حركة التجدد الديموقراطي
DEMOCRATIC RENEWAL MOVEMENT

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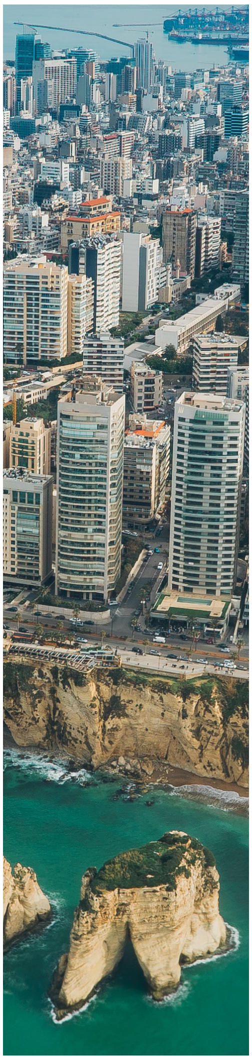
International Economic Support to Lebanon

How not to Lose the CEDRE Opportunity



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Introduction

What drives 17 major international powers and economic institutions to join a meeting dedicated to supporting the world's 83rd economy,[1] ranked 138th on the Corruption Perception Index,[2] and the third most indebted country on the planet?[3]

The April 6, 2018 *"Conférence économique pour le développement par les réformes et avec les entreprises"* (CEDRE) was another public, international demonstration of support to Lebanon, in spite of the latter's dismal track record in implementing reforms it had committed to in the past, and its tradition of institutional stalemate and political infighting. Under the leadership of French President Emmanuel Macron, more than USD 11 billion in pledges were made to finance 250 infrastructure initiatives that the Lebanese government had presented in its Capital Investment Program (CIP). Nonetheless, funding was conditional upon a series of structural and policy reforms aimed at increasing the transparency of the Lebanese government, enforcing strong discipline in public finances, reducing the deficit-to-Gross Domestic Product (GDP) ratio to less than 5 percent in five years, and combating the rampant corruption in the public sector.

Exactly two weeks later, the Democratic Renewal Movement (DRM) convened a meeting of experts to outline the conditions of success of CEDRE, in particular the reforms required for the CIP projects and their international funding to achieve their expected results. Twenty key recommendations emerged from the meeting and were communicated to the Lebanese government, Lebanon's international partners and relevant stakeholders. Recommendations included, among others, the need to integrate CEDRE within a broader economic vision for Lebanon, beyond the issues of

1 World Population Review, GDP Ranked by Country: http://worldpopulationreview.com/countries/countries-by-gdp/, accessed in June 2019.

2 Transparency International, Corruption Perception Index: https://www.transparency.org/cpi2018, accessed in May 2019.

3 Central Intelligence Agency, The World Factbook, Country Comparison: Public Debt: https://www.cia.gov/library/publications/the-world-factbook/rankorder/2186rank.html, accessed in May 2019.

infrastructure on the one hand and public finances on the other hand; to build the capacity of the public sector; to expand the powers of regulatory bodies; to prioritize projects according to needs, feasibility, and urgency; to showcase progress in the implementation of projects and reforms to the public opinion; to combat and curb the informal, mainly illegal economy; and to initiate a solid tax reform. The real aim being the restoration of a long-lost, much-needed trust that constitutes the key element for improving Lebanon's credit rating and public ownership of and engagement in the reform process.[4]

DRM also commissioned a detailed assessment of the Lebanese government's proposals pertaining to employment and job creation, public finances and tax measures, and good governance and fighting corruption.[5] While a long series of measures to strengthen and complement the government's commitments was issued, experts debating the assessment document expressed high levels of skepticism as per the government's ability to deliver given the very nature of the Lebanese political system. Nepotism and clientelism have reached such worrying levels in Lebanon that any measure to instill some levels of good governance would represent a vital risk for most parties in power today. Furthermore, as tensions grow by the day between the United States and Iran, as confrontation and proxy wars between Saudi Arabia and Iran are shaking the Middle East, as far right parties gain more power in Israel, and as Russia continues to expand its sphere of influence, the entire stability of the region is put into question, with all the negative implications on Lebanon's fragile and over-dependent economy.

A year after CEDRE, and after the late adoption of the 2019 budget by the Parliament in July, the reform process, as expected, has been paralyzed yet again by political tensions and a crippled decision-making process. The fight against corruption quickly turned into a politicized point-scoring media campaign and the few reform-oriented measures have been watered down to ensure their safe passage by a deeply divided government and parliament. While Lebanon's international partners are reiterating their readiness to support Lebanon and fulfill their CEDRE pledges, they have raised serious concerns regarding Lebanon's weak commitment to reform and severe delay in the implementation of the measures presented at the conference.

Will this international support continue? Is the risk of a deteriorating security situation in Lebanon the main reason the country is still backed? Are the damages caused by the delays beyond repair?

This paper will address these questions by:

1. Presenting an overview of commitments made by both Lebanon and its international partners during the Paris I, Paris II, Paris III conferences and CEDRE; and

2. Describing the attitude of the international partners towards Lebanon's fulfillment of its commitments or lack thereof.

4 Democratic Renewal Movement, *For a Fruitful CEDRE*, (كي يؤتى مؤتمر «سيدر» ثماره), April 2019: https://www.tajaddod.org/pdf/drm_cedre_roundtable_report.pdf.

5 Democratic Renewal Movement, *CEDRE Reforms: Walking the Talk*, (الإصلاحات الملازمة لمؤتمر «سيدر»: من النصوص إلى التنفيذ), November 2019: https://www.tajaddod.org/pdf/drm_cedre_reforms_f.pdf.

The first section is based on a thorough review of literature, legislation, facts and figures that accompanied and followed the Paris I, II, III and CEDRE conferences. The second section is based on meetings held with officials at the French Presidency, Development Agency, and Embassy in Beirut as well as European experts, in addition to statements and reports by European officials, the World Bank and the International Monetary Fund (IMF).

Learning from the Series of Conferences in Paris

Paris I

The Paris I conference was held on February 23, 2001 at the initiative of then-French President Jacques Chirac to support Lebanon's economic development. At the end of the conference, Lebanon received EUR 500 million from France in project financing support. In exchange for funding, Lebanon promised to stimulate the economy, modernize the tax system, improve public financial management, and maintain monetary stability.

Lebanon did follow through on some of its promises, for example. For example, a Value Added Tax (VAT) was introduced in 2002; a new public accounting law and an anti-money laundering framework came into force; some structural reforms and layoffs were made at Middle East Airlines (MEA) and Télé Liban; and the Army's pension scheme and social security were reformed. But Lebanon was not successful in privatizing MEA, Electricité du Liban (EdL), or the telecom sector. Neither was it able to decentralize the administration and the financial structure for municipalities, nor did it join the World Trade Organization.

After Paris I and in the lead up to Paris II in November 2002, the Lebanese government made headway by increasing the revenue base. Until 2001, Lebanon was spending more (not including interest payments on debt) than it was collecting. This changed in 2001 with the public budget achieving a primary surplus, with revenues exceeding non-interest expenditures. That ratio improved from \$1.00 - \$1.00 in 2000 to \$1.00 - \$0.72 by end of 2002, according to Ministry of Finance figures.[6] However, the debt-to-GDP ratio continued to rise on account of high interest rates. During this period the average interest rate on total debt was around 12 percent.[7]

6 Fiscal Performance sheets 2000 – 2002, Ministry of Finance: http://www.finance.gov.lb/en-us/Finance/EDS/FP. Author calculations.

7 *Lebanon: Paris II meeting, Beyond Reconstruction and Recovery: Towards Sustainable Growth*, Ministry of Finance, November 2002: http://www.finance.gov.lb/en-us/Finance/DC/AC/Documents/ParisII.pdf.

Table 1: Reforms Presented at the Paris I Conference

Measure	Action	Intended impact	Status (by November 2002)
State Media Reform	Lay off 500 workers from Télé Liban, cancel workers collective bargaining contracts and restructure the sector	Contain public expenditures	Done
Civil Service Reform	Reassign surplus workers to Civil Service Board and fill new position openings through the Board	Restrict the growth of public sector employees and contain expenditures	Done
Customs Tariff Reduction	Reduce effective customs tariff from 12% to 6%	Liberalize trade and reduce the price level in the economy	Done
Customs Law	Simplify and streamline customs procedures	Facilitate trade	Done
Investment Law	Create a one-stop-shop for investors, provide tax breaks and financial incentives to projects, and create investment zones	Attract and raise the level of investments	Done
Open Skies Policy	Introduce competition and provide unrestricted entry into Lebanon	Render Beirut International Airport as regional travel hub, lower airfares	Done
Land Acquisition by Non-Lebanese	Provide greater access for non-Lebanese to acquire real estate property and lower registration fees	Enhance investment in the real estate sector	Done
Public Accounting Law	Streamline and simplify budgetary procedures and strengthen treasury functions	Facilitate central government financial activities	Done
Money Laundering Law	Take new measures to guard against money laundering activities	Comply with international standards and regulation for combating money laundering activities	Done
Sugar Beet Subsidies	Terminate subsidies on sugar beet and wheat production	Liberalize agricultural sector and reduce expenditures	Done

