



COALITION OF ECONOMIC & SOCIAL SECTORS IN LEBANON

Paper on Socio-Economic Reforms

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Introduction

The current financial and monetary collapse of the Lebanese economic model, adopted since the 1990s, is inseparable from the crisis of the Lebanese political system itself. This political system has exhausted its capacity to extend the rentier and clientelist system with the necessary elements for its survival beyond this point. The adopted economic policies have been historically based on the finance of imports through both the attraction of foreign remittances and the inflation of the financial system along with the investment of the available liquidity in the vicious cycle of public debt amplification and in the ‘booming’ real estate sector.

This has intersected with a sectarian political system built on quotas and clientelism, lack of accountability, and the distribution of monopolies among those financially and politically affluent. In practice, this overlap between both the political and economic factors which have led to the crisis lived today, renders it difficult to separate any reforms required at the level of public finance and economic policies, such as the restructuring of the financial and banking sector, on one hand from the required reforms in the structure of the Lebanese political system on the other.

Thus, in the face of the punitive reality we are facing today which is now threatening the basic livelihood in Lebanon, it has become necessary to initiate a corrective process aimed first at addressing the losses incurred from the previous era in order to redistribute them based on a fair and transparent criteria. These criteria must explicitly exclude low and medium income individuals and attribute the largest shares of the incurred losses to all those who benefited from the existing economic policies. Next, this corrective process must initiate the restructuring of both the Lebanese economic model and political model based on new foundations that address the existing pitfalls.

Social justice should represent the key governing criterion in the process of rebuilding the economic model. This is translated in the decisive protection of the rights of the most vulnerable individuals and social groups. At the same time, there exists an urgent need to illuminate all forms of monopolies and exclusive agencies that have deformed the economic system through the prevention of open and fair competition and the appropriation of financial and business influences. The implementation of this measure represents a compliance with the provisions of the constitution that states that the Lebanese economic system is a free system that ensures private initiative. Additionally, the trajectory of rebuilding the Lebanese economic system necessitates the institutionalization of economic policies that provide a suitable environment for the growth of productive sectors capable of creating job opportunities and maintaining sustainable and real economic growth. All the above represents the basis of this paper.

Moreover, since the reassessment of the political system is integral in this corrective process, this necessitates a return to the Taif Agreement, which ended the civil war, but whose most progressive and corrective reforms have been disregarded. This translates first to the abolition of political sectarianism and the transition towards the establishment of the civil state, one that is capable of protecting the rights of the different segments of the Lebanese society without discrimination. A voluntary civil code for personal status laws, administered by civil courts rather than religious ones, represents a milestone towards this end. Another milestone revolves around the adoption of new mechanisms for the appointment of high-ranking officials on the basis of competence as opposed to the existing one traditionally based on the consociational and sectarian division of power.

Recently, the explosion in the port of Beirut on August 4, 2020 has clearly exposed the atrocious state of corruption within the public administrations of Lebanon. This is further revealed when the elusive details surrounding the arrival of the ship and storage of its explosive cargo in the warehouses at the port are investigated. For the above reasons, a thorough and transparent investigation into the blast must take place in order to set the course for justice for the blast victims and their families and to transparently expose all the details surrounding the explosion and pinpoint to the neglect and collusion that took place at all the official levels. This is in line with the abovementioned reforms that are critical at these times for the country.

A. Monetary and banking solutions

Even prior to October 2019, the Lebanese banking sector had been imposing capital controls on dollar deposits. The measures undertaken were gradual: from prohibiting the transfer of dollars abroad and placing decreasing ceilings on dollar withdrawals to the complete restriction on these withdrawals altogether. Today, in accordance with Banque Du Liban Circular 151, the banking sector allows depositors with foreign currency accounts to withdraw cash in Lebanese lira at a market rate set by the Banking sector. With this rate being set well below the black market rate, depositors are left to incur the loss from this difference.

Based on the government's reform plan as well as other financial reports, the crisis is the result of the existing gap between the Central Bank's assets in foreign currency and its liabilities towards the banking sector. This gap has been the result of the excessive costs of maintaining the exchange rate peg and financing foreign currency debt issued by the Lebanese government (Eurobonds) over the past three decades. The banking sector faces additional losses as the government recently defaulted on Eurobonds owned by them.

