

Reform and Recovery in Lebanon

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Table of Contents

Reform and Recovery in Lebanon	1
Executive summary	3
Foreword	7
Economic situation.....	8
Methodology	8
Major Challenges	9
➔ One must first agree on the reality of the crisis. A useful approach would be to compare the analysis with countries that faced a similar situation in order to understand the scope and foresee the future.....	9
1- Productivity Regress	10
2- Weakening Global Demand	10
3- Large Deficit of Foreign Trade.....	11
4- Expansion of Social Inequality	12
5- Increase of Public Debt.....	12
6- Corruption.....	13
The Vicious Circle	13
State Reform Policy	15
➔ The state undertakes and/or plans a series of actions as part of the reform. What are their chances of success?	15
Brief Evaluation of the Measures	15
THE SIX PILLARS OF THE REFORM.....	17
➔ When the crisis is systemic it is useless to fill in the gaps, you must develop a virtuous circle that sets up the pillars of an effective integral system.	17
Initiatives	18
I – Restore Productivity thru Mergers/Acquisition;	18

Mergers / Acquisitions	19
IMPLEMENTATION / TIME FRAME	20
I – Restore Productivity thru Mergers/Acquisition;	20
I – Restore Productivity thru Mergers/Acquisition;	22
New Deal to the production sector.....	23
I – Restore Productivity thru Mergers/Acquisition;	24
I – Restore Productivity thru Mergers/Acquisition;	25
I – Restore Productivity thru Mergers/Acquisition;	27
Synergy of the initiatives.....	28
DIRECT IMPACT OF INITIATIVES	29
➔ Patterns that describe the direct impact of selected initiatives on one another form a small part of the overall synergy that ensures change, yet they demonstrate the coherence of the system.....	29
1 – Decrease of Trade Deficit.....	30
2 – Decrease of Unemployment	31
4 – Foreign Direct Investment	32
5 – Public-Private Partnership.....	33
6 – Job Creation – Extension of the Work Force	34
7 – Reducing Inequalities.....	35
8 – Increasing Demand of local product.....	36
9 – Stabilization/Amortization of the Public Debt.....	37
10 – The Budget Balance	39
11 – Promoting Democracy and Civic Values	40
12 – The path to Inclusive Development.....	40
Reform plan	41

Reform and Economic Recovery in Lebanon

Executive summary

24/10/2019

The revolt that erupted on Thursday (October 18th) exposed the precariousness of a large majority of the population. Like all crises, the result is a significant decline in the standard of living of citizens. However the causes can be diverse and it is imperative to identify them in order to provide a solution to the crisis.

The beginnings of the crisis date back to the 1990s since the Lebanese Government systematized the use of auctioned treasury bills acquired mainly by local banks. The high real interest rate granted by the state marked the departure of the crowding out. This policy has continued to date with a public debt of \$86 billion, a stunted GDP of around \$53 billion and youth unemployment exceeding 40% and forcing them to emigrate.

Since the 2000s, the BDL has tried to limit the perverse effect of high rates by providing subsidized loans to certain production sectors and habitat. \$1.6 billion was allocated to the production and 100,000 young people gained access to the property. These loans have helped to delay the crisis without staving it off.

The normalization of the real interest rate is the basis of investment and employment. No recovery of the economy is possible before this normalization; while it is impossible given the country's huge foreign exchange requirements.

Questioning the Reform

The reform to date addresses a set of measures that can be grouped into (i) budget savings (ii) development programs (iii) privatization resources.

- Budget savings, without parallel compensation, will exacerbate the recession. This compensation can take place from public and / or private investments, or the financing of production and sustainable consumption provided that it is at least equivalent to the savings achieved;
- The CEDRE projects, the McKinsey plan, the oil and gas exploitation, are development programs; they cannot ensure a recovery of the

economy, they themselves need funds to get started; their beneficial effect would only be felt in the medium and long term;

- Privatization resources can at best reduce public debt; much more is needed to revive the economy. Lebanon has not run out of capital until recently; it did not prevent the depression we had.

The peculiarity of the reform envisaged to date is that it ignores private sector companies. Above all, it cannot promise the normalization of interest rates, and therefore the recovery of the economy.

Economic Recovery

The recovery of the economy can only surge from the prosperity of companies; and improving the State budget can only be the result of business prosperity, not the other way around. In the current situation, which is already experiencing a systemic breakdown of the economic circuit, the only way to recover is to join a "virtuous circle" which would have the effect of restoring real growth in the short term and which from now on generates favorable expectations.

1. **Improvement of Productivity**

Productivity has been severely affected by the demand crisis and the accelerated closure of businesses. The decline in production, as measured by the decline in exports, is about 35%. The most effective way for recovery is to promote mergers/acquisitions, generating new technology, better cost allocation, and immediate expansion of markets. The first thing to do is repeal the legislation that handicaps these operations.

2. **Support Aggregate Demand**

Consumption declined by 45% measured in retail sales between the beginning of 2012 and the end of 2018. In addition, demand has fallen sharply recently due to threats of unemployment that have opened wide the "liquidity trap".

3. **Addressing the imbalance of Foreign Trade**

The year-over-year deficit in the Trade Balance resulted in an equivalent loss of jobs and a permanent loss of currency. The deficit in 2018 amounted to \$ 17 billion.

This situation is the result of an unconscious policy of foreign trade and the signing of Leonine agreements from the year 2000. The State

acted then against its own interest and it has the obligation today to repair the prejudice.

4. **Reduce Income disparity**

The income disparity is in the realm of tax policy. The improvement of low wages is not only a social obligation but also has a great economic advantage. High income earners spend only a portion of their income, and a large part of it on foreign products and / or abroad; while the income of the majority of the population is entirely spent in the country and ensure a perfect rotation of the economic circuit.

In addition to these 4 economic provisions, two other exogenous provisions are indispensable to let rise the virtuous circle:

5. **The independent management of the Public Debt**

The rise of the Debt is at the roots of the crowding out that has undermined the economy of production, promoted the economy of rent, and precipitated the country in an unprecedented crisis.

