IMF assistance a 'bitter pill' to swallow

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BEIRUT: As the IMF wades into Lebanon's ongoing economic crisis, the country is aiming to become the sixth Arab state to receive assistance from the fund over the past decade.
In recent years, the IMF, through its public statements and messaging strategy, have placed added emphasis on the social dimension to their programs and stressed the need for "inclusive growth." With this they tend to push for social safety nets as an essential part of any loan program offered.

This social aspect helps to extend their image beyond the cold logic of debt reduction and fiscal surpluses.
Despite this, IMF programs in Arab states contain significant economic hardship. In Tunisia, where the IMF has been involved since the ousting of former dictator Zine al-Abidine Ben Ali in 2011, the country has experienced recurring waves of anti-austerity protests. As the cost of living and basic goods has increased, attempts by the government to impose additional taxes in line with IMF recommendations have been met with outrage, most recently against the 2018 budget that prompted widespread protests. Moreover these measures have had a muted impact on the country's overall public finances.
Although the budget deficit has been reduced and unemployment fallen by roughly 3 percent, public debt has soared from 41 percent of GDP in 2010 to 71 percent in 2018. As a result, debt-servicing payments reached a record 22 percent of the country's budget in 2018, limiting funds available for public investments in infrastructure and education.
In Egypt, the results of a $12 billion IMF loan have also been mixed. While GDP has expanded by a yearly average of almost five percent since 2016, the majority of Egyptians have seen their real purchasing power decline over the same period.
Development metrics have also been hit with The World Bank estimating last year that poverty rates have increased by seven percent since 2011 as the government has moved to cut fiscal deficits by removing subsidies on essential goods such as fuel. The exemption of military-owned companies from IMF-sponsored measures such as VAT increases or privatization-schemes, reflects the regime's double-success in safeguarding its vested interests while also securing IMF assistance.
Jordan's dealings with the IMF over the past decade have been aimed at reducing fiscal deficits that threaten the country's macroeconomic stability. The strategy for doing so has been subsidy cuts and raised taxes, which together have prompted waves of public anger against the government.
In 2018, fiscal reforms designed to boost government revenues by clamping down on tax evasion and broadening the tax base, were met with widespread protests that forced the then-Prime Minister Hani Mulki to resign.
In Lebanon, similar measures are to be expected. In its October 2019 Article IV report on Lebanon, the IMF sees a mammoth overturning of the budget deficit, currently at 10 percent of GDP, to a surplus of 5 percent in the medium term, as essential to addressing Lebanon's enormous public debt, which is in excess of 150 percent of GDP.
To achieve this, the fund recommends fiscal tightening through improved tax compliance, the introduction and/or increase of taxes such as VAT, fuel excises and vehicle tax, plus of course the elimination of electricity subsidies – identified as offering the most potential for expenditure saving. Other major reforms include reducing the public sector wage bill, introducing a strong social safety and implementing capital controls.
The Lebanese government has been making similar noises through its 50-page economic rescue plan, that won praise for its erudition, but fell short on substance.
According to former director at The World Bank and fellow at AUB Jamal Saghir, the plan is largely a government performance.
"The document is a kind of 'I know your language IMF'," Saghir told The Daily Star in a Zoom interview.
"As an economist, it is good to read, with an honest analysis, comprehensive, ambitious," Saghir said as he glanced over a copy of the plan from his desk in Washington.
"But if you look closer at the delivery side, the fiscal and monetary is ok, but the structural – meaning the energy sector, social, health sector, you have one paragraph here and there. The energy sector accounts for $2 billion and there is only one paragraph!"
Saghir has 40 years of experience negotiating with governments, and sees many question marks in Lebanon's declared commitment to reform. "Why in this program did they not add a time frame, milestones or metrics? When are they going to start? The IMF is not going to implement it for them. It's been three weeks."
Looking ahead to how negotiations will develop, Saghir envisages an ambiguous scenario in which the Lebanese are unsure of the negotiating format. The standard procedure in IMF negotiations is for the government to provide a road map for reform, but the Lebanese government has not done this.
The Lebanese negotiating team may wrongly think or hope the IMF will provide the metrics for reform.
These tiptoeing negotiations reflect both Lebanese unwillingness to reform and the IMF's desire to avoid bearing later responsibility for a crisis made in Lebanon.

“I don't think the IMF will impose metrics. They are too smart for that," Saghir added. “The Lebanese government has to realize this is a different league of discussion. Once you get into an IMF discussion, the fundamental reality changes. You cannot play your way out of it. When you call on the IMF it is the last resort."

When it comes to getting the IMF on board, Saghir sees formal capital controls as a place to start. "The Lebanese government was in denial," Saghir said in reference to the informal capital controls, "thinking they do not have to worry about it. I do not think this will fly. It needs to be put in order."

Yet bigger questions remain, such as electricity reform. "The energy sector will be a core reform program of any loan," Saghir predicted. "When you only have 64 percent of Electricity du Liban bills being paid, the IMF is not going to breeze over that. They will ask a lot of questions, so the paragraph on electricity reform in the rescue plan and last year's budget, will not be sufficient."

Enhancing tax compliance will be another challenge. Former Lebanese Economy Minister Nasser Saidi, believes removing banking secrecy is the sort of robust reforms needed. "Many professional do not pay tax or underreport their taxes. Lawyers, doctors, MPs. If you try to find out their wealth or income you come up against banking secrecy.”

Another issue is smuggling. Customs and tariffs are likely to go up, Saidi predicts, "but if there is still smuggling you destroy your ability to collect them."

Whether Lebanon can confront such challenges remains to be seen. Doing so is critical if they are to unlock the aid the country's economy so badly needs to resolve its staggering debt crisis.

IMF-support would – to begin with – allow for a desperately needed debt restructuring to restore confidence. This would mean the nominal sum of debt would be reduced, the maturities extended and interest payable cut.

"If the IMF is on board, the holders of debt will be willing to accept the restructuring. That is why the IMF matters," Saidi explains.

Yet IMF-backing for such a restructuring would come with three to five years of austerity, according to Saidi.

"We need to be cognizant of the fact that real income is going to go down. People are going to be poorer. That is not going to improve, indeed it may get worse. It is a bitter pill."

Saghir agrees with this.

"The reality is that with over 50 percent below the poverty line and around 30 percent inflation, Lebanon is not a middle income country anymore. From all the countries I know, it takes four years for growth to restart. It is going to be painful. Austerity programs are tough. The government needs to show the political will for reform and not wait for the IMF."