus on food exports, pharmaceutical products and rule of origin constraints.

Such review should strongly contribute to the development of key sectors, provide new opportunities for exports and for foreign direct investment in support of the development of the productive economy. The Ministry of Economy and Trade, with the assistance of local and international experts, will coordinate with all involved Ministries (Agriculture, Industry, Foreign Affairs), IDAL and Chambers of Commerce in order to:

- Enter and/or renegotiate and/or withdraw from existing trade deals;
- Impose tariff and non-tariff measures on imports.

H. TOURISM SECTOR

I. Overview:

Tourism has proven to be a vehicle of growth and job creation all over the world. Prior to the pandemic, it was one of the fastest growing sectors of the world economy. According to the Natural Resources Consultative Forum a $250,000 investment in tourism generates 182 full-time jobs. Moreover, tourism tends to accelerate reform and diversify exports, making the economy less vulnerable to fluctuations in demand. Other benefits of tourism include an increase in domestic consumption, help in poverty alleviation, and empowerment of women. Ultimately, Lebanon aims to build an economically productive and sustainable tourism sector.

Lebanon benefits, among others, from:

- A diverse and rich variety of archeological and/or historical sites and cities (including some of the oldest human settlements, famous Phoenician cities with Byblos being the most ancient still inhabited city on earth dating to more than 4000 BC, 14 UNESCO World Heritage Sites, etc.) with a 4,000-year cultural heritage;
- Exceptional natural sites and biodiversity conducive to outdoor, rural and agritourism (Jeita Grotto, one of the finalists to the World New Wonders, etc.);
- Numerous renowned religious sites and a pilgrimage destination announced by the Vatican (Holy Valley – Wadi Qannoubine –, Cana, Saint Charbel and much more);
- Outstanding and varied gastronomy experience, nightlife entertainment and other leisure offers (e.g. skiing, hiking, sun & sea, etc.);
- Good infrastructure geared towards business tourism (MICE – meetings, incentives, conferences, and exhibitions) noting that such tourism stimulates the economy even in the low season;
- Renowned medical and education systems conducive to related medical and educational tourism;
- A large diaspora community across the globe maintaining strong and regular links with its Lebanese roots.
- And now, the devaluation of the Lebanese Pound... making tourism financially attractive for international tourists.

Nevertheless, Lebanon's Tourism Sector faced and struggles with structural problems related to:

- Its internationally tarnished image and unclear branding;
- The lack of cohesion in terms of vision, strategy and focus along with weak communication and no related budget;
- The repetitive crises Lebanon went through being political, geopolitical, social, economic or financial, etc. making it less attractive to international tourists;
- High costs with respect to other popular destinations like Turkey (hotels, flights, etc.);
- Hotel room capacity (mainly in the low to medium end) and price/quality issues;
- Weak technological and transportation infrastructures;
- Pollution and waste and waste water issues;
- A Fragmented tourism ecosystem with responsibilities dispersed across several stakeholders (Ministries, agencies, NGOs, etc.);
- Finally, the COVID-19 disease which is expected to affect the worldwide tourism sector, including Lebanon, for a significant period of time.

II. Our Vision:

Become a destination of choice offering a unique combination of unrivalled entertainment, historical and cultural sites and breath-taking nature with regional niche offerings and specialized business, medical and religious tourism and thus, build an economically productive and sustainable tourism sector.

III. Our Goal:

Since 2010, tourism has been in decline while being a major employer while it has the potential to double leisure tourist entrances from 2 million to 4 million over a 5 to 7-year period as per the below plan.

IV. Our Strategy:

- Focus initially on Domestic and National Tourism as a tool for quick acceleration of tourism recovery;
- Then target local tourism, the Lebanese diaspora, the Arab countries and the EU;
- Develop and implement a full marketing and communication strategy leveraging the strengths developed in section I above for an improved country image;
- Provide the private sector with the necessary tax and interest rate incentives and the right environment to develop and invest in the tourism sector;
- Call on donors and municipalities to improve existing historical and archeological sites as per plans to be established by the Ministry of Culture in cooperation with other concerned Ministries and Directorates;
- Execute the necessary infrastructure investments and implement other required enablers.

V. Action Plan:

Tourism is a faster driver for economic recovery if compared with the industrial or agricultural sectors. The investments required, aside from communication and infrastructure, can be made by the private sector. The effective implementation as per the World Tour Organization (WTO) recommendations, is based initially on 3 key areas:

- Managing the crisis and mitigating the impact;
- Providing stimulus and accelerating recovery;
- Preparing for the future.