6. **Independence of Judicial authority**

Studies are ready in legal circles for the independence of justice. It is important to know that this is also a condition sine qua non for any foreign investment.

Interaction of measures

The distinctive sign of this plan is in the positive interaction of its measures. Normalization of the interest rate is impossible by conventional means, but it is possible within the framework of the **virtuous circle**, which thus appears to be the path of economic recovery.

- a. The virtuous circle, once disseminated and understood, will surely give rise to **favorable expectations**. The positive perception of the economic agents is the starting point of the plan, its immediate effect is to revive the investment in the production sector;
- b. **Investment** in the productive sectors, and mainly **Foreign Direct Investment**, are source of technology, productivity and real growth;
- c. **Real growth** indicates the state of development and determine the stage of emergence of the country. It consolidates the favorable expectations and is an indicator of the improvement in jobs' provision;
- d. As the **Unemployment** rate moves towards frictional unemployment, the unusually low Labor Force in Lebanon (45%) would gain ground and improve the standard of living of the population by the same amount;

- e. The increasingly intense demand for work would restore, for the first time in many years, the economic basis of the **wages grid** with the positive effect that one can imagine on income disparity, keeping the elite in the country, improving productivity and reducing poverty;
- f. The change would be felt in terms of productivity and would have a direct effect on the trade balance. Productivity is also the principal source of profitability for the company;
- g. The constant improvement of production's factors has a favorable effect on **businesses' profitability**, on which rely the revenues of the State, the balanced budget and the stabilization of the debt. Sectorial profitability is also the main attraction of FDI.

This example of the interaction of economic measures, which characterizes the virtuous circle, shows that it goes well beyond the direct measures adopted by favoring the positive impact of the fundamental elements that make up the economic circuit.

Foreword

All crises end up looking the same. They affect the standard of living of the citizen. Often they follow a period of great prosperity (the United States on the eve of 1929 - Lebanon in 1974), sometimes a large debt (Mexico 1971), a crisis of overproduction (southeast Asian 1996). Between WW2 and the Asian crisis there was practically no crisis that deserves to be mentioned. They were assimilated by the cycle. Krugman called his book at the time "The Return of Depression Economics " as if it were something, since Keynes, definitively disappeared by the virtue of money. In the early 1970s Friedman predicted the rise of inflation together with unemployment, which Samuelson named "Stagflation", a preview of the limits of monetary policy.

It is not enough for a great resource to revive prosperity; it must become part of the economic circuit; otherwise it can induce destabilization as it may cause a crisis itself (case of Dutch evil). At the same time, a huge squandering project can be a stimulus factor (WW2 has put an end to the global crisis). It seems that the foundation of wealth is not in wealth itself, but in the ability to generate and destroy that wealth (purchasing power and consumption) (Cf. the famous Keynes's trenches).

Most countries before falling into depression had the support of the World Bank, benefited of significant loans to ensure the recovery of their economies, received advice from international organizations and practiced the remedies requested by creditor countries and/or donors. If the economic circuit does not recover, the depression will be at the end of the road; it's a matter of time.

How to restaure the economic circuit? In the opposite way that generates the crisis; it is about creating a "virtuous circle" where the various factors tend towards an increasingly confirmed balance: production (supply), consumption (demand), savings, investment, employment, financing, foreign exchange, public service, etc. ...

The question is whether the Government's agenda (Anti-Corruption, CEDRE, McKinsey Plan, Hydrocarbon Resource, Contribution to Regional Reconstruction) can create a virtuous circle to re-establish the economic circuit?

Otherwise what to do to restore this circuit?

Economic situation

The popular revolt that erupted on Friday, October 18, exposed the dire situation that the citizen arrived at. The middle class is gone. The majority of citizens are no longer able to give their children a decent education, have little access to health, and hunger affects large sections of the peripheral population. At the same time the echo of corruption, true or amplified, makes the situation unbearable to the public who suffers.

Reform and economic recovery are the wish of all Lebanese. While the recovery is clear to public opinion, this is certainly not the case with the reform. Yet literature abounds on the subject over the past two years, at the initiative of Parliament, political parties and certain committed intellectual circles. Unfortunately, public opinion has learned only two things: fighting corruption and closing the budget deficit. Yet the most serious is the economic crisis, the sharp deceleration of activity, the collapsing businesses and unemployment that is rising inexorably.

It is necessary to know the real factors that triggered and sustained the crisis in order to find a solution. With the same causes having the same effects, we may never find a lasting solution if we do not identify the real causes of the crisis.

Methodology

Reform diverges from development by an imperative requirement of "costs and deadlines" to be met. Failing which, the deterioration of the situation is likely to be faster and efforts invested without result, as the nation continues its descent into an endless chasm.

A reform agenda must identify a limited and affordable number of initiatives with a major impact on the country's social, economic and political life, re-align the situation in the present, and strengthen the ground for longer inclusive development. Thus the transition from reform to development preludes state access to the status of the first world.

The presence of Syrians from 2011 has a cost, however this does not justify the deceleration of activity; on the contrary it has undoubtedly helped to sustain global demand as little as their means of consumption can be.

The beginnings of the crisis date back to the mid-1990s since emigration resumed, indicating the lack of work in Lebanon. Despite the reconstruction at the time, Lebanon did not offer enough job opportunities.

In 1998 Paris-I promised Lebanon \$900 million on the condition that certain reforms be made. While waiting for the funds, the Government issued Treasury Bonds, which were several times oversubscribed by the Lebanese banks. Faced with this easy funding, the Government dispensed with the reforms and dispensed with the Paris-I funds.

The high interest rate granted by the State allowed banks to apply an average spread of 5% between deposit rates and lending rates applied to businesses, thus starting the crowding out that was to slow economic activity. This policy has continued to date, raising public debt to \$ 86 billion, and depressing GDP at about \$ 53 billion, while youth unemployment rose over 40%, forcing them to emigrate.

The BDL has tried since 2000 to subdue the perverse effect of high rates by providing subsidized loans to privileged production industries and selected habitat. \$1.6 billion was allocated to the production and 100,000 young people gained access to the property. These loans have helped to delay the crisis without staving it off.