Value Added Tax	VAT draft law approved by the Council of Ministers (CoM)	Enhance revenue collection and widen the tax base	Done (implement-ed since 2002)
	VAT law ratified by parliament		
	VAT Implementation		
Global Income Tax	Draft law presented to CoM	Improve tax collection capa-bilities	No progress
	Law ratified by parliament (2003)	Expand taxpayer base	
	Implementation of law (2004)	Streamline tax collection Draft law being prepared.	
Privatize Middle East Airlines	Strategy presented to CoM	Resolve MEA high-wage bill	Restructuring, including lay-offs completed. Airline now profitable but not privatized
	Staff redundancy package	Limit expenditure drain	
	Initiation of privatization of MEA		
Privatize Telecom Sector	Telecom law approved by CoM	Improve efficiency	Law approved. Sale of mobile li-censes underway. Liban Telecom and regulatory agency created then stalled
	Telecom law ratified by parlia-ment	Allow for the introduction of state-of-the-art technology	
	Settlement of contractual dis-putes with Cellular Operators	Lower rates	
	Convert BOT into licenses and parliamentary approval of license agreements	Generate revenues for debt repayment	
	Initiate privatization of Liban Telecom		
Corporatize and privatize Electricité du Liban	Approval by CoM of draft law to convert EdL into a joint stock company	Limit expenditure drain	Law approved. No further progress
	Ratification of law by Parlia-ment	Improve provision of services	
	Initiate tender for manage-ment contract and 10% equity share	Generate revenues	
		Eliminate leakages	

Privatize Water	Beirut Water Authority concession approved by CoM	Enhance effective cost recovery	Draft legislation allowing concessions approved by CoM
	Beirut Water Authority concession ratified by Parliament	Revenue generation	
	Tripoli Water Authority concession approved by CoM	Enhance efficiency	
	Tripoli Water Authority concession ratified by Parliament		
Reform of the Army Pension Scheme	Readjust army retirement benefits and settle accrued retroactive benefits	Reduce current expenditures and drop in future liabilities	Done
Social Security Reform	Reduce social security contributions, settle arrears and provide alternative schemes	Retire contingent liabilities, lower cost of labor and promote employment	Done (from 38.5 to 23.5%)
Municipality Law	Promote decentralization and normalize financial accounts of municipalities	Provide efficient municipal services with positive fiscal externalities	Draft legislation presented to Parliament
Euro-Med Trade Agreement	Sign the Euro-Med Trade Agreement, accede to the WTO and execute GAFTA	Liberalize trade and generate economic growth	EU agreement signed June 2002. No further progress on WTO accession

Source: Ministry of Finance[8]

8 *Ibid.*

Paris II

At Paris II, on November 23, 2002 the Lebanese government focused on easing the pressure of the public debt, which by year-end would reach USD 29.4 billion for a debt-to-GDP ratio of 156 percent. Lebanon pledged to devote 80 percent of the increase from revenues resulting from reform measures and performance enhancements to service the public debt, and the state was asking for USD 5 billion in donor support to "to change the composition, reduce the cost, and lengthen the maturity of its debt through instruments such as sovereign guarantees, investments by Governments and Central Banks in new Lebanese Government foreign currency bonds."[9]

Donors pledged nearly USD 4.4 billion of which USD 2.4 billion turned into commitments dedicated for debt restructuring with an average interest rate of 5 percent and a final maturity of 15 years.

Table 2: Summary of Donor Contributions at the Paris II Conference

Country	Pledge	Date of transfer	Type of contribution
Malaysia	USD 300 million	Dec. 27, 2002	Eurobonds
Oman	USD 50 million	Dec. 30, 2002	Eurobonds
United Arab Emirates	USD 300 million	Jan. 15, 2003	Eurobonds
Kuwait	USD 300 million	Jan. 22, 2003	Eurobonds
France	USD 540 million	Mar. 3, 2003	Loan through the French Development Agency
Saudi Arabia	USD 700 million	Mar. 7, 2003	Eurobonds
Qatar	USD 200 million	May 27, 2003	Eurobonds
Total	**USD 2.39 billion**		

Source: Ministry of Finance[10]

9 *Ibid.*

10 *One-Year Progress After Paris II*, Ministry of Finance, December 2003: http://www.finance.gov.lb/en-us/Finance/DC/AC/Documents/One%20Year%20Progress%20Report-Paris%20II.pdf.

In addition to donor support, Lebanon's Central Bank and commercial banks offered financial support through two schemes:

a) USD 4.1 billion in total from the Central Bank: Banque du Liban (BdL) canceled USD 1.8 billion in treasury bills; exchanged another USD 1.9 billion in treasury bills, Eurobonds, and accrued interest for new debt with longer maturity and lower interest; and rolled over USD 400 million of principal and interest on maturing treasury bills it held through a new issue of a five-year, 4 percent special treasury bills in July 2003; and

b) Lebanon's commercial banks offered USD 3.6 billion in the form of a two-year, zero percent interest loan to the Lebanese state.[11]

Table 3: Paris II Total Support

International donors	Central Bank	Commercial banks	Total
USD 2.39 billion	**USD 4.1 billion**	**USD 3.6 billion**	**USD 10.1 billion**

Source: Ministry of Finance[12]

Lebanon established a special account exclusively for servicing Paris II-related debt at the Central Bank. It finished paying off this debt in March 2018. Paris II-related debt plus Central Bank and commercial bank offerings helped Lebanon decrease its debt servicing-to-total spending ratio by 6 percentage points by 2004, from 55.5 percent at the end of 2002, and to decrease debt servicing-to-GDP by almost 4 percentage points by 2004, from 16 percent at the end of 2002. One year after Paris II in November 2003 the average interest rate on total debt had declined by nearly 4 percentage points to 8.36 percent.[13]

Paris II contributions in addition to Central Bank and commercial banks' debt swap and zero-interest loans totaled USD 10.1 billion and helped Lebanon "re-profile" its debt, lowering the overall interest and decreasing the annual cost of debt servicing to the equivalent of 32 percent of the total stock of debt outstanding at the time. *"Despite the fact that the debt has increased in 2003 to reach around USD 33 billion by the year's end, the servicing of the debt for 2004 is going to be less by around 20 percent compared to what was achieved in 2003, and less than it was estimated to be before the success of Paris II, by almost 40 percent,"* said Riad Salameh, Governor of Lebanon's Central Bank, in a December 2003 interview.[14]

11 *Ibid.*

12 *Ibid.*

13 *Ibid.*

14 Schellen, Thomas. "Q&A Riad Salameh: The governor of the Central Bank gives his wrap of the year." Executive Magazine, December-January 2003-2004, pp 48-49. Print.

Paris II Reform Promises

Lebanon promised to follow through on the reforms presented at Paris I, mainly privatization, shoring up revenue while cutting spending, and paying down public debt. "*The importance of reforms,*" Salameh said referring to the state's promises made at Paris II, "*comes from the fact that we have to keep this confidence in our markets so that the interest rates could go lower for the economy.*"[15]

Lebanon did make progress by introducing a 5 percent tax on income generated by interest and other revenue enhancing measures related to tax administration. On the expenditures side, Lebanon introduced spending and treasury management measures and various initiatives relating to reform of public sector pensions.

With the introduction of the VAT in February 2002, Lebanon increased revenues year-on-year by 25 percent compared to 2001 levels and revenues grew by another 15 percent in 2003 compared to 2002, and 14 percent in 2004. Spending meanwhile grew by only 4 percent in 2003 year-on-year and shrank in 2004 and 2005.[16]

As for privatization, Lebanon hoped to earn USD 5 billion in privatization and securitization proceeds in 2003, and about USD 1 billion each year in 2004 and 2005. The state made some progress toward preparing the legal frameworks, particularly in the areas of telecommunications and water.

In the summer of 2002, ahead of Paris II, the Parliament passed a law authorizing the sale of two mobile phone networks, but all the received bids were considered too low. The tender then changed from a build-operate-transfer to a management contract for the mobile networks. Management of the mobile networks continued until 2007, when, in the context of Paris III, another attempt was made to sell the assets but ultimately failed. The 2002 law also mandated that a regulator be appointed to oversee the telecommunications sector but that was not realized until 2007. The regulator, however, was stripped of its powers due to a State Shura Council decision in 2011.[17]

The fixed telecommunications network was also promised to be privatized but never was. The plan was to establish the legal framework to launch a tender for the sale of up to 40 percent of shares of the assets, which was to be named Liban Telecom and would have replaced Ogero, the state-owned fixed line operator.

15 *Idem.*

16 Fiscal Performance sheets 2000 – 2005, Ministry of Finance: http://www.finance.gov.lb/en-us/Finance/EDS/FP. Author calculations.

17 Nash, Matt. "Playing to your strengths." Executive Magazine, February 10, 2015: http://www.executive-magazine.com/economics-policy/ict-playing-to-your-strengths.

In the fall of 2002, also ahead of Paris II, the Parliament approved a law to organize the electricity sector for privatization. The plan was to establish a regulator, separate production from transmission and distribution activities, and create a new public enterprise responsible for production and distribution that would eventually be 40 percent privately owned. Until today the regulator has never been appointed and the public enterprise never created. In 2012, some privatization of electricity services was tendered to three companies; the services included power distribution, maintenance work, and bill collection.[18] Fixing the electricity sector during the 1990s would have reduced the public debt by some USD 26 billion by the end of 2017, would have saved residents out-of-pocket spending on private generators some USD 17 billion, and the economy would have grown each year by an additional 1-1.5 percent.[19]

Since 2000, Lebanon has had plans to reform and privatize the water sector. That year, the Parliament passed a law that consolidated the number of water establishments from 22 to four: North, South, Bekaa, and Beirut/Mount Lebanon. The reform plan was to privatize the water sector leaving policymaking to the Ministry of Energy and Water with the four water establishments responsible for water supply, irrigation, and wastewater services. Only one water network, Tripoli's, was privatized in 2003 but the contract was not extended past 2007. By 2010, the law still had not been fully implemented: the four water establishments "severely lack managerial and financial autonomy and are impeded by limited inter-agency coordination and weak central government oversight. They have not been able to effectively operate and maintain water supply networks, fully engage with the private sector, recover costs and hire qualified staff."[20]

Lastly, Lebanon had plans for securitizing transactions and certain revenues, including revenues from telecommunications, tobacco as well as from Casino du Liban, and deposit them into a special account at the Central Bank dedicated to servicing the public debt. Parliament passed a law in summer 2002, finalizing the structure and the legal documentation.

