Lebanon: Cedre Reforms vs. Economic Imbalances

Introduction

The Cedre Conference constituted a great positive shock to Lebanon, since (50) countries and regional as well as international organizations decided on supporting the country with substantial foreign aid. This new international substantial financial support reflected the confidence of the international community in the Lebanon's capability of dealing with the current and future difficulties and challenges.

However, this international financial support was conditioned that Lebanon should implement fiscal, structural and sectorial reforms. Such reforms constitute a real challenge for domestic political authorities.

In fact, the domestic economy suffers, today, from deep and diversified imbalances which the government should deal will to lessen its extent and repercussions. This is a significant prerequisite for strengthening growth rates, expanding job opportunities, and improving fiscal and social conditions in the coming years.

The government of Lebanon should, as well, focus on launching the required operations in the oil and gas sector in the short term. The introduction of gas and oil activities to the Lebanese economy would diversify and increase the country's national income and personal income, as well as improving fiscal conditions.

I. Cedre Conference and its Results

The Cedre Conference was organized with the support of France on April, 6, 2018, with the participation of (37) countries and (14) international and regional organizations. It allocated nearly USD 11.6 billion in financial support to Lebanon, which was distributed as follows:

- USD 10.8 billion in loans, of which 93% is in the form of soft loans.
- USD 800 million in grants, including grants to support loans' interest payments.

The Conference aimed at developing the Lebanese economy, mainly by financing the Capital Investment Program (CIP) of the Lebanese government, and by supporting monetary and fiscal stability. To convince the international community with this CIP, the government presented its vision for stability, growth, and job creation to the Cedre Conference. The vision rests on four main pillars:

1- Enhancing public investment projects in the short term, which will be financed by external loans, especially in the fields of infrastructure which supports economic growth in the long term. This besides increasing the private sector role, which would promote new job opportunities and enhance the overall productivity of the national economy.

2- Maintaining financial and economic stability, mainly through the restructuring of public finances and increasing the scope of public investments, in a framework of viable macroeconomic and fiscal policies.

3- Implementing structural reforms to ensure the sustainability of investments in infrastructure and economic sectors, as well as fostering governance and private sector-led growth. These reforms focus on combating corruption, reform and governance on the fiscal front, restructuring and modernization of the public sector, upgrading the customs administration, reforming the capital markets, and strengthening the private sector role.

4- Adopting an effective strategy to diversify economic sectors, both productive and services, and enhancing export capacity, in an enabling business environment that lifts existing investment barriers and supports macroeconomic and financial stability.

The Cedre financial aid was distributed among countries and organizations as shown in the following table:

Distribution of Cedre Conference Aid (USD, million)

Country or Organization	**Value**	
World Bank	4,000	soft loans
European Bank for Reconstruction and Development	1,350	soft loans
Saudi Arabia	1,000	soft loans
European Investment Bank	980	soft loans
Islamic Development Bank	750	soft loans
France	500 173	soft loans grants
Arab Fund for Economic and Social Development	500	soft loans
Kuwaiti Fund for Economic Development	500	soft loans
Qatar	500	soft loans
Kuwait	180	soft loans
Holland	245 122	soft loans ready under specific conditions
Turkey	200	soft loans
European Union	183	soft loans
Italy	147	credit lines
United States of America	115	grants
United Kingdom	56 28	grants ready under specific conditions
Germany	61 12	soft loans ready under specific conditions
Japan	10	soft loans
Finland	7	soft loans
Total	**11,619**	

In this sense, the shares of donor countries and organizations are as follows:

- World Bank: 34.4% of total aid.
- European countries and organizations: 34.2%.
- Arab countries and organizations: 29.5%.
- Other countries and organizations: 1.9%.

These loans and grants are allocated to finance (280) projects in the infrastructure sectors, projects that stimulate the national economy, and projects that support the Syrian refugees.

The Cedre financial aid came to finance the government's CIP whose estimated total cost is USD 22.9 billion for 8-12 years.

The Cedre aid will finance the first cycle of the CIP which costs nearly USD 10 billion, USD 3-4 billion of which will be utilized under the public-private partnership PPP framework.

There were advocates and opponents to the Cedre Conference. The advocates stress that the Conference promotes international confidence in Lebanon; reflects the international community support to the country; and that the financial aid will support economic growth, infrastructure development, and job creation.