The normalization of the real interest rate (nominal rate minus inflation) is the basis of investment and employment. No recovery of the economy is possible before this normalization. However, the normalization of rates is today impossible by conventional means due to the heavy need of foreign currency.

Major Challenges

➔ *One must first agree on the reality of the crisis. A useful approach would be to compare the analysis with countries that faced a similar situation in order to understand the scope and foresee the future.*

- 1- Productivity Regress
- 2- Weakening Global Demand
- 3- Large Foreign Trade Deficit
- 4- Expansion of Social Inequality
- 5- Increase of the Public Debt
- 6- Corruption

1- Productivity Regress

The deterioration in productivity in recent years is mainly due to the rapid weakening of demand and its direct consequences, the build-up of stocks or the rising cost of underutilized services, the time to find a new adaptation to the market. The continued fall in demand has created a new and increasingly unfavorable input/output ratio for companies, leading many to a halt.

The decline in productivity began with the disaffection of tourism in 2011 and spread to all sectors. Businesses that have since closed have allowed others to resist for some time, but the bounce back was for short time and the lack of recovery has not stopped the movement.

Productivity is the fundamental element of the economic circuit because of its direct action, through foreign trade, on employment and the flow of foreign exchange in the country.

Table 1 - Gross Domestic Product

	2014	2015	2016	2017	2018*	2019*
Growth	1.90%	0.40%	1.60%	0.60%	0.60%	0.25%
Constant US\$	48.3	49.97	51.24	53.39	53.71	54.51
Constant US\$	47.38	51.84	51.66	51.00	50.45	50.91
Deflator	1.90%	-3.75%	-0.82%	4.48%	6.07%	6.60%

- estimation

2- Weakening Global Demand

The retail consumption index established by the Beirut Traders Association in collaboration with FRANSABANK stands at 54.25 at the end of 2018; 100 at the end of 2011. The Lebanese Franchise Association and CCIA-BML index intersects these figures over the same period.

The level reached by interest rates (the Beirut Reference Rate rose in June 2019 to 9.72% on the dollar and 13.38% on the Lebanese pound) exacerbated the situation. It is clear that this rate is likely to block any investment and significantly reduce the demand for credit.

The slope of unemployment is likely to frighten consumers and push them to defer non-essential purchases for fear of losing their income (Liquidity Preference Theory)

IMPACT OF INTEREST RATE ON GLOBAL DEMAND

- If $r < r(n) \rightarrow D(+) \rightarrow PX(+) \rightarrow \text{Inflation}$

- If $r > r(n) \rightarrow D(-) \rightarrow PX(-) \rightarrow \text{Deflation}$

J.G.K. Wicksell,

i. e. USD 10Y T Note: 1.50% 28/8/2019

"r" Real Interest Rate

"r(n)" Natural Interest Rate (Myrdal)

"D(+/-)" Global Demand

"PX(+/-)" General Price Level

Table 2 - Global Demand

- Retail 44.24 1st quarter 2019 - base 100 4th quarter 2011 (ACB-Fransabank)
sliding 1st quarter [in yearly basis] 7.21% overall ; excluding hydrocarbon 9.15%

	BEIRUT REFERENCE RATE					
	Jul.2014	Jul.2015	Jul.2016	Jul.2017	Jul.2018	Jul.2019
Interest on LL	8.61%	8.70%	8.70%	8.66%	10.70%	13.49%
Interest on USD	5.99%	6.11%	6.34%	6.79%	7.50%	9.81%

3- Large Deficit of Foreign Trade

In 2018 imports amounted to \$19.98 billion, while exports amounted only to \$2.95 billion with a deficit of \$17.03 - The current account, which records the movement of services and the transfer of income, was only able to reduce this deficit to \$12 billion, significantly limiting employment opportunities in the country.

Table 3 - Foreign Trade deficit

	2015	2016	2017	2018
Balance of Payment	-3.35	1.24	-0.16	4.82
Current Account	-8.12	-9.86	-12.4	-12.3
Balance of Trade	-15.12	-15.73	-16.74	-17.03
Import	18.07	18.71	19.58	19.98
Export	2.95	2.98	2.84	2.95

Since the early 2000s Lebanon has been convinced of the benefits of economic openness, it has eliminated tariffs, with rare exceptions, believing that it could upgrade its industry and agriculture to balance its foreign trade without need of protection. The political leaders of the moment, instead of recognizing their mistake, declared that Lebanon is an "import" country, and trade cannot be different. We owe them this catastrophic result.

The GATT and subsequently the WTO have long ignored the main objective of foreign trade, balance, focused on open borders to promote competition and factor optimization. Unfortunately, an economy can only benefit from this

after it has ensured a certain balance in favour of its development. The foreign trade deficit generates unemployment; similarly the surplus is a generator of inflation.

4- Expansion of Social Inequality

Two aspects dominate today's society: the disappearance of the middle class that once made Lebanon's fortune, and a large proportion of Lebanese living below the poverty line or 37% of the Lebanese population whose individual income is below \$4 a day. The proportion of residents living in these conditions is much higher.

On a human level this is unacceptable. Lebanon still has an estimated per capita income of \$19,000 in Purchase Power Parity. Economically, this is harmful because the more concentrated incomes are, the less the overall expenditure in the country is significant. The employee spends all of his salary, while the beneficiaries of high incomes spend only a small part of their income and most often outside the country.

Tax policy, with the dominance of VAT, is not intended to reduce inequalities if it has not contributed to exacerbate them itself.

5- Increase of Public Debt

With \$85 billion the public debt reached 153% of GDP. Debt servicing depends on the rates that will be applied in future issues. Already the debt service amounted in 2018 to \$5.4 billion or 10% of GDP (30% of budgetary expenditure or 46% of revenue) As long as the budget is in deficit, the public debt can only increase; and in the absence of growth, its ratio to GDP and its weight on the state budget will also rise. Fitch and Moody's CCC ratings have stigmatized this situation.

The most serious is that the size of the debt has generated record interest rates that have caused the crowding out of production companies and the risk of collapse of the national economy; especially since most of the debt is in foreign currency and held by the central bank and Lebanese banks.