18 El Amin, Mohamad, "Debate sharpens over power service providers." The Daily Star, July 12, 2012: https://www.dailystar.com.lb/Business/Lebanon/2012/Jul-12/180256-debate-sharpens-over-power-service-providers.ashx.

19 "Lebanon's insoluble electricity crisis (Part two)." The Monthly, Informational International, July 19, 2018: https://monthlymagazine.com/article-desc_4759_.

20 Project Appraisal Document on a Proposed Loan to the Lebanese Republic for the Greater Beirut Water Supply Project, The World Bank, October 2010: http://documents.worldbank.org/curated/en/897331468266980391/pdf/563410PAD0P1031e0only1910BOX353791B.pdf.

Paris III

Paris III, held on January 25, 2007 was different than Paris II. At Paris II, donor funding was not conditional, meaning the Lebanese state received money without specific designations or conditions. The United States, for example, did not pledge at Paris II because reforms were not linked.[21]

By the beginning of 2007, Lebanon was in dire need of international support. The July War in the summer of 2006 had an estimated direct cost of USD 2.8 billion in reconstruction needs plus an estimated indirect impact in lost output and income for 2006 at USD 2.2 billion, not to mention the death of almost 1,200 people and the thousands displaced. Some of the USD 250 million pledged at the Stockholm Conference for Lebanon's Early Recovery in August 2006 were included as project financing at Paris III. The Stockholm Conference was held following the July War in summer 2006 and aimed to help Lebanon in recovery projects and programs, creating the Lebanon Recovery Fund. The July War was "a major setback to the country's encouraging economic outlook and to the reform agenda," according to the Terms of Reference of the Lebanon Recovery Fund.[22] At the same time Lebanon was averaging a USD 2.2 billion deficit yearly during the four years since the Paris II conference in November 2002, and the public debt had climbed to nearly USD 42 billion for a debt-to-GDP ratio of 154 percent. Furthermore, Lebanon was facing a financial crunch in February 2007 to finance and roll over public debt amounting to nearly USD 3 billion.

At Paris III donors pledged a total of USD 7.6 billion.

Table 4: Overall Donor Support Pledged at Paris III (USD millions)

	Bud-getary support	Project financing	BDL	Sup-port to Private Sector	UNIFIL/ UN/ NGOs	Under-way/ under review	Total
Grants	981	198	--	--	231		1,410
Loans	1,403	2,486	75	--	--		3,964
Total	**2,383**	**2,684**	**75**	**1,279**	**231**	**957**	**7,604**

Source: Ministry of Finance.[23] Data as of March 22, 2007

21 Schenker, David. "Lebanon Goes to Paris III: High Stakes in France and Beirut." The Washington Institute for Near East Policy, January 24, 2007: https://www.washingtoninstitute.org/policy-analysis/view/lebanon-goes-to-paris-iii-high-stakes-in-france-and-beirut.

22 Terms of Reference of the Lebanon Recovery Fund, November 3, 2006: http://mdtf.undp.org/document/download/1842.

23 Recovery, Reconstruction, and Reform. International Conference for Support to Lebanon, January 25, 2007: http://www.finance.gov.lb/en-us/Finance/DC/AC/Documents/Paris%20III%20Final%20Document%20(English).pdf.

By December 31, 2009 Lebanon had received USD 3.2 billion of USD 7.6 billion in pledges for a fulfillment rate of 42 percent. In other words, after almost three years Lebanon received less than half of what donors promised to give in grants and loans at Paris III.[24] As of December 2018, Lebanon was yet to payoff Paris III-related debt with a remaining balance of USD 228 million according to Ministry of Finance data compiled by Economena Analytics.[25]

Paris III Reform Promises

According to the Eighth Progress Report dated December 31, 2008, Lebanon had fulfilled its reform promises at a rate of 28%.

At that time much of the delays in fulfilling reform promises was attributed to pending parliamentary action regarding the adoption of new legislation, the amendment of existing laws, and the allocation of new funding for newly created state agencies (e.g. the Telecommunications Regulatory Authority) or new departments, functions and roles at existing ministries. No budget for fiscal years 2006 to 2016 was adopted by Parliament. The Eleventh Progress Report concludes that forward progress on the reform agenda was not as advanced as originally projected: "increased results have been held up by lagging decision-making and approval processes, affecting both funding and reforms, and by capacity constraints besetting public investment activity."[26]

Instead of quantifying progress on the reform agenda by December 2009, the Eleventh Progress Report lists key achievements made during 2009 by implementer but does not attempt to track ongoing initiatives, to qualify reasons for delay. It also does not explain timelines for reform initiatives that were projected past 2009 to 2010 or 2011 as originally prescribed in the reform promises made at Paris III and outlined in the First Progress Report dated March 2007.

The following is a selected summary of what was achieved concerning Paris III reform initiatives as of December 31, 2009 and reported in the Eleventh Progress Report:

Ministry of Education and Higher Education

- Education strategy sent to Cabinet for approval;
- Five-year priority and action plan approved by the Ministry;
- Implementation of an Education Management Information System;
- Decree drafted for universal basic education for ages 6 to 15; and
- 11 new schools constructed and fully furnished; 38 unviable schools closed.

24 International Conference for Support to Lebanon – Eleventh Progress Report, Ministry of Finance, December 31, 2009: http://www.finance.gov.lb/en-us/Finance/DC/AC/Documents/Paris%20III%20-%20Eleventh%20Progress%20Report.pdf

25 Ministry of Finance, Gross Foreign Currency Debt: Paris III Eurobonds and Loans, retrieved from BRITE: https://brite.blominvestbank.com/series/Gross-Foreign-Currency-Debt-Paris-III-Eurobonds-and-Loans-3050/

26 *Ibid.*

Ministry of Social Affairs

- Draft law completed for restructuring the Ministry;
- A vision statement with general objectives defined for the Ministry's social strategy; and
- A framework strategy for testing mechanisms for social safety net programs developed and approved by Cabinet.

Ministry of Public Health

- The Primary Health Care accreditation program developed and implemented in 80 centers;
- The National Health Accounts updated and institutionalized;
- A National Committee for emergency management services created;
- A National Committee created to develop generic drug policies; and
- The existing reference drug pricing system reviewed and improved.

National Social Security Fund (NSSF)

- The first phase of the IT Master Plan implemented;
- The 2003 accounts audited; and
- 42 auditors and four lawyers appointed to regularly survey companies' NSSF contributions and to enhance the collection process.

Revising the electricity tariff structure was not met, nor was formation of the regulator or the corporatization of the public electricity utility. Referring to the privatization of the two mobile networks the IMF concluded that "privatization has been postponed due to unfavorable international capital markets."[27]

27 International Monetary Fund Staff Visit, Aide-Mémoire, September 2009, published by the Ministry of Finance: http://www.finance.gov.lb/en-us/Finance/Rep-Pub/RI-MLI/Reports%20Issued%20by%20Multilateral%20Institutions/English/Aide%20Memoire.pdf.

CEDRE

Lebanese officials went to Paris in April 2018 to present a plan for restructuring the economy. Since 2011, the country had been exhibiting recessionary symptoms and reforms were needed to reboot the economy. As measured by the Central Administration of Statistics, economic growth slowed from 8 percent in 2010 to 0.6 percent in 2017.[28] For 2018, the International Monetary Fund (IMF) projected the growth rate at just 0.2 percent for an estimated GDP of USD 56.4 billion. The IMF also estimated the public debt to reach USD 85 billion in 2018 for a debt-to-GDP ratio of 150 percent.[29]

At CEDRE, donors were presented a Capital Investment Program (CIP) to develop Lebanon's infrastructure and ease supply-side bottlenecks. The CIP was prepared to address specific economic shortcomings: tremendous challenges in public finances, monetary policy that has almost exhausted all options to maintain stability, low growth rates, high unemployment, increasing levels of poverty, and the balance of payments deficit. Lebanon needs to achieve a 5 percent growth rate just to stabilize the economy and maintain the economic model but has been reluctant to invest in the economy. The country's infrastructure is worn down because of years of low state investment and overstretched because of the large refugee influx and a growing national population. From 2010 to 2017, Lebanon spent roughly 4 percent of total expenditures on capital investment, an average of USD 600 million per year.[30] In the 2018 budget, capital expenditure allocations were reduced by 12.6 percent.[31] For the same period, 2010-2017, Lebanon's spending deficit (including interest payments on debt) averaged USD 3.6 billion each year according to Ministry of Finance figures.[32]

To rehabilitate and expand the nation's infrastructure, the CIP would raise debt and called for an investment need of almost USD 20 billion, including land expropriation costs of nearly USD 2 billion for 250 projects. These could generate some 178.3 million labor days over three phases each lasting about four years, from 2018 to 2030.

28 National Account Estimates for 2017, Central Administration for Statistics: http://cas.gov.lb/images/PDFs/National%20Accounts/CAS_Lebanon_National_Accounts_2017_Comments_and_tables.pdf.

