

# An Alternative Economic Revival Plan

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## Executive Summary

**T**his comprehensive Revival Plan advocates that no solution to the current economic situation is feasible without political reform that ensures independent, professional, and transparent governance. The impact of the regional conflict in the Middle East, and the activities of Hezbollah have resulted in lowering the probability of massive international aid. No amount of technical wizardry can overcome the crisis, or even manage it, without trustworthy political leadership. The current political caste has lost the confidence of a large portion of the people, the business community, potential investors, and international finance and development institutions.

### **An approach of continuity rather than liquidation**

The economic, financial, and fiscal challenges are high, and they have created panic expressed in the markets, by the Central Bank, commercial banks, and policymakers. A flurry of proposals have been made, most of which have adopted a 'liquidation' approach, and assumed that all liabilities are due immediately, while not taking into account of existing large-scale State assets. That approach is not realistic while this plan assumes continuity. It advocates an alternative to the 'common wisdom' currently being promoted.

### **Living beyond our means**

The country has been characterized by some as 'living beyond its means'. This characterization has led to counterproductive policies. To live within means, the 'means' needs to be increased rather than 'living' to be reduced. This means realizing more revenue opportunities instead of reducing expenditure (except when it is wasteful), in addition to having a more efficient and effective public sector, focused on non-production activities. Production activities should rather be undertaken by the private sector.

### **Starting with reviving the real economy**

There has been a plethora of analyses and recommendations presented by former and incumbent officials, as well as by a variety of people in the media. They have all focused on the fiscal, monetary, and financial crises. But they have mostly overlooked how to revive the economy, which should be the starting point and the prerequisite for solving the three-pronged crisis. Revival should include strong measures to kick start the 'real economy' and a plan tailored-made for each business sector. This is where it should start, not end like an afterthought.

### **There will be no foreign aid soon**

While deploring past policies as recipes for disaster, they are proposing solutions from the same toolbox. Most proposals are calling for more debt – up to \$30 billion – in foreign currency (from the IMF and others), doubling the current stock. This would increase seven folds the debt held by foreign entities. But it is a moot point for political reasons (neither the West nor some of our influential local political groups will facilitate IMF aid). Moreover, if political constraints are lifted, it will take time to negotiate a program with the IMF that is satisfactory to both sides. Typically, many milestones will be set up in an IMF program, and money will be disbursed incrementally each time a milestone has been reached. Finally, accomplishing the milestones will take time, especially if it includes disposal of assets and other forms of involving the private sector, restructuring the public administration and its payroll in addition to implementing the related necessary reforms, and making a credible inventory and valuation of State assets.

**No haircut**

Several flavors of haircutting deposits in banks have been proposed. Besides being unconstitutional, a haircut is counterproductive because it is recessionary. It is also unjust because it singles out one type of wealth while sparing other personal high valued assets. It is also regressive because it is effectively a tax on everyone (except those exempted) at the same rate. Most importantly it is unnecessary as is demonstrated by this plan.

**Dealing with sacred cows**

There are too many sacred cows that together make any kind of reform plan impossible. The biggest, namely the peg of the lira to the dollar, is now teetering on the brink of its demise. But others are deeply entrenched. They include dealing with gold reserves, electricity, Customs, all types of subsidies, basic reforms, and many more. Discarding some of these sacred cows is necessary to break the vicious cycle.

**The epicenter of the collapse**

The triple crisis is the result of the steady erosion of domestic and international confidence in the local public sector in all its aspects, politically and economically. The debilitating effect on the economy reached its culmination with the political and economic impact of the Syrian crisis. This has tipped the balance of an already mismanaged economy which was sustained, up to the year 2011, by significant financial inflows, resulting in successive positive balance of payments. Before that year, the economy was registering high economic growth rates. Budget deficits and debt were rising at a slower pace before the Syrian crisis.

**A realistic alternative approach**

The multitude of 'rescue' plans presented, here and there in the media, are not realistic. This Economic Revival Plan demonstrates the possibility and the feasibility of a recovery without resorting to massive additional borrowing, or a haircut on private sector deposits or loans, all while preserving the banking system. Public debt can be restructured and reduced, the budget deficit be turned into a surplus, the exchange rate liberated, and the balance of payments turned positive.

**A turnaround plan**

The Economic Revival Plan is a comprehensive and consistent approach, covering all facets of the crisis. Under this plan, the economy will be able to grow, jobs be created, and social safety net strengthened. It will create large opportunities for investment from local and international parties. This plan will cut the public deficit by \$6 billion – which with some additional cost cutting of non-essential public expenditures and combating contraband will allow the State to have a balanced budget in the short run. It could even achieve a budget surplus once partnering with the private sector takes place. The plan will result in immediate improvement in confidence which in turn will be a catalyst for investment, both local and foreign, and lower interest rates. It will also result in job creation, better credit ratings, and the kind of economy that the citizens of Lebanon deserve.

## The plan

### Fiscal policy

Reduce expenditures by deferring payments on debt service until a primary surplus is reached (a three to five year horizon), and stop producing electricity which should be bought from other countries and private companies, and lift the subsidy on fuel purchases. Expenditures should increase on public payroll (in lira, given the sharp decline of the currency), and on social welfare benefits provided to the poor. A massive program leading to the transfer of a large portion of public sector employees to the private sector (through privatization, management contracts, BOT, and other schemes) should be started immediately in all sectors. Some sectors can be addressed quickly. Others will take many years.

