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Tackling Lebanon's financial problems? You might be looking the wrong way

Jad Chaaban

The government is supposed to come up soon with a new budget for 2019, where "substantive reductions in spending" would be enacted, and where "everyone is expected to make painful concessions." The main idea is to reduce the government deficit and to make sure public debt growth is contained, while waiting for CEDRE loan money that is supposed to help finance infrastructure and create new jobs. Yet all this will not solve our problems.
For starters, public debt as a share of the country's total income (or its gross domestic product) stands at 150 percent, but it was higher before: 185 percent in 2002. Also, more than half of this debt is now in Lebanese pounds, and 92 percent of total debt in all currencies is held by local institutions (the Central Bank, commercial banks and Lebanese public entities). The debt situation is not good, but it is also not catastrophic and definitely manageable since largely held by local stakeholders.

So where is the problem? The main issue is that since 2011, with regional wars and local political instability, Lebanon's GDP growth fell sharply, and this caused a decline in people's available incomes, job losses, and above all it reduced the amount of taxes collected by the government (since most taxes are indirect and linked to consumption). In parallel, the Central Bank decided to increase interest rates to attract more dollars, in order to build foreign currency reserves. These reserves are needed to finance our imports (since we do not produce much locally) and to make sure we are covered in crisis against surges in depositors' demand for a safer foreign currency.
But by increasing interest rates most people kept their money in the bank; consumption and investments declined; and interest rates on loans automatically increased. The cost of borrowing therefore increased, which made it very expensive for companies to expand and invest. Companies currently in need of a cash loan would pay a staggering 15 percent interest rate to the banks. Who would borrow and operate in these conditions?
We are right now in a situation economists call "stagflation": stagnation with inflation, or no economic growth with rising prices. CEDRE loans are focused on infrastructure projects, and will not bring about growth in the short to medium term. These loans take several years to materialize, from public projects' conception to loan approval and disbursement.
Reducing the deficit, especially by increasing indirect taxes or reducing public sector salaries, will be socially unjust and further decrease private consumption and depress growth even further. Recent demonstrations and strikes across the country by public sector workers and various syndicates has shown that going down this route is mined with opposition and social unrest.

Continuing the policy of freezing public-sector hiring and short-term necessary spending is shortsighted, since the private sector is still in no condition to generate the required jobs and economic growth.
What is needed is a comprehensive economic development plan which connects fiscal policy (how the government manages its spending and revenues) to monetary policy (how interest rates and inflation are tackled).
The Central Bank needs to massively subsidize interest rates to lower the cost of financing and lower inflation. There needs to be a concerted monetary effort to lower interest rates. The government has to cut down on wasteful spending and use the savings to finance in the short term efficient projects that generate income and jobs immediately.
Investing in municipal jobs that cater for local communities is a case here in point. The government can in parallel ask for a grace period for its expensive debt service from the local banks, similar to what it did in 2002, until growth in public revenues picks up again.

The top 14 commercial banks (known as the Alpha group banks) have witnessed an average 7 percent increase in their net profits every year since 2011. This is despite the country's GDP stalling over the same period and many other sectors suffering. It is therefore more than fair to request that banks contribute more than others to help balance the public budget, by accepting zero-interest-bearing Treasury bills for a period of two years, similar to what they did in 2002.
Instead of more austerity, we actually need to spend our way out of this crisis.
In a country with a 35 percent poverty rate, and with a private sector fragmented into thousands of small and medium enterprises concentrated in trade and services, the public sector needs to step in and reverse its unsuccessful austerity paradigm. And this should not take the form of more hiring in security agencies or in inefficient public enterprises. More public workers and budgets should be allocated to public hospitals, the public university, natural reserves, municipalities, social housing, art and culture, touristic sites and other vital sectors of our economy.
And above all, the government's policies need to respect the law.

For 12 years between 2005 and 2017 the government spent funds and collected taxes without any official budget submitted and approved by Parliament. The official Finance Ministry accounts for these 12 years have not yet been submitted for approval by the Cabinet and Parliament. The government operates until today based on substantive Treasury advances, in the form of cash loans to ministries and public agencies.
Let's therefore start the real reforms by putting public finance back on the accountability track.

Jad Chaaban is a Lebanese economist and associate professor of economics at the American University of Beirut.