29 IMF DataMapper, April 2019: https://www.imf.org/external/datamapper/NGDP_RPCH@WEO/LBN?year=2019.

30 Public Finance Monitor reports 2010 – 2017, Ministry of Finance: http://www.finance.gov.lb/en-us/Finance/Rep-Pub/DRI-MOF/PFR. Author calculations.

31 Arbid, Jeremy. "Mapping the money." Executive Magazine, April 27, 2018: https://www.executive-magazine.com/economics-policy/mapping-the-money.

32 Fiscal Performance sheets 2010 – 2017, Ministry of Finance: http://www.finance.gov.lb/en-us/Finance/EDS/FP. Author calculations.

Table 5: Capital Investment Program (USD millions)

Funding phases	2018 - 2021	2022 - 2025		
	Phase 1	Phase 2	Expropria-tion, phases 1and 2	Total
Water	2,257	878	262	3,397
Waste water	1,364	1,040	48	2,452
Solid Waste	1,400	-	-	1,400
Transport	2,863	2,820	1,408	7,091
Electricity	2,151	1,441	-	3,592
Telecom	700	-	-	700
Infrastructure for tourism and industry	84	255	-	339
Total	**10,819**	**6,434**	**1,718**	**18,971**

Source: Presidency of the Council of Ministers[33]

The CIP pitch was generally well received by donor countries and multilateral institutions pledging USD 11.6 billion mostly in low-interest loans on the condition that Lebanon commit to reforms.

33 Capital Investment Program, Government of Lebanon: http://www.pcm.gov.lb/Admin/DynamicFile.aspx?PHName=Document&PageID=11231&published=1.

Table 6: Overall Donor Support Pledged at CEDRE

Donor	Pledges in USD millions
France	677
Italy	148
UK	85
Netherlands	369
Germany	74
Finland	7
Japan	10
Turkey	200
European Union	185
United States	115
World Bank	4,000
European Investment Bank	984
European Bank for Reconstruction and Development	1,353
Kuwait	180
Kuwait Fund for Arab Economic Development	500
Islamic Development Bank	750
Arab Fund for Economic and Social Development	500
Saudi Arabia	1,000
Qatar	500
Total	**11,635**

Source: The Daily Star, Al-Akhbar, donor statements[34]

34 “Breakdown of over $11 billion pledged to Lebanon at CEDRE.” The Daily Star, April 22, 2018: https://www.dailystar.com.lb/News/Lebanon-News/2018/Apr-06/444436-breakdown-of-11-billion-pledged-to-lebanon.ashx; “شروط «سيدر»: الحُلّة الجديدة للاستعمار”. Al-Akhbar, April 10, 2018: https://www.al-akhbar.com/Lebanon/247743/شروط-سيدر-الحلة-الجديدة-للاستعمار.

CEDRE Reform Promises

The reforms promised by the state involve fiscal discipline measures – mainly through the reduction of the debt-to-GDP ratio by decreasing the deficit by one percentage point of GDP over the next five years (though a starting point was not specified), reducing the subsidy to the failing public electricity utility, Électricité du Liban (EdL), which averaged USD 1.6 billion per year between 2010 and 2017 according to figures from the Ministry of Finance,[35] and by shoring up revenue to the treasury by increasing the tax base.

Since promising to reform at CEDRE, Lebanon overshot the total spending allocation in the 2018 budget by nearly USD 600 million, spending 17 percent more than in 2017, recording the first primary deficit (expenditures not including debt servicing) since 2013, and reaching a total deficit at 11 percent of GDP, or approximately USD 6.5 billion.[36]

In February 2019, Lebanon's Economic and Social Council (EcoSoC) – an advisory body to the government – issued a report on fiscal measures the state should adopt to address fiscal imbalances, including the elimination of the EdL deficit over the next three years; to reduce the cost of public debt servicing by at least 10 percent through a mechanism that the government, BdL, and commercial banks agree on; and, to reform public sector pension systems and benefits, review public sector personnel and positions, and freeze hiring for the year.[37]

Cabinet included and expanded on EcoSoC recommendations in the 2019 budget, which was adopted by the Parliament on July 19, 2019. Measures to shore up revenue and limit expenditures include:

35 Fiscal Performance sheets 2010 – 2017, Ministry of Finance: http://www.finance.gov.lb/en-us/Finance/EDS/FP. Author calculations.

36 Arbid, Jeremy. "Mapping the money." Executive Magazine, April 27, 2018: https://www.executive-magazine.com/economics-policy/mapping-the-money; Fiscal Performance sheets 2013 – 2018, Ministry of Finance: http://www.finance.gov.lb/en-us/Finance/EDS/FP. Author calculations.

37 "Lebanon This Week." Byblos Bank. Issue 572, February 11-16, 2019, page 3: https://www.byblosbank.com/library/assets/Gallery/Publications/LebanonThisWeek/Lebanon%20This%20Week%20572.pdf.

Table 7: Fiscal Measures Included in the 2019 State Budget

Revenue-related measures	Expenditure-related measures
• Raised taxes on interest earned on deposits, LBP-denominated treasury bills and bonds issued by the government, and on fixed income instruments like certificates of deposit from 7 to 10 percent; was at 5 percent before 2017 tax bill, a doubling of the rate in less than two years. The rate is effective for three years from the publication of the budget law. • Introduction of tax bracket for persons and enterprises at the rate of 25 percent for annual income above LBP 225 million (USD 149,000); was tax rate of 20 percent for individuals with incomes above LBP 120 million (USD 80,000), and 21 percent for enterprises with profits above LBP 104 million (USD 69,333). • Introduction of 3 percent duty on imports that are subject to the VAT, excluding fuel, raw materials, and industrial equipment. • An annual tax of LBP 50,000 on every kilovolt-ampere of electricity generation capacity owned. • New tax on pensions for civil servants and security personnel at 50 percent of the regular income tax rate and stipulates that the first LBP 10 million of the annual pension salary is tax deductible; benefits were previously tax exempt. Benefits for wounded or killed-in-action security personnel exempted from the income tax.	• Recruitment and hiring freeze in the public sector until the government conducts a comprehensive count of the number of employees and their positions. • A three-year suspension of the early retirement option for civil servants and most army personnel. • Increase of the minimum number of years of service required before retirement eligibility for army security personnel and civil servants. • Limited public sector salaries to 12 monthly salaries per year (some agencies were receiving 16, such as Ogero, Port of Beirut, Lebanese Petroleum Administration, Régie libanaise des tabacs et tombacs. • Public sector salaries capped at 20 times the national minimum wage – ceiling of LBP 13.5 million (USD 9,000), and restriction of benefits that civil servants receive at 75 percent of the annual salary. • Retirees prohibited from receiving multiple pensions from various positions held in the public sector.

- Healthcare and social assistance benefits for army personnel were reduced by 1.5 percentage point.
- New tax on the salaries and benefits of current and former presidents, prime ministers, speakers of Parliament, and members of Parliament.
- New annual fee of between LBP 100,000 and LBP 1 million per license plate for cars with special license plate numbers.
- Exemptions on customs duties and excise taxes on the purchase of vehicles by current members of Parliament were canceled.
- Exemptions on the payment of vehicle registration fees and *mécanique* fees for certain beneficiaries were canceled
- An 85 percent reduction on penalties for taxpayers to settle late payments of taxes and fees before the end of 2019
- Reduction of real estate registration fees from 3 percent to 2 percent on residential units valued up to LBP 375 million (USD 250,000) and from 5 percent to 3 percent on units above LBP 375 million.

Source: Executive Magazine, August 2019, issue 238

In line with CEDRE, the state commissioned management consulting firm McKinsey & Company to draft a vision meant to spur economic productivity and enhance the private sector environment. In addition to introducing new structural and sectoral reforms and doing business measures, the consulting firm compiled recommendations from international organizations. At its core, the vision aims to channel investments to industries and productive sectors that would have a multiplier effect, create jobs, and distribute income and wealth.

Table 8: Reform Initiatives Related to Digitization, Capacity Building, or other Efficiency Enhancements

Description	Status update
Legislation to regulate medicinal marijuana	N/A
New law or amend existing legislation to redirect tobacco subsidies elsewhere	N/A
Whistleblower protection law protecting public sector workers that report ill deeds	Legislated: #83, October 2018
Law requiring state officials to disclose private assets	N/A
Law to establish a National Anti-Corruption Commission to oversee public information requests, whistleblower filings and other anti-corruption measures	Legislated: #6, June 2019
Transformation of the stock exchange into a private entity	Decree needed to implement Capital Markets Law #161, August 2011
Implementation of Capital Markets Law #161, August 2011	Decree needed to implement Capital Markets Law #161, August 2011
Law to establish a sanctioning committee and a financial markets tribunal; was an article in the Capital Markets Law #161, August 2011	N/A
Review of the Code of Commerce, including the provisions related to companies/corporations, with the aim of modernizing the 13 legal status of businesses	Under review by parliament committee
Facilitating e-transactions by recognizing electronic signatures and adding protections to personal data	Legislated: #81, October 2018
Allowing the establishment of commercial entities best suited for firms offering private equity and venture capital avenues	N/A
A legal framework for asset-based lending, e.g. selling bonds to investors	N/A
Streamlines resolution of business lawsuits through arbitration	Legislated: #82, October 2018
New rules to license insolvency practitioners to advise businesses in distress	Under review by parliament committee