On the marketing side:

- Retain in 2020 a good international PR / communication company to promote Lebanon as a destination of choice for international tourists and develop and establish a brand and marketing plan for tourism in Lebanon (budget $2 m);
- Allocate an annual marketing communication and advertising budget of at least $50 m starting in 2021 including:
  - An active social media presence to push, promote and interact with tourists;
  - Engaging tourists on social media and organizing their feedback and reviews to devise action plans to improve on their “customer experience”;
  - Establishing a data base through partnerships with different travel channels/ platforms to organize, aggregate and store user generated content for marketing;
  - Developing and promoting structured tour recommendations for each niche segment (continuous);
  - Developing an electronic and published FAQ for tourists;
- Establish partnerships with local and international tour operators for inbound tourism (continuous);

- Add explanatory signage in museums and historical and archeological sites through donations and /or sponsorship with the private sector for financing (continuous);
- Prepare a strategy for the digitalization of the tourism sector (2021+).

On the incentive side (to be decided in 2020 and implemented in the 2021 budget and on):

- Reduce the VAT by 5% and provide a 10-year tax break on profits as fiscal incentives for new investments in the tourism sector (e.g. hotels, parks, amusement/water parks, beaches, etc.);
- Reduce the VAT by 5% as a fiscal incentive for the improvement of existing touristic facilities (e.g. hotel capacity, quality, price to quality ratios, etc.);
- Provide a 3-year 50% reduction on NSSF fees for graduated employees under 25 that are employed for the first time by the touristic sector;
- Provide a tax-free incentive for artists participating in festivals (Beiteddine, Bustan, Jbeil, etc.)
- Donations related to the improvement of the tourism sector should be deductible from taxes on revenue or profit;

Other:

- Consistently launch campaigns with NGOs and the public at large to clean beaches and other important sites (continuous);
- Establish partnerships with USEIL (Union of Sustainable and Ecotourism Institutions in Lebanon), and implement STILL (Solidarity Tourism Initiative Lebanon) an initiative launched by USEIL to accelerate tourism recovery after Covid-19 and with NGOs (e.g. Loubnan Sawa, Tastahiqou al-Ahsan, Droubna, LMT, LRI, Jouzour Loubnan, AFDC, etc.) to develop eco-tourism;
- Improve the Tourist Journey Experience:
  - Facilitate visa applications and delivery via digital means (2020);
  - Facilitate and accelerate the processing of tourists in the airport and from/to the airport and create fast lanes for those in business class and those paying a fee (2020 / 2021);
  - Implement taximeters and clear instructions and multilingual fares and information on all transportation services (2021);
  - Set a hotline for information, complaints, etc. for tourists (2020);
- Advance digital transformation in the tourism sector e.g. virtual reality, online reputation, etc. (2021+);
- Improve the maintenance and ensure the cleanliness of touristic sites (2021+);
- Provide quality F&B services through PPP in major touristic sites (2021+);
- Sell additional gaming licenses to international operators (2021);
- Rent Municipal and/or State land at 50% of the market price for the first 10 years for new touristic investments (starting in 2021);
- Organize an annual shopping festival and provide incentives for festivals organized by the private sector (starting in 2021).

VI. Enablers:

- Review and modernize all articles of law related to the Tourism industry (2020);
- Develop pedestrian zones and cycling lanes in all major cities (starting in 2020 in Beirut City Center);
- Allow free access to beaches from the extreme North to the extreme South (starting in 2020 in Beirut City Center);
- Accelerate the Airport expansion with more flight connectivity and an open sky policy (see investment plans);

- Implement urban planning and transport infrastructure improvement (see investment plans);
- Implement waste water treatment plans including beach and river cleanup (see investment plans).

I. SOCIAL AFFAIRS AND DISPLACED

I. Overview:

The effect of the economic crises combined with the impact of COVID-19 will increase unemployment and the level of both poverty and extreme poverty to levels unseen in Lebanon since the beginning of the 20th century with a much higher impact on the rural economy and inhabitants that are suffering from poor infrastructure and access to basic services.

By early February, the World Bank was already expecting the level of poverty to exceed 45%. Combining the effect of COVID-19 and of the recent strong devaluation of the LBP, the level of poverty may very well exceed 60% of the population by year-end.

On one hand, this is a social time bomb and, on another hand, the success of any given society is directly linked to the well-being of its citizen.

II. Our Vision:

To provide a social safety net that shall protect the most vulnerable families and to develop a sustainable economic environment that will foster the creation of job opportunities to allow such vulnerable families to graduate out of poverty.