The opponents to the Cedre Conference expect further growth in the public debt (currently USD 80 billion) since the majority of the financial aid is loans. They also consider that the funds would not support growth and job creation due to existing corruption. In addition, they stress that Lebanon may not meet the conditions of international donors as it did in the previous Paris I, Paris II, and Paris III conferences, where some funds are still not utilized. Some opponents see that a new government is on the way, and question if this new government would fulfil the conditions of the Cedre Conference.

The conditions of international donors under the Cedre Conference stress that the financial aid should be directed to:

- Infrastructure projects, projects that generate job opportunities for the Lebanese and Syrians, supporting industrial and agricultural exports, housing projects and development projects in the areas hosting Syrian refugees.
- Public-private partnerships (PPP).

For Lebanon to benefit from the Cedre financial aid, Lebanon is asked to implement several fiscal, structural, and sectorial reforms.

II. Required Reforms

The donor countries and organizations which participated in the Cedre Conference requested several fiscal, structure and sectorial reforms from the Lebanese government.

The reforms are the following:

1- Fiscal Reform, mainly the reduction of the fiscal deficit-to-GDP ratio by 5% for the five coming years, i.e. by 1% for reach year. This should be achieved by the following measures:
   a- Enhancing overall collection.
   b- Reducing the existing gaps in the public finance system.
   c- Rationalizing spending as possible.
   d- Reducing the financial transfers from the government to EDL; such transfers exceeded 4% of GDP in recent years.
   e- Seizing employment in the public sector.
   f- Reconsidering the pension system for the public sector employees.
   g- Increasing the rates of some taxes such as VAT and fuel taxes.

2- Structural Reforms, mainly increasing the potentials and productivity of the Lebanese economy, by adopting a private sector-led growth policy, and enhancing social equity. This also includes implementing the EU Compact related to security stability and anti-terrorism, governance, law enforcement, growth enhancement and crating new job opportunities. This in addition to abiding by the international compacts related to sustainable development goals and anti-violence actions and others. Among the required structural reforms, we can mention the following:

   a- Anti-corruption actions in line with the international agreements of the UN.
   b- Reform and governance in the fiscal and customs sectors.
   c- Government digital transformation (e-government).
   d- Modernization and restructuring of the public sector.
   e- Justice Reforms.
   f- Governance in the oil and gas sector.
   g- Business enabling environment suitable for the promotion of the private sector activity and initiatives.
   h- Reforms in the capital markets.

3- Sectorial Reforms, mainly in the following sectors:

   a- Electricity, by creating new production units, modernizing existing production units, upgrading existing infrastructure, PPP projects, and restructuring the EDL and its corporatization to function as a private sector entity.

   b- Solid wastes, by creating new factories, and modernizing existing factories to manage such wastes in the direction of producing new energy sources.

   c- Water, by modernizing the Law of Water for 2012 so as to better manage and expand the underground water resources, existing water networks, and sewage and dirty water treatment; besides introducing new water tariffs; and enforcing the existing water legal framework.

d- Telecoms, by liberalizing this sector so as to attract private investments. This requires reconsidering the telecoms law number 431, in the direction of assigning a regulatory authority to manage this sector and introduce the private sector philosophy.

In fact, there are serious fears against the potential mismanagement and misuse of the Cedre funds, under current political conditions, due to the existing corruption, tax evasion, and customs gaps. This could increase public indebtedness (currently USD 80 billion), because 93% the Cedre foreign aid is in the form of loans.

Hence, Lebanon is challenged today by its ability to fulfil the Cedre obligations, and hence to use its funds, keeping in mind that the funds of the previous Paris I, Paris II, and Paris III conferences are not so far completely utilized.

The required reforms on the part of the international donors of the Cedre Conference should focus on dealing with, and reducing, the existing imbalances in the Lebanese economy on the economic, financial, and social levels.

III. Economic Imbalances

The existing imbalances in the Lebanese economy are diversified and deep. There is, first, the weak economic growth rates which stood, according to the IMF, at 1% for 2017 and is expected to reach 1.5% for 2018. This is highly affected by the weak activity of the leading sectors such as tourism, real estate and construction. This weak growth rate is accompanied by inflation which recorded 5% for 2017, due to higher costs of imports (especially oil imports) besides weaker USD dollar. Hence, stimulating higher growth rates in the coming years requires increasing the activity of agro-industry, tourism, real estate, construction, banking and capital markets sectors.