Establishing a business support unit aimed at providing start-ups with free information, advice and licensing support	Unit established at IDAL
A legal framework allowing companies to register and own proprietary ideas and inventions	N/A
A legal framework for companies to compensate employees with equity	A law has been drafted
A legal framework to control monopolies, collusion, exclusivity agreements, and patent infringement	A law has been drafted
A legal framework facilitating company closures (time and cost reduction)	A law has been drafted
Regulating the restructuring of corporate debt	N/A
New rules allowing non-financial companies to issue preferred shares	N/A
Measures to restructure the government and improve service provision through e-governance	Under review; requires Cabinet endorsement
Cabinet to tender a package for a liquefied natural gas (LNG) terminal to supply fuel for power generation	Bids under evaluation
Development of power generation capacity through public financing to complete ongoing generation projects; and hiring a transaction advisor to initiate implementation of a program to develop new generation capacity by independent power projects (IPPs).	N/A
Establishing the regulatory authority to regulate the electricity sector, as per law #462 of 2002	N/A
Restructure the management and workforce of the public electricity utility to follow corporate best practices	N/A
Amend regulations to incentivize hospitals to specialize instead of build new departments	N/A
New rules allowing local committees to form and oversee industrial zones	N/A
EU funded plan to automate the operations and procedures of judicial courts through the development of software and procurement of hardware at the Beirut Palace of Justice and the Jdeideh and Jounieh courts	N/A
EU funded plan to reinforce judicial institutions' capacities through the provision of technical expertise from EU Member States, and support to develop the Lebanese legal aid system to increase access to justice for vulnerable populations	N/A

EU funded plan to enhance the judiciary's capacities to handle terrorism cases in full compliance with international legal instruments and human rights norms, standards and good practices	N/A
A legal framework to license and incentivize "knowledge-intensive" export-driven businesses	N/A
Amend relevant laws identified through roundtable discussions in order to enhance female participation in the labor force	N/A
Limit public spending by re-freezing hiring in the public sector (unless approved by Cabinet), design a unified public sector employee scheme for social benefits, review government subsidies and contributions to public mutual funds, rationalize public spending on fuel, evaluate public employees performance	N/A
A World Bank loan of $43 million to improve access to land use and value data, property rights data, and geospatial information via the Land Registry and Cadastre	N/A
Codifying anti-corruption and transparency measures in the petroleum sector	Legislated: #84, October 2018
Establish a sovereign wealth fund to manage hoped-for revenue from oil and gas	N/A
Cabinet to pass a decree stating that any increase in power supply from new power generation output would be matched by an automatic and commensurate increase to the tariff to offset EdL subsidies	N/A
Increase of the corporate tax rate from 15 percent to 17	Legislated: #64, October 2017
Introduction of a tax on the value appreciation of property beyond standard transaction tax rate	Legislated: #64, October 2017
Increasing interest income tax rate from 5 to 7 percent	Legislated: #64, October 2017
Increasing VAT rate from 10 to 11 percent and improving compliance	Legislated: #64, October 2017
Increase gasoline excises	N/A
Introduce new stamp duties and fees	Legislated: #64, October 2017
A World Bank loan of US $50 million designed to improve budget transparency, cash management, public debt management, Ministry of Finance e-services, and the efficiency of public procurement	N/A

Passing a public private partnership law	Legislated: #48, September 2017
Cabinet to authorize the Council of Development and Reconstruction (CDR) to prepare and negotiate the Greater Beirut Urban Transport Project	N/A
Parliament to ratify the revised Public Procurement Law of 2013	N/A
A law to allow legal and commercial relationships for franchising businesses	N/A
Cabinet to scale up the National Poverty Targeting Program (NPTP) by approving the expansion of the electronic-card food voucher, and the necessary budgetary allocation, from the current 10,000 extreme poor households to 15-20,000 extreme poor households; and the Ministry of Social Affairs and the Presidency of the Council of Ministers to finalize the updating and renewal of the NPTP database of poor households via a recertification of all beneficiaries currently in the database (110,000 households) and an assessment of new applicants based on the new targeting formula and agreed protocols of assessments and supervision.	N/A
A legal framework for solid waste management	Legislated: #80, October 2018
Stimulate investments in the tourism sector through new legislation and amending IDAL's organizational law	N/A
Allow Casino du Liban to open new facilities and allow others to legally obtain gambling operations licenses	N/A
Protect groundwater resources by amending the legal framework and enforcing the law	Legislated: #77, April 2018

Source: Presidency of the Council of Ministers, McKinsey & Company; International Monetary Fund; World Bank[38]

38 Vision for Stabilization, Growth and Employment, Government of Lebanon: http://www.pcm.gov.lb/Admin/DynamicFile.aspx?PHName=Document&PageID=11260&published=1; Lebanon Economic Vision, McKinsey & Company: https://www.economy.gov.lb/media/11893/20181022-1228full-report-en.pdf; Article IV 2017, International Monetary Fund: https://www.imf.org/en/News/Articles/2018/02/12/ms021218-lebanon-staff-concluding-statement-of-the-2018-article-iv-mission; Priority Reforms for the Government of Lebanon 2017, World Bank: http://documents.worldbank.org/curated/en/438461495869364907/pdf/P163010-05-27-2017-1495869360288.pdf.

Lebanon's Performance Assessed by International Partners

Cautious Optimism Dependent on Reforms

"No other country that I know of, at least not in the middle-income category, has had that kind of show of support."[39] This is how a current high-ranked French official commented on the initial results of CEDRE a during a meeting with the author in Beirut in April 2018. The number of countries and institutions involved and the amount of pledges showed the level of international, French-led commitment to supporting the Lebanese economy and avoiding a collapse that may have dangerous consequences in an already unstable region.

"Lebanon cannot afford a major economic crisis. A financial crisis quickly turns into an economic crisis, followed by a social crisis, which leads to a political crisis, and unfortunately in the case of Lebanon, a severe political crisis carries the risk of turning into a security crisis," the French official added, stressing on the need to avoid *"that negative dynamic."*[40]

Support for Lebanon was not limited to the expression of interest in investing in infrastructure projects. CEDRE followed an international Ministerial Meeting in support of Lebanon's Armed Forces and Internal Security Forces, held in Rome on March 15, 2018, and preceded the Friends of Syria conference, held in Brussels on April 24-25, 2018, dedicated to supporting Syria's neighboring countries that have hosted Syrian refugees. These gatherings reflected a strong international enthusiasm to help Lebanon avert economic and security hazards. As such, the international community demonstrated awareness that Lebanon's recovery is dependent on investments and cash influx into the country, but also on preserving stability through effective and well-equipped military and security agencies. The country's recovery is also dependent on its ability to manage the burden of

39 Interview with author, April 2018.

40 *Ibid.*

refugees on its territory, further motivated by the reluctance of European countries to welcome more refugees on their territory. French Minister of Foreign Affairs Jean-Yves Le Drian explicitly stated in his inaugural speech during CEDRE: *"to be effective, our aid cannot be limited to the humanitarian sector. It is clearly the entire economic fabric, and in particular infrastructures and public services, which are actually suffering and consequently require support."*[41]

Lebanon's international partners showed understanding of the challenges that Lebanon has had to face. It is not true that international partners are unaware of Lebanon's complex political game. They point out to several instances, after the civil war, where politicians could not escape working together for stability despite their political differences. The international community's current support is very much linked to the current affairs in the region, which could very well get much worse and negatively affect Lebanon's stability. This assessment was made clear in Le Drian's opening speech during CEDRE: *"[Lebanon] is bearing the full brunt of regional tensions and first and foremost of the Syria crisis. It is combating terrorism at its borders and within its own country. With more than a million refugees, it has taken on more than its share of the burden of those fleeing Syria. (…) During this tumultuous time, the Lebanese people have acted in an outstanding spirit of responsibility over the past few months."*[42]

The political context was also conducive for international support. French President Emmanuel Macron's involvement in initiatives designed to keep Lebanon stable had begun, a few months earlier, with his mediation to end Prime Minister Saad Hariri's ordeal in Saudi Arabia and his temporary resignation. Also, political parties represented in the Cabinet maintained relatively high levels of entente and joint commitment to the CEDRE agenda, although engaged in the parliamentary election campaign during spring 2018.

A climate of cautious enthusiasm among Lebanon's international partners was palpable in the first few months that followed CEDRE. All partners, nevertheless, insisted that the real condition for Lebanon's recovery was to reform long decried governance methods that have plunged the country into the abyss of corruption perceptions rankings.[43]

Three weeks before CEDRE, the IMF assessed that "economic performance and financial inflows are expected to remain weak under the baseline scenario of unchanged policies […] Lebanon needs urgent action to preserve confidence and support macroeconomic stability. A reform agenda focusing on three areas can improve the country's economic outlook. First, fiscal policy needs to be immediately anchored in a consolidation plan that stabilizes and then reduces debt as a share of GDP. Second, risks to financial stability should be contained, including by gradually incentivizing banks to strengthen their buffers. Third, structural reforms, including reforming the electricity sector and addressing corruption and governance, could promote sustainable growth and improve equity and competitiveness."

41 Opening Address by Jean-Yves Le Drian, Minister for Europe and Foreign Affairs, CEDRE, Paris, April 6, 2018: https://www.diplomatie.gouv.fr/IMG/pdf/cedre_discours_du_ministre_en_cle8a64f3.pdf.