Table 4 - Budget

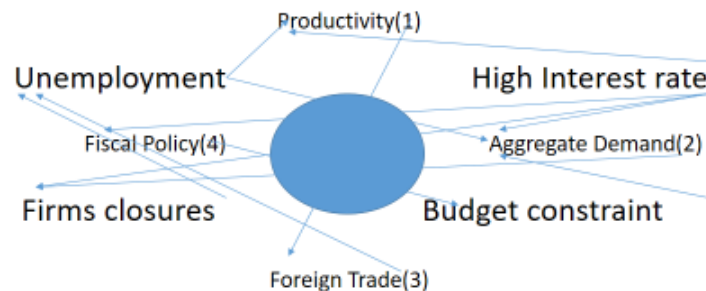
	2014	2015	2016	2017	2018
Budget Deficit	-3.07	-3.95	-4.94	-3.75	-6.24
Budget Income	10.88	9.58	9.92	11.62	11.54
Budget Spending	13.95	13.53	14.86	15.37	17.79
Public Debt	66.57	70.31	74.86	79.5	85.1
Debt's Service	4.19	4.46	4.76	4.99	5.41
Primary Result	1.31	0.72	0.72	1.42	-0.64

6- Corruption

In principle, corruption is economically neutral: Purchasing power unduly passes from one agent to another but remains available on the market. However, the effects on public management are catastrophic. The companies that use this process are far from the best, and the costs driven are far from the most economical. Corruption is the source of "anti-management»

However, it is not by law or bureaucracy that corruption can be stopped, but by an independent and effective justice system. This is the case all over the world. The least corrupt countries still enjoy a judiciary independent of the political authorities and are able to perform their duty in full confidence.

Diagram 5 - The vicious circle



The Vicious Circle

These challenges feed on each other to form a dynamic that counters any solution or "good practice" that is supposed to right a situation or close a gap. Therefore:

The decline in productivity and demand are likened to a fatality, yet the Beirut Traders Association and the Lebanese Franchise Association follow them closely. These are the only statistics followed by the private sector in the rules of the art.

Economists are divided on fiscal policy. In the same television programme an economist recalls that in times of crisis it is very dangerous to raise taxes because this would greatly increase deflation; and in the second window an economist from the mainstream advocates raising VAT to 15%, it is true, on luxury goods. The least that can be said is that the former avoids depressing demand but without proposing anything to improve it (He could have suggested a more expense-friendly tax restructuring); while the latter designs an economic model based on the performance of the public sector; in short, a monetarist model that only works in a full-employment economy.

The Minister of Industry has difficulty getting the country to admit the most timid protection. The bankers, who would be his objective allies, are paradoxically on the side of his opponents. Miracle if the Minister of the Economy could impose a 3% tax on a list of products that fades a little more every now and then.

Finally, the fight against corruption would be wishful thinking as long as the magistrates were appointed by the political leaders and the latter depend of their great electors, the kings of corruption. Unfortunately, we have witnessed many times the marginalization of magistrates who had the esteem of their colleagues and the admiration of the nation. There would be no justice as long as the magistrates depended on the parties, and those who refused an injustice or an undue favor were very quickly dismissed in a sideline.

The Vicious Circle Condensed

High Interest Rates *f.* Decrease in reserves, increased country risk, restrictive monetary policy, political and / or security deterioration.

Progressive Decline in Global Demand *f.* Unemployment, trap of liquidity, significant decrease in revenues

Acceleration of Business closure *f.* *Crowding out effect*, contraction of the market, lack of feasibility, lack of liquidity, unfavorable expectations.

Unemployment Rise *f.* Business interruption, competition from foreign labor, over-sized public sector and urgent need to offload staff.

Inflationary Tension *f.* Financing of the twin deficit in front of a lack of production.

State Reform Policy

→ *The state undertakes and/or plans a series of actions as part of the reform. What are their chances of success?*

- Fight against corruption
- Budget Savings
- CEDRE Projects
- McKinsey Program
- Oil and Gas Exploitation
- Stability of the Lebanese currency

(Left behind : Production Companies)

Brief Evaluation of the Measures

Fight against Corruption

The fight against corruption is a definite moral imperative. However, the objective must be clearly distinguished from the harm that corruption has caused the country. On the economic front we have seen that corruption is neutral; purchasing power is transferred from one agent to another without affecting aggregate demand. It is from a management point of view that the problem lies. Corruption does not favor the best offer but the one in which the decision-maker has an interest, to the detriment of the state. As such, the nomination and/or partisan distribution of civil servants positions has the same effect as corruption because it does not allow the selection of civil servants according to the strict rules of competence and merit..

Réducing Budget Deficit

Unfortunately, the state is divided on whether to increase taxes. This has the double disadvantage of further compressing demand and ransoming the economically weak. Especially since an increase in taxes is unlikely today to result in an increase in revenue. (Laffer curve). Budget savings would be better perceived provided they were offset by other expenditures, including concurrent private or public investment for fear of exacerbating prevailing deflation.

CEDRE Projects

This is not a question of dealing with the value of CEDRE projects or their profitability, but simply their effect of "reviving" the economy. Keynes said: in times of recession the state has the advantage of digging trenches and

filling them the next day to give work and purchasing power to the unemployed.

Unfortunately, owing to the Administration, the study of each project takes an average of 14 months and the allocation 9 months, and this from the launching decision. Moreover, a political party declared its intention to control every stage of the life of the project in the Government and Parliament (and the projects involve much more operations than study and attribution).

It is better to forget its mobilizing effect of the economy; CEDRE would be much more of an instrument of development.

McKinsey Program

Nor is it about being for or against. The program in question is essentially an "inclusive development" program that seeks to reduce the rental economy and promote the production economy, spreading the benefits as much as possible to all regions and to all population groups

The trouble is that the McKinsey Program itself needs prosperous economic conditions to get started. It can't create them. Lebanon will certainly benefit greatly from McKinsey program, if it can carry it out; and for that we need economic means.