That being said, small and middle depositors should not pay the price of any the banking sector's incurred losses resulting from wrong investment choices over the years specifically in their excessive reliance on lending the state and Central Bank. Moreover, these depositors are today the victims of preferential treatment whereby large amounts of the remaining foreign deposits in the banking sector have been externally transferred for the benefit of the banks themselves, their owners, politicians, and large depositors. In the background of all this, depositors are also paying the price of the state's financial mismanagement and the Central Bank's misuse of its back then available reserves which have ultimately dissipated the deposits of Lebanese.

Any future correction must target only the top 1% of depositors with the largest bank accounts. However, this should only be done based on specific mechanisms (detailed in the section below). These corrections should be in accordance with both

- Paragraph (F) of the constitution's introduction which states that "The economic system is free and ensures private initiative and the right of private property."
- And article 15 which states that: "Rights of ownership shall be protected by law. No one's property may be expropriated except for reasons of public utility, in the cases established by law and after fair compensation has been paid beforehand."

Therefore, today we call for:

- *Passing an equitable law that organizes and regulates the capital controls currently administered by commercial banks*, to avoid preferential practices and to prevent banks from abusing policies to their benefit. This law must identify a transparent and clear timeframe for these procedures as part of a wider, comprehensive exit plan from the current situation.

- ***Rejecting any form of “haircut” on deposits in the banking sector for small and medium depositors.*** This rejection includes both direct cuts which directly target the value of deposits and indirect cuts which exchange deposits for shares in long-term sovereign funds or sovereign debt securities.
- ***Rejecting all forms of “hidden” cuts to the value of deposits, as being applied today through the lirafication of withdrawals at an exchange rate well below the market rate.*** This bears the losses on the depositor while the banks benefit by gradually correcting their balance sheets through eliminating dollar liabilities.
- ***Exhausting all available options before resorting to any measures that might impose any losses on the average depositor.*** These options include forcing banks to bear the losses by tapping on their profits and capital assets, while pushing forward to a recapitalization through the liquidations of some banks, mergers and other interventions.
- ***Recapitalization by transferring a portion of deposits into shares in the banks or into Lebanese Liras, should only be undertaken as a last resort and only for the top 1% of available deposits*** in the banking system. Pursuing such options ought to be accompanied by a comprehensive framework to systemically correct the financial sector’s budgets afterwards.
- ***Embarking on a forensic audit of the Central Bank and operating banks' budgets in Lebanon*** to reveal the reasons behind the large gaps within these budgets and to identify responsibilities.
- ***Short-run control over the currency exchange rate and the utilization of the available dollar reserves in order to subsidize essential imports remains vital*** at this stage particularly in terms of the social consequences which may result from further depreciation in the currency. In the long-term, however, the currency peg comes with dangerous consequences including draining the Central Bank's foreign reserves and endangering the competitiveness of productive sectors vis-a-vis imported goods. A more sustainable way forward would be an exchange rate with a managed float linked to a diverse basket of hard currencies needed to finance the country’s trade activities.

B. Public finance solutions

The overarching economic crisis is the direct outcome of the structure of the Lebanese economy and the adopted fiscal policies. Tax measures have for long encouraged the growth of a rentier economy and discouraged productive economic activities and have contributed to the concentration of wealth among an elite through the heavy reliance on indirect taxation that target all the population equally. Fiscal policies have also generated persistent public deficits, which led to high public debt and burdened taxpayers with debt financing. This too has contributed to the concentration of wealth in the hands of large depositors who financed government debt and benefited out of high interest rates. Therefore, this calls for radical reforms in the country’s tax system and in the adopted fiscal policies through:

- ***Adopting a new and modern tax system that guarantees equitable redistribution of wealth through direct and progressive taxation*** to finance state expenditures. The tax schemes include increasing taxes on profits, interest, real-estate, inheritances, and wealth.
- ***Restructuring public debt through negotiations with local and foreign creditors in order to decrease the actual size and interest on it.*** Any restructuring scheme that does not aim to reduce the actual size of the overarching debt and merely aims at decreasing interest on that debt will fail to achieve the primary outcome of interest which is: decreasing the share of public debt out of gross domestic product.
- ***Recovering the profits from all the financial engineering operations undertaken by the Central Bank from banks, bank owners, and large depositors.*** In addition to recovering the inflated profits that accumulated as a result of the high interest rates set by BDL (against certificate of deposits and other schemes). This can be achieved through a one-time direct taxation on interest profits as part of the debt-restructuring scheme.
- ***Prioritizing public spending on infrastructure,*** specifically in those that essentially benefit productive sectors such as electricity, communication, transportation and solid and liquid waste management, in addition to protecting these spending from any austerity measures.
- ***Setting an accountable and efficient plan to resolve Electricité du Liban (EDL's) large financial losses*** accumulated from in the electricity sector. Any removal of the tariff subsidy should not take place as long as electricity is not fully provided by the state.
- ***Countering corruption in all public administrations to eradicate its drainage of public expenditures.*** This translates to giving these administrations an adequate amount of independence and control in the face of political and financial interventions. This cannot be accomplished without achieving judicial independence and protecting all judicial appointments from political interventions.
- ***Restructuring the public sector and closing all unnecessary councils and funds*** which currently constitute a major drainage of the government budget (CDR, Council of the South ...).
- ***Waiving banking secrecy laws to uncover tax evasion and fraud and the unlawful accumulation of wealth.*** In addition, utilizing the agreement on the “Automatic Exchange of Financial Account Information” to track smuggled funds from tax evasions and illicit enrichment outside Lebanese borders.
- ***Recovering all illicitly diverted funds uncovered through the “Automatic Exchange of Financial Account Information” agreement,*** particularly those that have been masked by banking secrecy laws.