42 Le Drian, CEDRE opening address, April 6, 2018.

43 Transparency International, Corruption Perceptions Index 2018: https://www.transparency.org/cpi2018.

The staff assessment report commented on the Lebanese government's CIP submitted to CEDRE and warned that "if implemented under unchanged policies, [it] would only provide a limited growth boost while worsening the public debt trajectory."[44]

But what international partners also showed during CEDRE is that they do not take Lebanon's promises at face value anymore. A clear link was drawn between Lebanon's implementation of a series of sectoral and governance reforms on the one hand and the disbursement of funds and loans for infrastructure projects on the other hand.

Ambassador Pierre Duquesne, French Inter-Ministerial Delegate to the Mediterranean and in charge of coordinating the CEDRE process, emphasized in his speech during the conference that, unlike the previous three Paris conferences, a multilateral follow-up mechanism would be put in place to monitor the implementation of the Lebanese government's commitments.[45]

Olivier Ray, Regional Director for the Middle East at the Agence française de développement (AFD), outlined the objectives this mechanism at a DRM roundtable on April 20, 2018: "*Lebanon did not receive a blank check of USD 11 billion at CEDRE. The funds will be channeled during a four- to six-year period, based on an assessment of each project on its own merits, based on criteria related to economic efficiency, contribution to social equity, and environmental impact. No project will pass if it does not meet basic criteria. Projects submitted at CEDRE can still be enhanced. International technicians will be discussing with relevant ministries and the [Council for Development and Reconstruction] (CDR) how to improve their economic efficiency and environmental impact.*" He compared the follow-up mechanism to a "*social contract between the international community and Lebanon, to make sure that all the different actors make their part of the deal and follow up on their commitments.*" Ray also stated that "*we need to make sure the Lebanese government does its share of the job. There is a consensus in Lebanon that the international community must put consistent pressure*" *as the required reforms will be "challenging vested interests.*"[46]

The details of the mechanism were presented by Jacques de Lajugie, Head of the Regional Economic Services for the Levant at the French Ministry of Foreign Affairs. "*The CEDRE process consists of two follow-up mechanisms (…) a coordination group in Beirut, which is of a highly operational nature, and another that will bring together multilateral donors (the World Bank, the European Union, the United Nations) and the countries that have contributed the most (Germany, France, Saudi Arabia, Kuwait), which will have a more strategic focus. The Lebanese side will be represented by the Presidency of the Council of Ministers, the Council for Development and Reconstruction, and the Ministry of Finance," in addition*

44 Statement by International Monetary Fund Staff for the April 6, 2018 CEDRE, March 14, 2018: http://www.pcm.gov.lb/Admin/DynamicFile.aspx?PHName=Document&PageID=11305&published=1.

45 *Intervention de Pierre Duquesne à la Conférence « Investissement libanais dans les infrastructures »*, April 6, 2018, https://hcp.gov.lb/hcp.gov.lb/_1uw4gyf.pdf. Author translation.

46 Olivier Ray, Regional Director for the Middle East at the Agence française de développement (AFD), DRM roundtable, April 20, 2018.

to the Central Inspection body. *"If the monitoring committee finds an irregularity in one of the projects funded under the CEDRE program, the bidding process will be suspended, as well as the funding. And the state entity responsible for this irregularity will be blacklisted,"* he explained.[47]

Mounting Impatience

A month after CEDRE, on May 6, 2018 Lebanon held its first parliamentary election in nine years. On May 24, Saad Hariri was re-appointed Prime Minister. After his official nomination, he stated: *"It is an honor that President Michel Aoun has designated me to swiftly form a new national unity Cabinet that will continue its objectives of tackling the Syrian refugee crisis, as well as a set list of reforms on both the societal and economic level."*[48]

Things were not as swift as first expected. The new Cabinet was only formed on January 31, 2019. Eight months of lost opportunity for key reforms and the improvement of the business climate in a country facing a severe slowdown in its growth.

Ray from the AFD outlined why Lebanon must reform: *"Lebanon critically needs strong investment in its public services. It is ranked 130th out of 137 countries for the quality of its overall infrastructure This is not an acceptable level, especially not for a middle income country. The Lebanese people and international partners can expect more."*[49] Failing infrastructure deters investment.

Lebanon's international partners expect from Lebanon to deliver. It is not understandable how, with the education and talents in Lebanon, some major problems have not been solved or tackled appropriately; electricity and waste management being the clearest examples. Stronger signs of international economic support will materialize in Foreign Direct Investment by private companies, which are not controlled by governments. By increasing the country's attractiveness and creating the appropriate conditions, investors will come and replace to a large extent the need to borrow in order to revamp Lebanon's infrastructure.

The controversy over an offer to help Lebanon address its chronic electricity problems made by Siemens, a German provider of energy solutions and power plant construction, during the visit of German Chancellor Angela Merkel and Siemens AG CEO Joe Kaeser to Beirut in June 2018, is further evidence to the negative impact of Lebanon's dysfunctional decision-making process on the overall attractiveness of the country. In September 2018, in a leaked WhatsApp voice message, MP Yassin Jaber said *"he heard allegations that in a meeting*

47 Ouazzani, Kenza, "CEDRE: one year later, where are we?" L'Orient-Le Jour English, April 9, 2019 : https://www.lorientlejour.com/article/1165541/cedre-one-year-later-where-are-we-.html.

48 "Hariri re-appointed as Lebanon's premier." An-Nahar English, May 24, 2018: https://en.annahar.com/article/809186-binding-parliamentary-consultations-kick-off-to-nominate-a-pm.

49 Ray, AFD, DRM roundtable, April 20, 2018.

between Siemens representatives and the electricity ministry, the latter had rebuffed the company's offer to assess Lebanon's power needs for free and assist with drawing up solutions." He told the Financial Times that "he was concerned that giving Siemens the cold shoulder would deter foreign companies from doing business with Lebanon." [50]

Siemens' short explanation came through a tweet by its CEO Joe Kaeser, in response to a Lebanese Twitter user who asked *"whether Siemens presented or discussed any offer to the Lebanese government or* [then-caretaker Minister of Energy and Water] *@CesarAbiKhalil regarding the electricity."*[51] Kaeser confirmed that he did *"offer to help improve the whole electricity value chain and have our team to come in and assess what's best for the people. No response yet from Government. Our door is open! Offer still good. Call anytime!"*[52]

The charge by MP Jaber and Siemens CEO triggered a technical response, also on Twitter, from Abi Khalil saying that he looked forward to *"cooperating with Siemens on needs assessment, and accordingly perhaps receiving a formal proposal."*[53] Abi Khalil, in another tweet, wrote: "*I reiterate my invitation to Siemens and all qualified companies to stay tuned to the ministry's announcements regarding the upcoming* [independent power producer] *tender for* [the planned power plants] *Selaata I and Zahrani II."*[54] In that sense, the ministry considers "that without a proper tendering process, an unsolicited offer from Siemens could not be accepted."[55]

The official German position remained diplomatic and limited to confirming that technical meetings were held later on, in October 2018, between representatives of Siemens and the ministry.

Lebanon's European partners in particular stress on the fact that they need to be more forceful in pushing Lebanon forward. Things in the region are getting worse and will impact the Lebanese economy. Yet, they cannot force the Lebanese government to act. This is also the point made by Olivier Ray, who said that *"international companies are more than willing to come but their conditions include the independence of regulatory authorities and a true roadmap to fight corruption."* He gave the solid waste crisis as an example; if it not solved, *"the*

50 Cornish, Chloe, "Lebanon's electricity supply solution is a slow-burner." Financial Times, October 29, 2018: https://www.ft.com/content/cd6cb0d0-d6c9-11e8-a854-33d6f82e62f8.

51 "Siemens CEO confirms electricity offer." An-Nahar English, September 27, 2018: https://en.annahar.com/article/869590-siemens-ceo-confirms-electricity-offer.

52 *Ibid.*

53 *Ibid.*

54 "CEO of German company confirms it made electricity offer." The Daily Star, September 27, 2018: https://www.dailystar.com.lb/News/Lebanon-News/2018/Sep-27/464611-ceo-of-german-company-confirms-it-made-electricity-offer.ashx.

55 Cornish, Chloe, "Lebanon's electricity supply solution is a slow-burner." Financial Times, October 29, 2018, https://www.ft.com/content/cd6cb0d0-d6c9-11e8-a854-33d6f82e62f8.

state itself and the political class risk losing the bits of legitimacy they still have. It is therefore not only a technical question."[56]

Skepticism and disappointment over the slow implementation of the reforms can also be read in the World Bank's April 2019 Lebanon Economic Update. "The Ministerial Statement for the new Government, which motivated a vote of confidence by Parliament, reflects a commitment to significant structural reforms and the will to effect the CEDRE opportunity. While this constitutes a positive signal, our baseline scenario precludes this outlook. Instead, lack of obvious sources for an economic boost suggests medium-term economic prospects remain sluggish."[57]

It is as if the World Bank, in its most likely scenario, considers Lebanese authorities incapable and/or unwilling to conduct the necessary reforms. Such reforms are not only in the fields of fiscal discipline, fighting corruption, and enhancing crippling infrastructure. Lebanon must also work toward producing reliable statistics: "one of the key challenges to empirically informed policy is to strengthen the data and analytical base of the government, especially the Central Administration of Statistics (...). In the absence of such data, distributional analysis of the impact of shocks and reform scenarios is severely constrained, including for extremely urgent reforms as in the electricity sector," adds the World Bank's document, confirming the lack of transparency and shortage of reliable data from government sources.[58]

The reform movement in the first year following CEDRE had been – at best – slow and limited to some fiscal and transparency measures (presented in Table 8 above). *"These reforms, despite having started, do not rise to the expected level and this is what we have said with all frankness to the Lebanese government,"* said World Bank Middle East and North Africa (MENA) Vice President Ferid Belhaj, during his visit to Beirut late March 2019.[59] Belhaj added that *"If Lebanon wants to see any money from CEDRE soon, it needs [to] get serious about implementing reforms… If it fails to do so, the amount will be zero – let me be very clear about that. Zero. This is something that every single decision-maker in Lebanon will know. CEDRE is a contract; they [those who made pledges at CEDRE] have reforms that can be financed. If you don't get reforms, there will be no financing,"* he warned.[60]

56 Ray, AFD, DRM roundtable, April 20, 2018.

57 Lebanon's Economic Update – April 2019, The World Bank: http://pubdocs.worldbank.org/en/757651553672394797/Lebanon-MEU-April-2019-Eng.pdf.