Gas and Oil

In the opinion of experts, it is not yet possible to confirm that the Lebanese subsoil contains hydrocarbons before digging the first well and perhaps the second and third. This has not yet been done. Suppose we do it tomorrow, we will simply have an assurance of the existence of the hydrocarbon mass; we will not yet have a negotiable idea of the quantity and difficulty of extraction. That is, the state still needs time to negotiate contracts with full knowledge of the exploitation's value.

Unless the tenderer agrees to take all the risks; which cannot happen unless the state agrees to sell this resource at scarified prices, which is by no means desirable Again, it is a matter of waiting to know the value of this resource and make the most of it. How long? The question must be asked of the regulator before venturing out on time. In any case, it is several years.

Stability of the Lebanese currency

The stability of the pound is not a topic of discussion. It's a paradigm that's been in place for about a quarter of a century.

Currency parity is in principle affected by the change in the average productivity of the country compared to its trading partners (Mundell-Fleming model) "when productivity between two trading partners diverges, wages

might increase more slowly in the weakest country, failing which its currency will fall and affect the general standard of living" In this regard, Paul Krugman notes "what matters is the internal rate of productivity growth; international competition is important, but the country's productivity is in no way dependent on it". However, money is not immune to speculation. Yet a credible currency will never be attacked; while a "not credible" one will always come under fire.

The strength of the currency depends on the flow of foreign exchange to the country. Each of the following sources consolidates the parity of money, but presents a higher financial risk if the employment is not in accordance with its nature:

- A. Income from exports, tourism and other services is the main source of foreign exchange;
- B. The **Transfer of workers**, as well as the income of Lebanese Investments abroad. The destination of these incomes is in principle the consumption of households that have remained in the country;
- C. **Foreign Direct Investment**. Funds generated by this type of investment must in principle be invested in products that retain the value of the assets sold;
- D. **Foreign deposits**. Placement in the form of credits must take into account the length of placement;
- E. **Financial engineering**. In principle, it must bridge an exceptional situation in the short time.

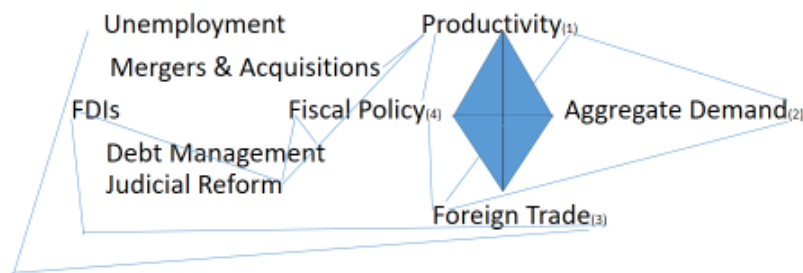
THE SIX PILLARS OF THE REFORM

→ *When the crisis is systemic it is useless to fill in the gaps, you must develop a virtuous circle that sets up the pillars of an effective integral system.*

- I – Restore productivity through Mergers & Acquisitions;
- II – Support Global Demand;
- III – Reduce Foreign Trade deficit;

- IV – Fiscal Policy limiting inequalities;
- V – Independent management of the Public Debt;
- VI –Independence and Integrity of Justice;

Diagram 6 Synergy



Initiatives

I – Restore Productivity thru Mergers/Acquisition;

- II – Support Global Demand;
- III – Reduce Foreign Trade Deficit;
- IV – Fiscal Policy limiting inequalities;
- V – Independent management of the Public Debt;
- VI – Independence and Integrity of Justice;


Primo vivere. CEDRE conference understood that the reform had to be done by companies in the logic of the market. Only a frankly favorable climate for productivity could improve the overall situation of businesses in Lebanon and henceforth the country's economy. It must be noted that all the isolated efforts that have been made over the past 20 years to support certain sectors and/or upgrade them have not been enough to consolidate the economy. Of course, there have been some successes on an individual level, but no positive effect at the national level. Today we need to revive the economy from Lebanese unemployment above 25%, a trade deficit of 35% of GDP and a public debt of more than 90 billion dollars, with all the indicators in the red. This does not bode well for the future. The company can be counted on to improve its own lot if given the opportunity. Here the opportunity is called "productivity" and should in principle enable it to better compete internationally.

Industrial enterprises, farms, are increasingly demanding protection. This has become indispensable, but it does not solve everything, given two factors:

- The first is that the protection is likely to be disappointing. Producers will be able to increase their market share slightly; they will not be able to take a significant share of the import. The "New Theory of International Trade" for which Paul Krugman was awarded the Nobel Prize in 1979 notes that in the advanced markets we know the theory of competitive advantages is defeated by the oligopolistic tendency of transnational companies, not to mention the modern behaviour of the consumer who favors variety over price. Purchasing power is sufficiently concentrated in Lebanon to largely favor the preference of "choice" over "price" partially defeating protection.
- The second is that it is imperative to produce for foreign markets. It is almost impossible to sell all production on the local market under acceptable conditions. The limit comes as much from the demand requirement for "choice" as from "economies of scale" on the supply side.

If local producers can be given the opportunity to move closer to their "optimum productivity level" and thus improve their markets both within and in export, protection can be advantageously supplemented in the medium term, as foreign markets would become more welcoming to Lebanese products.

Pattern 7 - Restore business productivity through facilitating enterprises' mergers and acquisitions;

- Reforms engaged in coordination with the Private sector
- Productivity
 - Mergers / Acquisitions

Economies of scale, Seasoned management, Enhanced marketing, favorable framework for R/D and Innovation
- Action Plan
 - Transfer social security obligations to the Merging entity
 - Exempt the merger from the Tax on asset valuation

Mergers / Acquisitions

The Merger/Acquisition offers the fastest way to ensure a significant improvement in productivity, while at the same time it values and ensures the sustainability of the intangible capital of companies. It is from the

mergers/acquisitions supported by the BDL, during the previous two decades, that the banking system has become the privileged sector of the Lebanese economy. While criticism can be made of their dominant position, which is condemned by anti-trust laws, this does not apply to SMEs that provide the bulk of production in the country.

Two measures stand in the way of corporate mergers/acquisitions:

- The requirement of a CNSS quitus in a merger;
- The capital gains tax payable for the revaluation of assets.

