



*May 4, 2020*

## **LIFE's Response to the Government of Lebanon's Decision to Seek Financial Assistance from the IMF and its updated Financial Recovery Plan**

LIFE welcomes the decision of the Government of Lebanon to start negotiations with the International Monetary Fund ("IMF") in order to obtain a rescue package. LIFE is also pleased with changes made to the final version of the government's "Financial Recovery Plan" (the "Plan"), some of which were advocated by LIFE in our recent paper dated April 20<sup>th</sup> including (i) a **more realistic, (though still ambitious) projection of the currency exchange rate**, (ii) a **more nuanced approach relating to the restructuring of the financial sector** including more definitive language regarding measures to strengthen the protection of depositors and (iii) further **strengthening of the social safety net, including universal health care**.

While we continue to be encouraged by the Plan's candid assessment of the situation and comprehensive approach, we highlight below a few comments relating to assumptions, omissions and some developments on the ground which are still of some concern to us:

- Given the likely worsening budget deficit (especially following the economic slowdown resulting from COVID-19), we feel the Plan's **"phased" approach, while comprehensive, is not radical or detailed enough to put Lebanon on a sustainable path of fiscal recovery**. Furthermore, Lebanon's request falls under the IMF's "Exceptional Access" track, requiring particularly stringent fiscal measures which we are not convinced would be entirely met by the proposed measures.
- While we are pleased that the Plan recognizes the need to stop all subsidies to Electricité du Liban ("EdL"), something we have been calling for since 2017, the Plan does not project this happening fully until 2024. In addition, it still refers to an EdL strategy announced by the previous cabinet which is of questionable credibility and feasibility. Given that EdL remains a major source of fiscal leakage, **we call for a more actionable reform plan for the electricity sector and a more front-loaded phasing out of subsidies**.
- LIFE believes the net external funding required over the next 5 years to stabilize the country to be **substantially higher than the US\$10 billion mentioned in the Plan or expected from the IMF**. CEDRE-related funds which the French government reconfirmed last Friday are highly conditional, include loan and loan guarantees and are generally not earmarked for fiscal consolidation but rather for infrastructure and related investments. This is why we hope to see more ambitious structural reforms, further fiscal discipline and a strengthened rule of law so that private capital including foreign direct investment can flow back as soon as possible thereby helping the country further on its path towards economic stabilization.
- LIFE continues to consider that **the Plan should include a strategy for the privatization of state-owned enterprises in the medium term** in order to attract foreign direct investments, help bridge the financing gap and improve the competitiveness of the Lebanese economy. Such strategy need not necessarily always imply an outright sale of government assets but we do feel that introducing more competition, independent boards, professional management teams and partial sales will help in maximising value to the government in the long term, in addition to improving services. Any such programme will require a strong and independent judiciary and regulatory authorities, a transparent and competitive bidding process and, where possible, replacing monopolies with competing and well-regulated operators.

- While we are encouraged by the language relating to cracking down on corruption, it is sorely lacking in specificity. LIFE continues to believe that the **“forensic” audit requested for Banque du Liban (“BdL”) should be explicitly and unambiguously expanded to cover all government ministries, major agencies, public bodies and individuals involved in public tenders.** This should start immediately and include areas that consumed most of the government’s revenues over the past years such as EdL.
- The Plan mentions that the reforms will “require new legal powers for the government and the relevant supervisory bodies”. LIFE welcomes any action that helps accelerate the implementation of the Plan but by the same measure, reiterates its support for the reinforcement and unhindered application of the rule of law, a prerequisite for any credible reform. This requires **an independent judicial system to enforce the law indiscriminately and apolitically and act as an independent check on fast-track powers granted to the government.**
- While we welcome the planned **move to a more flexible exchange rate** in order to “prevent artificial real appreciation and preserve competitiveness”, **we do not think the assumption of a foreign exchange devaluation of 5% per year against the US dollar after 2020 to be realistic** in achieving this goal based on empirical evidence and historical precedents, especially given the external imbalances.
- The Plan still remains vague on how the financial sector will be restructured and eventually fully recapitalized. We are encouraged that the Plan now recognizes that any impact on depositors needs to be considered in an orderly, fully legislated and transparent manner, and only as a last line of defense but we feel that the details on how this can be achieved have yet to be fleshed out. **We also believe that it must go hand in hand with immediate, credible and wide-ranging fiscal and structural reforms** absent which, such restructuring will prove futile further exposing depositors to a deteriorating sovereign credit and discouraging future recapitalization of banks.
- The updated Plan recognizes that the *de facto* capital controls implemented by individual banks are a “source of unequal treatment of depositors as loopholes remain” and while it does suggest the government will take action towards fairer and more comprehensive implementation, it falls short on calling for the **immediate legislation of capital movements** enabling the remaining systemic liquidity to protect the supply of food, medical and other essentials, while supporting the economy’s productive sectors. We also would support an audit of capital outflows since October 2019 to ensure a proper review can be conducted.
- While the Plan does include some proposed structural reforms, it still does not articulate a sufficiently clear **economic vision for the country** from which a more comprehensive set of reforms can be immediately initiated to kick start the path towards a **more sustainable and productive model for the Lebanese economy.**

Seeking the IMF’s help is an important step in the right direction. However, any hope of stabilization will still require strong economic leadership and political consensus. It will require a real intention to reform on the part of the political parties representing the ruling coalition and cooperation among all stakeholders. As such, we are concerned by the **recent tensions between the Cabinet and the BdL who in time of crisis will need to work together more than ever.** LIFE hopes that the adoption of the Plan will form the basis for a constructive dialogue across all relevant actors including civil society and business associations in order to build a broad national consensus enabling swift execution.

**The time to implement is now.**

**LIFE**

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