58 *Ibid.*

59 McDowell, Angus and Bassam, Laila, "Lebanon economic reforms 'not at expected level', says World Bank." Reuters, March 29, 2019: https://www.reuters.com/article/lebanon-economy-worldbank/lebanon-economic-reforms-not-at-expected-level-says-world-bank-idUSL8N21G3I6.

60 Kanaan, Farah-Sylvana, "World Bank official: Lebanon gets nothing without reforms." The Daily Star, March 30, 2019: https://www.dailystar.com.lb/Business/Local/2019/Mar-30/480017-world-bank-official-lebanon-gets-nothing-without-reforms.ashx.

Red Alert: All Alarm Bells Ringing

The level of frustration over the delays in implementing reforms has grown to worrying levels among most of Lebanon's international partners. Each in their own style, partners have been sending strong signals to the Lebanese government and financial circles warning of the dangerous consequences of failing to implement the reforms outlined in CEDRE.

France, which has been the most involved in the CEDRE process, has not stopped urging the Lebanese political forces to get their act together and engage in the reform agenda. International pressure, however, cannot achieve any long-term result without local ownership. Olivier Ray makes it clear: *"Development is an endogenous process. Nothing can be pushed from outside. When you have an in-house constituency that pushes in that direction then you can accompany the process."*[61]

Not only are delays in reform preventing funds from reaching Lebanon, they are also weakening the ability of Lebanese institutions to deliver. Today, and in the absence of a clear political will to reform beyond cosmetic cuts to spending levels, state agencies have difficulties elaborating strategies for capital investment, tendering projects, and deploying funds. Ray points out that *"the CDR has difficulty disbursing existing funds on time. Imagine tripling that amount."*[62] The Lebanese government must admit the need to build the capacity of the public administration and also the Parliament to conduct the reforms and implement the CIP. For example, parliamentary administration had to be helped by the French partners to find, in its archives, the Water Code bill that had to be passed expediently ahead of CEDRE.

The IMF also has concerns about Lebanon's ability to implement the reform program in the field of public investment management. At the end of its periodic consultation with Lebanon in June 2018, the IMF board stated: "Directors emphasized the need to strengthen public investment management to ensure successful implementation of the authorities' Capital Investment Program. They welcomed the authorities' request for a public investment management assessment (PIMA) from the Fund and encouraged expeditious efforts to address the weaknesses identified in the PIMA before increasing public investment."[63]

While some actions have been taken on the budget deficit and electricity front, the government has yet to initiate reforms of the governance process. Nothing in the current political climate and state of affairs foretells any progress in this regard. Consequently, Jacques de Lajugie, the French Foreign Ministry official, warns: *"If the reforms are not implemented, the funds will simply be recycled elsewhere;"*[64] meaning that the pledges that were made are not open ended

61 Ray, AFD, DRM roundtable, April 20, 2018.

62 *Ibid.*

63 "IMF Executive Board Concludes Article IV Consultation with Lebanon." Press Release No. 18/250, International Monetary Fund, June 21, 2018: https://www.imf.org/en/News/Articles/2018/06/21/pr18250-imf-executive-board-concludes-article-iv-consultation-with-lebanon.

64 Ouazzani, Kenza, "CEDRE : one year later, where are we?" L'Orient-Le Jour English, April 9, 2019: https://www.lorientlejour.com/article/1165541/cedre-one-year-later-where-are-we-.html.

and could be deployed for other countries. Foreign governments, donor agencies, and multilateral institutions may not wait for Lebanon to launch its reform process. *"Even after the formation of the government, things did not improve. There are serious doubts about the credibility of the commitments made by the government,"* Lajugie added.[65] Surprisingly undiplomatic, French Ambassador to Lebanon Bruno Foucher deplored that Lebanon has *"lost a lot of time and that the debate was not at the level of the challenge, given the bad situation of the country."*[66]

During his June 2019 visit to Lebanon Belhaj, MENA Vice President at the World Bank, stated in diplomatic fashion that: *"Lebanon has taken a sound path with reforms in its 2019 draft budget and power sector but it will have to keep going. In general we are optimistic, but at the same time our optimism is cautious because of the economic situation in the region."*[67] It is difficult, however, to forget his much more alarming statement during his previous visit to Lebanon in March 2019, when he said that the *"Lebanese economy is defying gravity, [like] a man who jumps out of a window and, while he falls down, keeps repeating to himself 'so far, so good'.'"*[68]

Key Requirements

Lebanon should begin implementing long-awaited reform measures to signal commitment to international partners, financial circles, and Lebanese citizens. Alas, the recently ratified 2019 budget does not go far enough in the required direction: the total deficit will not decline by nominal spending reductions, by delaying some expenditures, or by basing forecasts on questionable assumptions, especially considering that more than half the fiscal year has already passed.

According to the IMF, which recently concluded its 2019 Article IV mission, *"Lebanon's projected budget deficit for 2019 will likely be well above the government's target of 7.6 percent of gross domestic product"*. Instead, the IMF predicted the real deficit to be around 9.75 percent.[69] At CEDRE, Lebanon pledged to reduce the deficit-to-GDP by one percentage point of GDP per year over five years. For 2018 the deficit-to-GDP ratio reached 11.04 percent.[70]

65 *Idem.*

66 *Idem.*

67 Francis, Ellen, "World Bank: Lebanon reforms on sound path but must not stop." Reuters, June 28, 2019: https://www.reuters.com/article/us-lebanon-economy-worldbank/world-bank-lebanon-reforms-on-sound-path-but-must-not-stop-idUSKCN1TT1MM.

68 Kanaan, Farah-Sylvana, "World Bank official: Lebanon gets nothing without reforms." The Daily Star, March 30, 2019: https://www.dailystar.com.lb/Business/Local/2019/Mar-30/480017-world-bank-official-lebanon-gets-nothing-without-reforms.ashx.

69 Francis, Ellen and Perry, Tom, "IMF sees Lebanon's 2019 deficit bigger than government target." Reuters, July 3, 2019: https://www.reuters.com/article/lebanon-economy-imf/update-2-imf-sees-lebanons-2019-deficit-bigger-than-government-target-idUSL8N24360P.

70 Fiscal Performance sheets 2016 – 2018, Ministry of Finance: http://www.finance.gov.lb/en-us/Finance/EDS/FP. Author calculations.

French officials have outlined what they believe are reform priorities. First, filling vacancies in the – supposedly independent – sectoral regulatory authorities in telecommunications, energy, and civil aviation. *"It must be done, because without filling these vacancies, these authorities do not function. If these sectors are not regulated there will be no investments in them,"* warned Duquesne in March 2019.[71] France is also calling for empowering the Higher Council for Privatization and Public Private Partnerships (HCP-PPP) and giving it *"the means to regulate public-private partnerships in Lebanon by allowing it to recruit forty additional people and to have an independent budget."*[72] This advice contradicts Lebanon's policy to freeze public sector hiring for a period of three years according to a reform measure proposed in the 2019 budget (see table 7), and the leadership vacancy at the HCP-PPP following the March 2019 resignation of its director general, Ziad Hayek.

Endorsed in April 2019 Lebanon's electricity plan, meant to restructure the sector by improving supply and reducing electricity generation cost, was met with criticism by French officials. *"The cost of production provided by the interim solution will be much higher, considering the techniques used and the amount of additional fuel required. This will lead to a massive increase in the EdL deficit and the government will not be able to achieve savings,"* said Jacques de Lajugie, who "also regretted that the electricity plan does not include the appointment of members to EdL's Board of Directors and the creation of a sectoral regulatory body."[73]

EdL's continued financial losses and additional costs incurred by generator subscribers to cover gaps in state-supplied electricity, not to mention the difficult-to-quantify costs to public health and the environment from high polluting private generators fueled by diesel, mean the Lebanese state will not be able to meet its deficit reduction goals, and would therefore need to further finance the deficit at unattractive interest rates. *"In 2019, it is estimated that the Government will need close to USD 5 billion in foreign currency financing, for which the Ministry of Finance has expressed the desire to tap the Eurobond market. While it is unclear that market appetite for Lebanese Eurobonds is sufficient, BdL stands ready to intervene, or engineer, as in recent years,"* according to the World Bank.[74]

This reference to the Central Bank's financial "engineering" role sheds light on a major concern over sovereign exposure and the sustainability of Lebanon's monetary policy that the IMF, in particular, has been flagging in very explicit terms. *"The BdL should rely on a conventional interest rate policy instead of financial operations and encourage banks to gradually strengthen buffers. The BdL's past financial operations have accomplished important objectives, but they increased risks in the system (sovereign exposure, interest rate and liquidity risks, dollarization). The Central*

71 Ouazzani, Kenza, "CEDRE : one year later, where are we?" L'Orient-Le Jour English, April 9, 2019: https://www.lorientlejour.com/article/1165541/cedre-one-year-later-where-are-we-.html.