There would be no harm in overriding these two requirements, especially since the business does not evaporate in the merger and/or acquisition by a third party that assumes the assets and liabilities of the merged or purchased business. On the contrary, improved solvency is an additional guarantee to administrations that in the majority of cases lost their debts.

A BDL plan to support the mergers and acquisitions would be infinitely less costly and more effective than the assisted interest rates it has granted over 20 years to support various sectors; and more rational market selection would be made, once conditions are met.

IMPLEMENTATION / TIME FRAME

It is conceivable that the initiative will be taken by a decision of the Economic and Social Council and/or by a consensus of the Economic Organisations:

- An agreement would be reached with the General Confederation of Workers on the CNSS quitus;
- This agreement would be endorsed by the CNSS, the Ministry of Labor, and submitted to the Government;
- If the Ministry of Finance agrees to the repeal of the capital gains tax or its transfer to the new entity, the project could be submitted to the Government without delay.

In either case two months would be sufficient once the decision is taken in principle for the vote of the law.

1a Transfer of the quitus of NSSF to the merging company
1b Exemption of the capital gain's tax in case of merger

I – Restore Productivity thru Mergers/Acquisition;

II – Support Goba Demand;

- III – Reduce Foreign Trade Deficit;
- IV – Fiscal Policy limiting inequalities;
- V – Independent management of the Public Debt;
- VI – Independence and Integrity of Justice;

A year ago, Demand could have restarted thanks to the favorable expectations of the conducive environment to improving productivity and the climate of reform in general. Today we must take into account the stagflation that depresses the market and the need for more direct action.

We are going through a period where all credits are frozen and prohibitive interest is applied in the rare cases where financing is possible. Beirut benchmark indicates 13.5% for the Lebanese pound and 9.5% for the Us dollar.

These conditions are sufficient to accelerate the vicious cycle that runs towards depression. It is compulsory to bring out a gradual relaxation on commercial loans and sustainable consumption. Of course, the stability of the pound remains a priority, but an alternative plan must be considered. It seems that John Williamson's "BBC¹", method for currency management, is the most suitable for the current economic climate.

To the extent that the budget deficit requires a restrictive fiscal policy, monetary easing appears vital.

Pattern 8 - Support Global Demand

- Productivity gains must alleviate trade deficit
- However, there is no time to wait for productivity outcome. We should support the failing companies and limit the outflow of foreign currency
- Production companies need to recover revenue and profitability to achieve economies of scale
- Action Plan
 - Finance production at realistic interest rates (1)
 - Consider an emergency plan to ensure the stability of the currency, for example the BBC (2)

IMPLEMENTATION / TIME FRAME

The support of demand through monetary policy is the central bank's responsibility. However, it would be a few months before the credit easing

¹ BBC Basket of Money, Broad Band, Crawling

was enough to revive the economy. But in any case the slide towards depression should stop as soon as the first weeks of normalization.

Krugman in "Return of depression economics" supports the idea that "Monetary policy affects inflation only with a long lag; therefore it would be necessary to have some more flexible intermediate target. A rational strategy is to adjust unemployment around the best estimate of the level consistent with stable inflation at the desired rate; even while recognizing that these estimates are imperfect and that the structure of the economy change over time in any case". Naturally, adjustments must follow according to whether inflation exceeds or remains below the target range.

It is generally estimated that a dynamic balance requires inflation of 2 to 3%; an exit from the crisis requires a higher rate, 3 to 4%

I – Restore Productivity thru Mergers/Acquisition;

II – Support Global Demand;

III – Reduce Foreign Trade Deficit;

IV – Fiscal Policy limiting inequalities;

V – Independent management of the Public Debt;

VI – Independence and Integrity of Justice;

The balance of trade, in its modern understanding, covers products and services; whereas in Lebanon it only reflects the movement of goods. Lebanese statistics take into account services in the "Current Account" which also includes transfers of emigrants as well as income from investments abroad.

When the balance of trade (goods and services) tends towards an equilibrium, the growth translates into new jobs. While the Balance of Payments surplus/or deficit translates into an increase or decrease in the country's foreign exchange reserves.

The current account deficit in 2017 amounted to US\$12.4 billion, reducing the trade deficit (goods) of US\$4.6 billion due to the export of services and the transfer of migrant workers. On the other side the balance of payments resulted in a deficit of US\$4.82 billion. The balance of payments deficit has caused the financial turmoil of the past two years.

The only possible parade today is in reducing the current account deficit. There is no control over the movement of capital, the positive balance of

which should never have been used to cover the import bill; however we can count on the transfers of migrant workers to their families in Lebanon which have always been constant and reached last year US\$7.2 billion leaving a positive net balance of around US\$4.8 billion.

Pattern 9 - Reduce Foreign Trade deficit

- The trade deficit is accountable for the endemic unemployment in Lebanon
- The balance of payments deficit also threatens financial stability
- There are three types of money inflow in Lebanon: (i) transfers from expatriate workers, (ii) foreign direct investment and (iii) banks' deposits. Their use to cover imports is a source of unemployment; in particular the use of deposits presents in addition a major financial risk.
- Action Plan
 - Consider a minimum protection to compensate for the gap in production due to high costs of production factors and rising interest rates in Lebanon
 - Apply a reasonable protection on products that justify more than 40% value-added in Lebanon at the factory's gate
 - Apply a higher protection for a limited period, i.e. 40% over 3 years, for labor intensive or energy intensive product that are threatened
 - Include tradable services (software, books, songs, architectural and engineering schemes, studies, ...) in current trade agreements, mainly the Association Agreement, leaving the professional services (lawyers, engineers, medical doctors, professors, ...) to the WTO

IMPLEMENTATION / TIME FRAME

A year or two before, prior to the foreign exchange deficit, we could hope that productivity consolidation (Initiative I) would improve sufficiently the current account to prevent the country from resorting to protection in order to restore the production sectors. It would be risky today to wait any longer.

The task should go back to the Higher Customs Council to develop and execute a plan to reduce the trade imbalance and exaggerated need for currency that has caused the "crowding out effect" of the Lebanese economy with the consequences that we are witnessing on the private sector activity and the state budget.

