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# Reforms a painful pill but what the doctor ordered

Osama Habib

BEIRUT: Lebanon's Cabinet may find it hard to convince the population to swallow the pill of "painful and unpopular" reforms, but anything short of hard financial measures could gravely affect the future of the country in the medium and long term. The Cabinet is still carefully but persistently reviewing every item in the 2019 draft budget to ensure that the state will be able to cut the deficit by 2 percent this year.
Lebanon has more than $86 billion in public debt and a huge fiscal deficit that has reached more than 11 percent of the country's gross domestic product.

Previous measures adopted by the Cabinet have not produced the desired results, as most economic indicators have been on the negative side.

Prime Minister Saad Hariri, who realizes that failing to cut the deficit this year will send the wrong message to the international community, declines to give elaborate details about the proposed budget to avoid a negative backlash from the civil servants, public school teachers and retired government staff.

Many public employees and staff of autonomous government institutions have already held strikes and sit-ins in anticipation of any government action that could affect their salaries and benefits.

Banque du Liban's employees' syndicate literally crippled the financial markets after staging a strike that was only suspended Tuesday to give the Cabinet few more days to clarify its position of the wages and benefits of the Central Bank's staff.
The Cabinet seems divided on some of the items in the draft budget, fearing that any hasty decision could destabilize the country and lead to endless strikes and protests.

But it is almost certain that the Cabinet will agree on increasing taxes on interest rates on deposits from 7 percent to 10 percent, and increase taxes on "higher wages" to 21 percent.

The Cabinet agreed in principle to cut the benefits of ministers, lawmakers and former MPs in a bid to show the public that sacrifices start from the top.

A source told The Daily Star that the Cabinet agreed to cut the benefits of the ministers and MPs to convince government staff that they also needed to make certain sacrifices for the benefit of the country.
"I don't think the Cabinet will cut the wages of the civil servants, but it may consider cutting the 16 months salaries of certain autonomous institutions and make it 12 or 14 months a year. But selling this idea may not be easy in the beginning," the source said.

Economist Ghazi Wazni said the citizens had been expecting a "salvation budget," but the measures did not meet expectations.
He added that the proposed budget lacked economic and social vision. "The budget includes a reduction in the deficit from 11.54 percent to 8.73 percent of GDP, from LL9.816 trillion (around $6.6 billion) to LL7.852 trillion, a decrease of LL1.964 trillion," the economist said.

**Wazni said public expenditure was estimated at LL26.117 trillion.**

Wages and retirement salaries of civil servants, Army personnel and retirees is close to LL8.532 trillion, representing 32.7 percent of total spending. "The government should freeze the increase on salaries and wages for three years, thus achieving an annual saving of nearly LL200 billion, reducing compensation from additional work, bonuses and allowances (LL148 billion), reviewing the random employment of more than 10,000 people and pensions and allowances of former deputies and presidents," Wazni proposed.
Debt servicing is now at LL8.312 trillion, representing 31.8 percent of expenditure, compared to LL8.214 trillion in 2018.

"There is a lack of clarity in the increase of debt servicing - [there is] only LL98 billion in the budget of 2019 [for this], while it is supposed to increase to more than LL900 billion due to the rise of public debt to $6.5 billion in 2018, and the replacement of the $10.4 billion bond and dollar bond maturities in 2019," he said.
Other economists expressed surprise that successive governments have not been able to crack down on tax evasion, which is estimated at more than $4.9 billion a year.

A recent report by JPMorgan expected GDP growth in Lebanon to remain under pressure due to fiscal adjustment, but it would be supported by improved sentiment and external support.

“The country’s external backdrop improved with the partial stabilization of Syria and Iraq, potentially supporting a recovery in trade, investment and travel flows in the Levant. Domestic political uncertainty has also eased following the formation of a new Cabinet,” the report said.

It emphasized that there was now an opportunity to move forward with urgent reforms, supported by pledges amounting to $11 billion (20 percent of GDP) at the CEDRE conference in Paris last year.

JPMorgan slightly revised down growth to 1.3 percent in 2019, up from 1.0 percent last year, but it saw significant downside risks, both due to necessary fiscal adjustment if reforms are passed and to the impact of rising uncertainty if reforms fall short.
“While Cabinet formation has supported sentiment, delays in the execution of much-needed reforms could dent confidence against the background of large fiscal and external deficits and high debt,” the report warned.
“While public sector reforms are expected this year, JPMorgan projects the budget deficit to remain large at 9.4 percent of GDP this year down from 11 percent last year. The authorities have finalized budget plans and are expected to announce these imminently,” the report said.

It added that a gasoline excise tax was possible, but political opposition could mean that new taxes would not be introduced due to the subdued growth environment.
“While a clampdown on tax evasion is expected, such measures are unlikely to yield quick results and broaden the tax base in the near term,” the report said.

JPMorgan did not expect electricity tariff hikes this year, although plans to raise tariffs from starting from 2020 would support sentiment. Transfers from the budget to Electricite du Liban are equivalent to almost a third of the budget deficit.

The report said no difficulties were anticipated in financing the fiscal deficit.
It expected Banque du Liban to continue to play the pivotal role in supporting deficit finance and that the Central Bank would continue to encourage public-sector reforms.