A second source of economic imbalance is the composition of the country's GDP where the private-sector consumption spending constitutes nearly 70% of GDP for 2017 and is estimated at nearly USD 37 billion. The private investment spending constitutes nearly 42% of GDP or USD 22 billion. The government spending on goods and services (both consumption and capital expenditures) constitutes 26% of GDP or USD 14 billion. This means that the size of the public sector is large in the Lebanese economy and in, in general, non-productive. Also, net exports (the difference between exports and imports) is negative of nearly USD 20 billion and 38% of GDP. Hence, Lebanon's GDP greatly depends on the private investment and consumption spending, keeping in mind that the government's capital spending does not exceed 8.5% of total public spending; and total imports (nearly USD 23 billion) greatly exceed total exports (USD 3 billion). In this sense, the Lebanese economy is consumption-led economy because of the greater size of private consumption and imports. Increasing growth rates in the coming years definitely need better private and government investments in order to diversify the structure of the national economy. This is hoped by the Cedre Conference and the government's CIP.

A third imbalance in the Lebanese economy is the continued fiscal deficits and growth of the public debt. According to the statistics of the Ministry of Finance for 2017, the fiscal deficit totaled USD 3.8 billion, due to higher spending (USD 15.4 billion) over revenues (USD 11.6 billion). The largest share of public spending, nearly 91.5%, is current spending consisting of wages and salaries of the public sector, financial transfers to EDL, and interest payments on the public debt. These continued fiscal deficits feed the growth of public indebtedness which stood at USD 80 billion as of end-2017, with an annual growth rate of 5-6%. This results in a crowding out effect, where the public sector competes with the private sector for banking credit and investment. The debt-to-GDP ratio is high at nearly 150%, together with a high fiscal deficit-to-GDP ratio of nearly 8% as of end-2017. In this sense, the internal deficit in the Lebanese economy (i.e. the fiscal deficit) constitutes a major economic imbalance, together with the foreign deficit (or negative net exports).

A fourth source of imbalance in the national economy is the weak outdated infrastructure, due to low investment rates by the public and private sectors, over the past years. Several infrastructure sectors such as electricity, telecoms, roads, water and others, require substantial investments to enhance the economic contribution of the overall infrastructure sector. The spending on the electricity sector since 1991 has recently reached USD 13 billion and is, thus, contributing to the fiscal deficit. The government's financial transfers to EDL reached USD 1.3 billion or 34% of the total fiscal deficit and 8.4% of total spending in 2017. Therefore this sector need substantial private and public investments, mainly to construct new production units, so as to increase power supply in order to meet the growing power demand. Also, private investments in the telecoms sector is highly needed, in order to develop this sector and increase its income which stands today at USD 1.3 billion or 11.2% of total revenues. Liberalization of the telecoms sector is a prerequisite for expanding the scope of competition in this sector, thereby leading to its modernization and better economic contribution.

A fifth source of economic imbalance is the existing Syrian refugees, which are recently counted at nearly 1.5 million persons, and which constitute a substantial pressure and burden on the national economy, public finances, infrastructure, labor market, social conditions, and demographic situation in Lebanon. According to the World Bank estimates, the cumulative loss to Lebanon due to the Syrian crisis since its start, as measured by lower economic growth rates, is estimated at nearly USD 18.2 billion till the end of 2015. This is accompanied by declining public revenues (due to lower growth) of nearly USD 4.2 billion for the period 2012-2015. Also, the Lebanese exports lost one-third of its value due to the loss of some markets and trading routes. There is, besides, an increase of nearly 200,000 persons who entered the poverty line; some 250,000-300,000 persons are now unemployed; and the general unemployment rate in Lebanon has grown up to 20% according to the World Bank estimates, and up to 30% among the youth according to UNICEF forecasts.

A third source of imbalance in the Lebanese economy is the higher economic contribution of the trade and services sector (nearly 70% of GDP), in comparison to the contribution of agriculture (10%) and manufacturing (20%). This means that any negative shock to the trade, tourism, or banking sectors could lead to lower economic activity and growth rate. In this sense, the Lebanese economy remains highly unbalanced. It is hoped that the discovery and production of oil and gas in Lebanon would diversify economic structure and increase national income, thereby stimulating better growth rates in the future.