New Deal to the production sector

It is not a question of abandoning the economic opening that Lebanon has always adopted and consolidated for two decades; but to resort to time-limited measures that are necessary to safeguard that opening on the long run. As a basis for discussion we can move forward:

- A 10% rate is required on all imported products, which have an equivalent whose added value in Lebanon exceeds 40% ex-factory, to restore the gap that the production sectors are experiencing due to the lack of a favourable environment;
- The rate can be increased at 25% for intensive labor products or that need an energy cost of more than 5% of their ex-factory price;

- The rate can reach 40% for a maximum of 2 years for concerns threatened with shutdown and which initially meet the previous conditions.

3a Restore the prerogatives of the Higher Customs Council
3b Work out a coherent protection plan
3c Negotiate the introduction of services in all agreements

I – Restore Productivity thru Mergers/Acquisition;

II – Support Global Demand;

III – Reduce Foreign Trade Deficit;

IV – Fiscal Policy limiting inequalities;

V – Independent management of the Public Debt;

VI – Independence and Integrity of Justice;

In 2018 several changes affected taxes in Lebanon. They were applied with the aim of reducing the deficit that was determined in the budget to US\$4.8 billion (8.9% of GDP) The achievement amounted at the end of the year to US\$6.5 billion (12.1% of GDP) as the Laffer curve played its part as expected.

To avoid a repeat of the same phenomenon and reduce the deficit from 11.5% of GDP to less than 9% of GDP, the Government has chosen this year to reduce operating expenses and wages. In times of stagflation, the result would be a slowdown in business and a contraction of the tax base that would thwart the expected reduction.

The risks of tax evasion have led the State to favour taxes that are easy to identify (VAT), and/or to collect, rather than tax justice. With the accumulation of changes, rarely made in a sense of fiscal fairness, we have come to a complex system that does not serve the social and economic objectives that should have governed its application.

One of the consequences was the impoverishment of a large segment of the population, 37% who live below the poverty line. Another consequence is the lack of demand on local products, the lack of new investment and the abysmal unemployment that we know.

It is high time to revise tax policy in a more egalitarian sense, regardless of the difficulty of perception and even the extent of the base; the benefits that can result, including inclusive development and social peace, are much more important.

Pattern 10 - Adopt a Tax Policy Review Program with the aim of reducing social inequalities

- Tax fairness
 - Direct / Indirect Taxes – Quasi Taxes → preference for taxes that spare the economically weak
 - VAT – Single rate – Exemptions → VAT does not distinguish the taxpayer's ability. It should never increase and may drop over time.
 - Income Tax → its role is to reduce inequalities for the sake of the rich as well as the economically weak (1)
 - Custom duties → Over the next decade, Customs will be an essential tool for Lebanon's economic and social stabilization.
- Tax stability → Essential to attract Foreign Direct Investment
- Long term Vision → On the long run the social welfare and security of a country depend on its fiscal policy.

IMPLEMENTATION / TIME FRAME

"Fiscal stability" requires time to elaborate and implement a modern tax system. Although sources that can serve as benchmarks abound and we can later correct the applied rates and even the tax structures, it is better to take your time, no case is absolutely similar, Lebanon is among the most less egalitarian and this defect weighs heavily on its development and security.

A tax overhaul should be done in the long term, and avoid intermediate changes that still represent a handicap to investment.

It is better to define the final objectives from the outset and take the time it needs for an impact assessment of each of these changes to ensure that they are in line with the objectives, and to admit only those that would frankly be to reduce inequality in the country.

I – Restore Productivity thru Mergers/Acquisition;

II – Support Global Demand;

III – Reduce Foreign Trade Deficit;

IV – Fiscal Policy limiting inequalities;

V – Independent management of the Public Debt;

VI – Independence and Integrity of Justice;

Public debt can hardly fall without an autonomous administration that has the authority of the issue and has sufficient negotiating room to define and execute a rational policy that optimizes the terms of the government debt. The interest rates that are expected to rise over the next 18 months will increase debt service and make the situation even more difficult if it is not

created. Since Lebanon's independence, tax issues have been the responsibility of Parliament. In fact, all borrowings to date have been covered in advance by legislation. All the better if this law be based on concrete and direct information from the debt agency.

Today the stabilization of the debt and especially its reduction, in order to absorb the extra borrowing offered by CEDRE, cannot be achieved without an independent authority that arbitrates the conflict of interest between public finances and monetary policy, and releases the evolution of the debt from their contingencies.

In any case, \$85 billion fully justifies an independent administration. Apart from the substantial savings it can achieve, it can imagine engineering likely to drastically reduce debt service. Governments to date have secured all the desired funding in grants or assisted credits, but never to our knowledge managed to reduce the burden of debt or alleviate its service. Yet the \$5 billion deficit that is undermining our Budget is precisely debt servicing. And all things being same, the situation will quickly worsen especially with the current trend of rising interest rates.

For example, Lebanon issued \$3 billion in euro-bond in the first half of the year between 7% and 8.25% at 10 and 15 years, despite the peg to the dollar for more than 20 years, while the US10Y T-notes rate was 1.80% and most EU countries' bonds with negative interest over 10 years. The spread is huge for a stable currency. What's going to happen from now on?

In the 1970s, the government debt had put Mexico's economy on the brink of bankruptcy. The state obtained the guarantee of the U.S. Treasury and interest rates suddenly fell to a passable level that quickly allowed the country to recover. If the Lebanese State had negotiated a guarantee of part of its euro-dollar debt instead of increasing its amount at prohibitive rates, we would not be there. Precisely this is the function of a Debt Administration.