Tax and other revenues will initially fall due to the recession and the shortage of hard currency to finance imports, declining corporate profits and wages, lower interest rates, and rising unemployment. Direct taxation should be waived on most companies and individuals, except for high earners. Indirect taxation should be increased on imported products, except on those already exempted.

### Public debt

Restructure public debt by writing off all debt owed to the Central Bank (equivalent to \$37.5 billion in lira and dollar combined), and rolling over all other debt after renegotiating its interest rates which must be commensurate with rates paid on CDs. With the market rate of the lira at more than double the official rate, and assuming a 50 percent haircut on outstanding Eurobonds, this would effectively bring gross public debt down to around \$30 billion (lira and dollar combined). If no haircut on Eurobonds is undertaken, total public debt will amount to \$45 billion.

### Central Bank

The accounts of the Central Bank (BDL) need to be clarified, and details sought should be provided. What has been considered as losses are being accounted for as provisions against future earnings – which is acceptable. The debt owed to BDL by the government should also be written-off in this manner. It is one way to create money without triggering higher inflation or currency devaluation. The peg should be lifted completely. This will have many positive and negative impacts on all balance sheets, including that of BDL. Gold (\$16 billion) cannot remain an inert unproductive asset. It should be incorporated into the restructuring of debt and public finance. The Central Bank will gradually release deposits by banks, according to a timetable expected to take many years. These measures will also need a legal framework.

### Bank restructuring

Proposals to write-off the capital of banks and force mergers are counterproductive. The restructuring should be phased and given a three to five year period in order to reach healthy balance sheets. Each bank will have two systems. One relating to pre-November 17 (deposits and loans), the other would be dedicated to new ('fresh') deposits and loans. Old funds will be restricted the first two years and will be released gradually starting the third year until the fifth year. 'Fresh' money will be unrestricted and will allow a slow and gradual resumption of banking activities. These measures will also need a legal framework. Banks should be encouraged to voluntarily reconstitute their equity in consultation with their stakeholders (depositors, borrowers, lenders, and shareholders).

**Sovereign Wealth Holding Fund**

A holding company will be incorporated and will have the State as its sole shareholder but will operate as a private sector financial firm. It will hold all State assets that have a commercial function including gold, real estate, utility entities, shares in companies such as MEA, Casino, Intra, and other existing or future (such as oil and gas) assets. It will have a board of directors from the private sector. Its mission will be to corporatize all entities that need to be, and establish a future plan for each, including privatization, management contract, and other forms, to optimize revenues. Part of the proceeds will be transferred to the State Treasury for debt repayment, limited budgetary support, the Poverty Alleviation Fund, as well as for savings for future generations.

**Poverty Alleviation Fund**

A fund dedicated to bring support and subsidy to the poor will be built with the current National Poverty Targeting Program as its cornerstone. It will be funded by the State, international donors, and by proceeds from the Sovereign Wealth Holding Fund. It will provide vouchers to be used for services freed from subsidy (fuel, electricity, etc.) as well as for basic purchases such as food, education, health, and other necessities.

**Balance of Payments**

Major changes are expected to occur in the Balance of Payments, both in its Current Account and Capital Account components. These changes will result from the current crisis as well as from restarting the economy according to the Economic Revival Plan. This plan includes recommendations to kick-start the private sector and undertake infrastructure projects earmarked at the CEDRE conference. Export will increase, imports will decrease, foreign funds will rise to support infrastructure projects, and remittances will start again when the banking sector resumes its function – at least in regards to ‘fresh’ money, and incoming tourism will flourish as the devaluation of the currency will render the country affordable, and outgoing tourism will shrink tremendously.

**Reforms**

The list of necessary reforms is very long. The government has committed to a series of reforms starting from the Paris conferences (I, II, and III) and has updated its list during the CEDRE conference. These are necessary – but not sufficient – measures. They should be implemented as soon as possible, and complemented with some more bold measures, like the ones proposed in this plan such as eliminating a large number of ministries, adopting e-government to its maximum extent, simplifying administrative procedures, having an independent and effective judiciary, implementing administrative decentralization, and redesigning a tax system for the period post this five-year plan.

### **Kick Start the Real Economy**

Growing the economy and restoring lost jobs will need inputs from all quarters.

- a) Infrastructure projects are needed to be initiated. Projects worth \$6 billion of Public Private Partnership projects were approved at the CEDRE conference. This would attract new financing, create opportunities for many local sectors, and is needed by the country.
- b) Involving the private sector in the management of all commercial aspects of State activities will have an immense positive impact on the revival of many companies and even growth in their business, and in the businesses of their suppliers
- c) An economic vision – as articulated by the McKinsey report – needs to be translated into actionable projects. Implementation can start immediately on many elements of the report
- d) Each business sector has a list of short term needs and long term measures that need to be enacted upon more than 250 measures are proposed in the plan. Common to all sectors is the following:
  - Access to finance at low interest rates
  - Reschedule and raise the level of existing loans
  - Moratorium on paying past dues in taxes and NSSF
  - Amicable legal settlements with furloughed employees
  - Mechanisms needs to allow imports both for raw materials needed by industrialists, as well as by traders to supply businesses and consumers. This includes spare parts and business consumables, as well as household necessities not available from local manufacturers
  - Measures to improve components of the 'Ease of Doing Business' index