There is also the imbalance caused by the political and security instability in some countries of the region, which cause economic, financial and social burdens on the Lebanese economy, due to strong mutual interconnections. Such regional developments have negatively affected trade and investment exchanges, foreign direct investment, and financial transfers from the diaspora. It also led to lower exports, lower financial and real-estate investments, and declining Gulf tourism.

Another source of economic imbalance in Lebanon is the high rate of corruption, tax evasion (nearly USD 4 billion or 7% of GDP) lower customs collection, and lower collection of electricity and water funds (nearly 40% only). These uncollected financial resources affect negatively the growth of public revenues and economic growth rates.

IV. Conclusions and Policy Recommendations

If we consider a cost-benefit analysis, one can say that the Cedre reforms could realize significant benefits to the Lebanese economy, mainly: (i) controlling the public finances, (ii) enhancing economic activity, (iii) developing the existing infrastructure, and (iv.) increasing public and private investments. However, the use of Cedre funds in the national economy (in case reforms are implemented) could lead to several costs mainly: (i) the possibility of debt increase, (ii) possibility of an increase in production costs due to the intention of the government to raise the rates of some taxes (VAT, on fuels) besides higher tariffs for electricity and water. This could constitute an additional pressure on the productive and services sectors. Higher costs could lead to higher inflation rates which could also be affected by the supply of new money in domestic markets. It is worth indicating here that the expected investments in infrastructure sectors are, by nature, long-term investments that require longer terms and substantial funds to achieve the desired objectives. This factor will be taken into consideration by the private sector in under taking decisions to enter such sectors. In addition, the new wages and salaries scale which was recently ratified (its real cost is nearly USD 1.8 billion, up from an estimated cost of USD 800 million) in addition to the new introduced taxes, could all lead to direct repercussions on the national economy, public finances, inflation rate, and cost of living in 2019 and beyond.

This is why the Lebanese authorities should strive to optimize the benefits of the Cedre Conference, while, at the same time, should also seek to reduce its costs, so as to achieve the desired fiscal, economic, sectorial and social goals.

Also, the Lebanese authorities should implement the required structural reforms, including reducing or halting the misuse of public money, in order to realize the desired objectives of the Cedre Conference. Without actions to fight corruption, weak collection, tax evasion, customs gaps, the Cedre funds could constitute a new pressure instrument on public finances, economic activity, and social conditions.

The appropriate management of the deliverables of the Cedre Conference should constitute the prime priority of the Lebanese authorities in current and future periods. This requires a serious and responsible implementation of the Cedre reforms.

Hence, the Lebanese authorities face today the challenge of proving its ability to fulfil its international commitments. This is a necessary and prime condition to utilize the Cedre funds, following the recent positive parliamentary elections on the 6th of May 2018.

With a new parliament and later a new government, the country's political and economic bodies should focus on designing and implementing effective action plans to put the Cedre results into implementation. Reforms should be launched, and dealing with the existing imbalances should be a major priority. This is crucial for advancing economic growth rates beyond the recent levels of 1-2%. Achieving growth rates of 7-8% and even 10% is possible and could be achieved like in some previous years. With higher growth rates, unemployment could be reduced, as well as poverty levels.

The domestic authorities should, as well, focus on dealing, effectively, with the Syrian refugees' case, mainly by focusing on their gradual return to their home country. This could basically lessen the current economic, financial and social pressures on the Lebanese. The authorities should take serious actions to benefit from the Brussels Conference related to supporting the Syrian refugees.

The launching of investment projects in the infrastructure sectors (especially electricity, energy, water, telecoms and others), under the PPP model, would constitute a valuable opportunity to increase public and private investments in the national economy. This would stimulate higher economic growth rates and better fiscal conditions, besides upgrading and modernization of existing infrastructure to support the overall economic activity.

Also, the Lebanese authorities should focus on incentivizing private investments in the oil and gas sector. Such investments could lead to a growing economy, a controlled public debt growth, diversification and increase in national income, and better living conditions to the Lebanese.

According to the estimates of the IMF, and without the Cedre reforms and CIP, the debt-to-GDP ratio is forecasted to increase from 150% in 2017 to 157% in 2018 and further to 178% in 2023. This is why expanding the scope of economic activity, via reforms and CIP as well as PPP projects, is a prime priority in order to stabilize and then reduce the debt-to-GDP ratio in the coming years.

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