72 *Ibid.*

73 *Ibid.*

74 McDowell, Angus and Bassam, Laila, "Lebanon economic reforms 'not at expected level', says World Bank." Reuters, March 29, 2019: https://www.reuters.com/article/lebanon-economy-worldbank/lebanon-economic-reforms-not-at-expected-level-says-world-bank-idUSL8N21G3I6.

Bank should instead raise interest rates if it needs to secure higher foreign exchange inflows," said an IMF staff mission as early as March 14, 2018.[75]

It is a message that the IMF has consistently stated in its Article IV conclusions and other public statements. For example, in June 2018 the IMF *"emphasized that the BdL should take a longterm view in its policymaking and return to more conventional monetary policy tools."*[76] A year later, the IMF stated that *"buying the Lebanese government's proposed low-interest debt would worsen the Central Bank's balance sheet and undermine its credibility."*[77]

The way to avert Lebanon's deficits spiraling out of control would be, according to the IMF, through *"an immediate and substantial fiscal adjustment [that] is essential to improve debt sustainability, which will require (…) a welldefined fiscal strategy, including a combination of revenue and spending measures, amounting to about 5 percentage points of GDP."*[78]

75 Statement by IMF Staff for the April 6 CEDRE Conference, March 14, 2018: http://www.pcm.gov.lb/Admin/DynamicFile.aspx?PHName=Document&PageID=11305&published=1.

76 "IMF Executive Board Concludes Article IV Consultation with Lebanon." Press Release No. 18/250, International Monetary Fund, June 21, 2018: https://www.imf.org/en/News/Articles/2018/06/21/pr18250-imf-executive-board-concludes-article-iv-consultation-with-lebanon.

77 Francis, Ellen and Perry, Tom, "IMF sees Lebanon's 2019 deficit bigger than government target." Reuters, July 3, 2019: https://www.reuters.com/article/lebanon-economy-imf/update-2-imf-sees-lebanons-2019-deficit-bigger-than-government-target-idUSL8N24360P.

78 "IMF Executive Board Concludes Article IV Consultation with Lebanon." Press Release No. 18/250, International Monetary Fund, June 21, 2018: https://www.imf.org/en/News/Articles/2018/06/21/pr18250-imf-executive-board-concludes-article-iv-consultation-with-lebanon.

Conclusion: The Lebanese Economy's Race against Time

Political, fiscal, monetary, and financial data have led to a consistent, negative assessment of Lebanon's economic outlook and credit rating across the leading agencies. On March 1, 2019, S&P Global downgraded Lebanon's credit outlook from stable to negative. "The negative outlook reflects the risk that a lack of material reforms to reduce the budget deficit will see investor confidence wane," the S&P report said. "As a result, non-resident deposit flows may decelerate and foreign exchange reserves could continue to decline, eroding Lebanon's ability to service foreign currency debt."[79]

More recently, on June 26, 2019, Fitch Ratings also expressed strong doubts about the government's ability to meet the objectives it has set in the 2019 budget. "Lebanon's draft 2019 budget targets fiscal consolidation, but we do not expect full implementation, and additional fiscal and structural reforms would be required to stabilize government debt/GDP," Fitch stated in a press release. Fitch further added that: "Proposals to issue T bonds at below-market rates, most likely to the Central Bank, reflect the difficulty of cutting spending and tight liquidity in the financial system (…). [This measure] also indicates a degree of financial stress and raises questions about the government's debt sustainability, especially given the greater reliance on the Central Bank for financing."[80]

The most critical assessment came a day later from Moody's, which warned that "despite the inclusion of fiscal consolidation measures in the draft 2019 budget, slowing capital inflows and weaker deposit growth increase the risk that the government's response will include a debt rescheduling or another liability management exercise that may constitute a default under our

79 El Sawy, Nada, "S&P downgrades Lebanon's credit outlook to negative from stable." The National, March 2, 2019: https://www.thenational.ae/business/economy/s-p-downgrades-lebanon-s-credit-outlook-to-negative-from-stable-1.832106.

80 "Lebanon Targets Deficit Reduction; Financing Pressures Continue." Fitch Ratings, June 26, 2019: https://www.fitchratings.com/site/pr/10080502.

definition."[81] Moody's report prompted a rebuff by Minister of Finance Ali Hassan Khalil, who only said that "*matters are under control.*"[82]

While Lebanon's international partners seem aware of the risks and the aftermath of a financial collapse, there has been no public discussion yet of what to do in case of a major crash or government default. When asked 'What if Lebanon fails?' the French officials reiterate their belief that a financial crisis would begin a domino effect leading to a security crisis that could be exacerbated by the refugee burden. Yet, there are no plans made for a Lebanese financial collapse. Ways need to be found to avoid it through more pressure for fiscal discipline and good governance. If Lebanon's international partners start devising plans right now, they would be precipitating the problem, by launching a self-fulfilling prophecy that would send the markets into panic mode.

Despite local economists, both critical[83] and supportive[84] of the government, minimizing the risk of a default, the authorities' response has not given any strong signal that they have realized the urgency to address the most pressing weaknesses. One can attribute this inability to enact fundamental reforms to the cumbersome institutional process to adopt legislation in Lebanon and to the fact that many parties can *de facto* use some form of veto power until they receive "something in exchange" of their vote on a specific policy. The Lebanese Center for Policy Studies (LCPS) conducted a thorough evaluation of the progress in implementing the Paris III reforms in a policy brief aimed at learning from previous experiences to ensure the success of the CEDRE process.[85] The policy brief concluded that "the higher the institutional requirements of a reform measure were, the less likely the government [is] to implement it." The brief recommended therefore to focus on reform measures that can be decided through ministerial decisions and government decrees rather than laws that have to pass through the slow parliamentary process. Most of the CEDRE reforms can only be enacted after a particularly high level of institutional requirements.

The main missing ingredient, however, is not technical. It is the lack of political will to halt the drain on public resources that ruling parties have lived off for years as their access card to maintaining power through clientelism. This is why LCPS highlighted the need to "prioritize reform in public administration rather than solely fiscal adjustment and privatization."[86]

81 Perry, Tom, "Moody's sees risk of Lebanon debt rescheduling despite budget." Reuters, June 27, 2019 : https://www.reuters.com/article/lebanon-economy-budget-moodys/update-2-moodys-sees-risk-of-lebanon-debt-rescheduling-despite-budget-idUSL8N23Y24H.

82 *Ibid.*

83 Traboulsi, Karim, "Lebanon's economy is not collapsing... but it is a 'zombie'." The New Arab, January 15, 2019: https://www.alaraby.co.uk/english/indepth/2019/1/20/lebanons-economy-is-not-collapsing-but-it-is-a-zombie.

84 Habib, Osama, "Economists shrug off Moody's warning." The Daily Star, June 28, 2019: http://www.dailystar.com.lb/Business/Local/2019/Jun-28/486283-economists-shrug-off-moodys-warning.ashx.

85 Atallah, Sami, Mahmalat, Mounir and Zoughaib, Sami, *CEDRE Reform Program: Learning from Paris III*, The Lebanese Center for Policy Studies, November 27, 2018: https://www.lcps-lebanon.org/publications/1543408456-policy_brief_35_eng_(final).pdf.

86 *Ibid.*

In its "For a Fruitful CEDRE"[87] report, the Democratic Renewal Movement underlined the "priority of restoring trust" through a series of key recommendations, including, among others:

- Building the capacity of the public sector to fulfill the role assigned to government institutions, by restructuring ministries and public administrations, raising the efficiency of civil servants, and strengthening their loyalty to the state, all while stopping employment on the basis of political loyalty.
- Ensuring that ministers and other officials (…) refrain from violating the laws pertaining to their administrations, especially those relating to the role and independence of regulatory bodies in the telecom, energy, and civil aviation sectors.
- Expanding the powers of supervisory bodies, enhancing their independence and immunity, and allowing swift actions by public prosecutors to strengthen their role in holding officials to account.
- Establishing the recently legislated National Anti-Corruption Commission on the basis of transparency, competence, and independence, and giving it full powers and resources to carry out its role.
- Raising the capacity of the Parliament's administrative staff and information systems so that MPs can carry out their supervisory and legislative roles effectively and transparently.
- Strengthening the organization and financing of the HCP-PPP (including by appointing a new director), so that it carries out its role within the framework of the PPP law and acquires the necessary negotiation, financial, administrative, and contractual expertise.
- Bringing economic activity back to the legal fold, after the "black/gray economy" has come to represent no less than 20 percent of the GDP. This includes smuggling, customs and tax evasion, trade and intellectual property infringement.

In the absence of the political will to reform, Lebanon can expect only short-term measures that are the lowest fruit hanging from trees lining the path of least resistance: a series of new taxes and spending reduction measures that will hurt the lower and middle classes; and more financial engineering by the Central Bank. These actions will reduce consumer spending, stall economic growth and further erode confidence.

This is despite the severe and repeated warnings by international partners and donors, multilateral institutions and the international credit rating agencies. International partners will keep encouraging Lebanese authorities to change course and implement the agreed upon reform agenda but will retain the liberty to redirect the pledged funds to projects elsewhere. The top-down approach, with international partners attempting to incentivize Lebanon to take the common-sense steps needed to reform and avert disaster – financial, economic, social, security, or otherwise – will not work without local buy-in.

Will Lebanon act before it is too late?

92 Democratic Renewal Movement, *For a Fruitful CEDRE*, April 2019:
https://www.tajaddod.org/pdf/drm_cedre_roundtable_report.pdf.

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