III. Our Goals:

- Promote social inclusion by leveraging gender equality, safety net enhancement, eradicating poverty, child & women protection, elderly care, people with special needs, education, trainings, financial literacy and provide links for access to finance;
- Improve people's livelihoods, wellbeing and income, reducing poverty, rebuilding the rural areas and securing the peri-urban zones are key elements;
- Encourage the rural population to reverse migration from the city or from abroad to the countryside.

IV. Our Strategy:

- Coordinate the efforts of concerned Ministries (Social Affairs, Tourism, Labor, Displaced, Industry, Agriculture and Economy) to optimize the use of our scarce resources;
- Coordinate with multilateral agencies, NGOs and donors to create a better impact and to avoid duplication of efforts;
- Review the current programs through a SWOT analysis and assess their efficiency;
- Seek for the support of the Lebanese diaspora and of the private sector's involvement through targeted programs with clearly established Governance;
- Leverage the Social Affairs Development Centers (SDCs) that are currently undergoing upgrading and automation to achieve a better provision of primary health care, social education and local development as a tool to build and improve welfare structures outside of Lebanon's main cities.

V. Action Plan:

- Develop and implement a full marketing and communication strategy to raise awareness and secure funds with an expected annual budget of $1 m (2020+);
- Enhance and implement social safety nets to protect marginalized families, fight poverty in poor areas, and propose community plans to improve their conditions and provide the basic services to them from education, health, and social services with a special focus for areas that witnessed conflicts – expected budget $1 m in 2020, $1.5 bn in 2021, $1 bn in 2022 and $0.75 bn in 2023 and 2024 (continuous);
- Invest in the recent programs, IMPACT and the new SSNP PMT data collection in order to build a reliable database and continuously update it and verify it as a key element to develop focused and effective programs with a better understanding of the needs and more focused targets to act upon (2020+);
- Encourage sustainable investments through micro-credit and partnerships between the public and private sectors, municipalities, donors and NGOs (continuous);
- Establish a coordination structure between the Ministries of Social Affair and Displaced, the Municipalities, the multilateral agencies, the donors and the NGOs in order to:
  - Solicit and optimize financing for the sustainable development of the economy, professional training, transfer of knowhow and continuous education adapted to each region and / or product and / or service (2020+);
  - Ensure through each completed project transfer of knowhow to other communities with on-line courses and project plans allowing to reproduce successfully such projects (2021);
- Encourage the rural population to reverse migration from the city to the countryside by:
  - Securing markets for agricultural products and traditional industries specific to each region and take advantage of the exchange rate difference for foreign currencies for export (2021+);
  - Securing optional and / or obligatory social protection services (healthcare & retirement) to motivate rural people to start entrepreneurship instead of looking for a job (2021);
  - Encouraging the fragmentation of Public Sector purchases to allow small enterprises to participate in tenders and purchase inputs from local producers (2020+);
- Accelerate the return of displaced Syrian refugees in order to alleviate the social and economic weight on host communities and on the government (continuous).

VI. Enablers:

- Availability of complete Covid19 compliance procedures;
- Availability of basic services in remote areas, specifically the internet service, common transportation, improve road network, the availability of basic commodities, and facilitating the completion of the necessary transactions, especially paying fees and registering institutions, etc.;
- Enhanced Inter-ministerial collaboration;
- Digitalization of the Ministry of Social Affairs and the Ministry of Displaced Procedures.

Appendix 4: Estimated Costs of Social and Economic Support Measures

FIRST ESTIMATES					
m$	**2020**	**2021**	**2022**	**2023**	**2024**
Social Safety Net	1,000	1,500	1,300	1,000	750
Expenses	105	242	299	249	249
Subsidized Loans	400	1,500	1,600	1,600	1,600
FC liquidity for raw material	400	600	600	600	600

Expenses					
m$	**2020**	**2021**	**2022**	**2023**	**2024**
Lab	20	10	7	7	7
Knowledge Economy		52	52	52	52
Incubators	10	20	30	20	20
Industrial Zones	50	40	40		
Tourism	20	100	150	150	150
Misc.	5	20	20	20	20
TOTAL	**105**	**242**	**299**	**249**	**249**

Subsidized Loans (Mainly in Hard Currency)					
m$	**2020**	**2021**	**2022**	**2023**	**2024**
Industry	250	750	850	850	850
Agriculture	150	450	450	450	450
Tourism		300	300	300	300
TOTAL	**400**	**1,500**	**1,600**	**1,600**	**1,600**

TAX INCENTIVES	
New Investments	No impact on budget
VAT	To be calculated
NSSF	To be calculated