- ***Improving tax control by all available means***, including the establishment of a unified tax number, consolidating all incomes through the tax authority to analyze it, and establishing an electronic link between the Ministry of Finance and other departments. In this context, it is useful to move from specific taxation, which allows unobserved revenues to go untaxed, to a unified tax on income.

- ***Any of the aforementioned tax schemes should be adopted based on clear and accurate predictions on the benefits of these measures on the economy and society***. In addition to providing tax incentives and exemptions to be more effective and fair.

C. Productive sectors solutions

Productive sectors (specifically agriculture, tourism, and industry) have suffered extensively during the post-war period and have been marginalized from the country's overall national income and production. This is specifically attributed to (1) taxation policies, which encouraged rentier sectors at the expense of productive ones, in addition to (2) high interest rates, which led to a rise in the cost of borrowing for investment purposes and encouraged saving of funds instead of lending deposits to productive sectors. Moreover, these sectors have also suffered because of reduced investment in infrastructure and the costly policy of pegging the currency which deteriorated the competitiveness of local production.

The latest developments have crippled the former financial and monetary model in terms of the structure of interests and the dilemma of stabilizing the currency exchange rate. Nevertheless, an alternative model has yet to come about. After decades of neglect, extensive state intervention is needed to boost these productive sectors. This requires the following measures:

- ***Serious cooperation between various syndicates to determine the needs of these sectors***, namely related to infrastructural improvements necessary for them to prosper (irrigation projects, energy, transportation, etc.). This assessment will represent the basis for any future investment projects that the government or other creditors want to undertake in these sectors. Moreover, these needs should be given priority in terms of funding in annual plans and budgets of relevant ministries.

- ***Prioritizing these sectors, in light of the current financial crisis, to ensure the availability of foreign currency for the import of raw materials and basic and primary goods***. It is important that these sectors in particular are given access to foreign currency, since they are the only ones capable of insuring the reflow of hard currencies back into the country through exports and through the reduction of the outflow of hard currencies by providing the needs of the local market.

- ***Establishing and supporting various agricultural and manufacturing cooperatives***, in order to satisfy the common needs of workers in these sectors.

- ***Activating the country's diplomatic channels with the Lebanese diaspora***, to introduce them to investment opportunities and bring together interested investors with agriculturalists and

industrialists to invest in projects across Lebanon. Notably, the depreciation of the currency offers investment opportunities in various productive sectors in Lebanon, in light of the high price of imported goods and the increase in the international competitiveness of locally-produced goods.

- ***Reviving the official frameworks supporting the agricultural sector***, starting with Agricultural Chambers and the Agricultural Credit Bank.

- ***Creating financing funds for small and middle-sized enterprises and providing financing funds from international institutions***. These funds are particularly important to improve access to finance for productive sectors to satisfy local needs and deplete the need for imports.

- ***Encouraging the creation of a knowledge-based economy capable of employing advanced technology to improve the country's productive capacity***. One such method occurs with the growth of small and medium-size enterprises. Such commitment would benefit from the high level of skills available amongst Lebanese youth, and could potentially create the necessary jobs to match these skills. This would also result in higher growth and the accumulation of hard currency.

D. Social Safety Nets

Any solution to the current financial crisis needs to protect society's most marginalized citizens. Plans to promote economic growth would need to be coupled with the development of social safety nets to protect the basic livelihood of the most vulnerable groups through:

- ***Strengthening public education by providing adequate support to public schools and the Lebanese University specifically during this stage***. The low levels of financial support received by Lebanese public schools and the Lebanese University need to be increased immediately to lessen the pressure on families with children in tertiary education in addition to undertaking the necessary administrative corrections to strengthen its independence.

- ***Reforming the National Social Security Fund by improving its administrative and information systems***, filling vacancies in its administration, and resolving the outstanding receivables owed to it by the Lebanese state. Solving these three issues has become a necessity, especially since indicators suggest a looming insolvency crisis in the fund.

- ***Setting a clear plan that aims at increasing the scope of beneficiaries from the National Social Security Fund*** by particularly to include those who are self-employed, informal workers and migrant workers.

- ***Continuing to offer much needed but streamlined support for social welfare institutions, especially those related to persons with special needs*** (including elderly, orphans, persons with disabilities, etc.). The final goal is to have such services offered by public institutions and schools, in order to limit the clientelist methods through which these institutions receive financial support from the governments.

- ***Developing regulatory decrees and legislations to protect students from the dollarization of tuition fees in private institutions*** which leaves students at risk of dropping out of education because of their inability to pay tuition fees.

- ***Enhancing the role of the Ministry of Social Affairs*** by reducing unnecessary expenditures and promoting its capacity to oversee and control the work of the various organizations benefiting from its support.

- ***Prioritizing and supporting the National Poverty Targeting Program*** as part of a comprehensive state plan to deal with the current economic crisis and updating the social services of the program to meet the necessary needs of families.

- ***Enact adequate policies to incentivize formal employment, protect existing employment and prevent layoffs in the midst of this crisis.***

- ***Providing proper support to the health sector, by fulfilling the financial and administrative needs of public hospitals and developing a unified health card to rationalize the hospital bill incurred by the Ministry of Health.*** In addition, it is necessary to provide comprehensive health coverage to all Lebanese citizens, while working to unify the social security funds to protect the interests of current beneficiaries.

E. Liberating our economy from monopolies

While the Lebanese Constitution states that the country has a free market economy, in practice, there are no laws that directly address the prevention of monopolies or exclusive agencies. This has fostered the establishment of monopolies, across different sectors in the economy, which are owned by the elite and protected by both political and sectarian covers.

Recently, the Ministry of the Economy has laid out an anti-trust draft law. Since then, the draft law has been heavily debated and underwent several critical changes. We affirm the following notes on this law and on the governments' approach to deal with monopolies and exclusive agencies:

- ***Prompt action to transfer the draft law to the Council of Ministers and subsequently the parliament for discussion and voting,*** without succumbing to pressures of monopolists and/ or their political and sectarian covers.

- ***The final version of the draft law should put an end to all forms of monopolies, exclusive agencies and cartels.*** These firms have hindered competition, reduced consumer choices, controlled the movement of goods and set their convenient prices. Following international standards, the draft law should specify that the share of any firm in the market should not exceed 15%.

- *Negotiations of the draft law should undergo a transparent consultative process* with different civil society organizations and syndicates.

- *Providing the regulatory committee for competitive economy with administrative and procedural independence* and adopting a transparent framework based on competence rather than quotes to select members of this committee.

- *Abolishing the articles in the draft law that give the Minister of Economy and Trade authority to intervene and amend the provisions of this law* according to considerations related to “public interest.” Such authority is flagrant and can be abused under many pretenses which is premonitory for economic bodies.

In conclusion, the proposals and demands put forth in this paper represent the apprehensions of different social and economic groups from the negative ramifications of any governmental plan on their livelihoods. The public rescue plans base their solutions to the crisis purely on accounting and financial calculations without incorporating these considerations into a holistic economic plan.

Any plan for financial recovery must be based on a broader economic vision that: (1) takes into account the needs of all sectors, primarily the productive ones and (2) protects the interests and rights of the most vulnerable and economically marginalized groups. Therefore, we call for open and transparent discussions between the various economic and social sectors prior to the adoption of any recovery plan.

Signatories

The General Confederation of Lebanese Workers

Lebanese Association for Taxpayer Rights

Consumers Lebanon

Association of Depositors

Mada Youth Network

Association of Independent University Professors

The Coalition of Economic and Social Sectors is an independent coalition of associations and unions representing key economic and social sectors in Lebanon. Established in the Spring of 2020 following major economic and social crises in the country, our main goals are to defend the rights of the groups we represent, and to push for policy reforms that protect and improve our collective livelihoods. <https://coalition-lebanon.org/en/main/>