Pattern 11 Independent management of the Public Debt

- Need to stabilize Debt → 153% of GDP
- Need to reduce Debt to make room for the CEDRE's funding → 11BN\$
- Idem, to take account of the debts due by other public entities whose default would fall into the Central Budget
- Need to avoid conflict between the financial and monetary policies
- Need to reduce Debt service → 5BN\$; Budget deficit → 6.5BN\$ 2018 ; Leb Euro-bonds → 7% 10Y n → 8.25% 15Y ; BRR April 2018 → LL 13.06% → US\$ 9.52%

IMPLEMENTATION / TIME FRAME

Debt management should begin with a precise knowledge of the state's commitments. It is not enough to know the amount and maturities of the public debt, nor to push these maturities to the Greek calends; it is also necessary to know precisely the commitments of the "Council for Development and Reconstruction" and other public administrations, including the "Electricity of Lebanon" and the municipalities.

The stock of the debt is only important compared to the GDP and the upward or downward trend it takes. However, it is essential to have sufficient transparency and planning to avoid surprises. Regardless of the amount of debt it remains manageable if it is consistent with the GDP. Failing which, further measures are needed. The most important thing is not to let the situation deteriorate unnecessarily. A declining debt trend is already an early exit from the crisis.

However, any solution requires a responsible authority that assumes the entire debt and has the authority to negotiate and engage in a solution.

- I – Restore Productivity thru Mergers/Acquisition;
- II – Support Global Demand;
- III – Reduce Foreign Trade Deficit;
- IV – Fiscal Policy limiting inequalities;
- V – Independent management of the Public Debt;
- VI – Independence and Integrity of Justice;**

From justice we can rebuild the whole administration, enforce the rule of law and ensure respect of all human and social values to which the citizen aspires. Today, modern society sees justice as the power that protects the citizen from arbitrariness and/or the excesses of other powers. As such, justice cannot be dependent on any power other than itself.

It would be wise to entrust the supreme authority of the judiciary to the Supreme Judicial Council by protecting it from political interference. It would be up to the judiciary to appoint magistrates, to decide on their transfers, to establish and revise procedures, to propose laws and regulations, and to take any provision to guarantee the independence and integrity of the judiciary. The Supreme Judicial Council should be already in charge of judicial reform.

Pattern 12 - Independence and Integrity of Justice

From Justice All Rights Flow

- Entrust full authority to the Supreme Judicial Council protecting it from political interference
- Give Justice Reform the Highest Priority
- The Council entrusted for initiating the reform could be formed of renowned jurists chosen among the minority confessions (1)
- In the future the Superior Judicial Council would be formed by co-optation,
- and would be the first administration able to go beyond confessionalism and to fix its choices on integrity and competence

IMPLEMENTATION / TIME FRAME

One imagines the difficulty in the current state of affairs of appointing a Supreme Judicial Council independent of political currents while respecting a certain denominational distribution.

The Council in charge of initiating the reform could be formed from leading jurists chosen from absolute minority confessions.

In the future the Supreme Judicial Council would be formed by co-optation, and would be the first administration capable of overcoming confessionalism and fixing its choices on integrity and competence.

Synergy of the initiatives

The reform induced by the 6 initiatives above (productivity, demand support, reduction of the external deficit, fiscal justice, debt economy, independence of the judiciary) presents a double synergy:

- Temporal: The good perception of the reform should give rise to favorable expectations that will improve market condition and give way to effective measures that have not yet been implemented and / or that have not yet had the time to produce their effect;
- Aggregate: It is not only the primary initiatives and the measures that support them that will change the reality, but the innumerable effects that will appear from their application and interact to consolidate the reform.

Among these effects we can already identify some whose involvement is clear as object and/or subject of the reform. More may still be revealed during the analysis.

Pattern 13 - Impact of the basic targets ⁽¹⁾

Productivity, Effective Demand, Foreign Trade, Fiscal Policy, Debt management, Judiciary system.

- Short Term Reform – The good perception of the reform should rise favorable expectations that are self-fulfilling
- Aggregated Impacts: It is not only the primary initiatives, and measures that support them, that will change the reality, but the innumerable effects that will emerge from their application and interact to consolidate the reform
- Long Term Development – On the long run a good reform tends towards inclusive development. While targeting development at start is an impossible task.

DIRECT IMPACT OF INITIATIVES

➔ *Patterns that describe the direct impact of selected initiatives on one another form a small part of the overall synergy that ensures change, yet they demonstrate the coherence of the system.*

1. Decrease of Trade Deficit
2. Decrease of Unemployment
3. Investment Expansion
4. Foreign Direct Investment

5. Public-Private Partnership
6. Job Creation, Expansion of Labor Force
7. Reducing Inequalities
8. Increase Demand of National Products
9. Stabilization / Amortization of Public Debt
10. Budgetary Balance
11. Promoting Democracy and Civic values
12. The path to Inclusive Development.

1 – Decrease of Trade Deficit

The financial emergency now requires a direct initiative, which would however be limited in time, and would later allow a gradual return to greater liberalization of foreign trade. Attempts should be made to revise trade agreements by introducing certain important services to national production such as computer programs, architectural studies, civil engineering plans, cultural and/or artistic production, and intellectual products in general, but without affecting the liberal professions that would be considered when joining the WTO.

Given the structure of demand, improving productivity would be more effective than protection. Indeed, a large portion of imports is insensitive to price, and the increase in the tariff would be far from proportionately reducing imports. Let us remember here the importance of variety to the consumer, which is becoming more and more confirmed, as the standard of living rises, all over the world.

The improvement in productivity stems in part from the extension, albeit limited, of the company's share in the local market; but above all from the expansion of the external market. Add to this that productivity improvement will be gradual and cumulative.

First, it will allow the company to sell its production in good conditions, then increase its turnover, and finally invest. Each development normally corresponds to the average period of the transformation cycle 6 months. The full cycle corresponds as in the majority of cases to 18 months. Favourable

expectations will certainly reduce the recovery period of the company and of the country.

Pattern 14 - Decrease of Trade Deficit

- Result of:

- Gain of Productivity ⁽¹⁾



Impact on:

- Increase of Local Investment
- First decline in Unemployment
- Foreign Direct Investment in Production sectors
- Economic stabilization

2 – Decrease of Unemployment

Unemployment has reached unsustainable levels in Lebanon for more than two years. In the best cases the figure is constantly around 20% The presence since 2011 of displaced Syrians is not a sufficient explanation; especially since at least one-third worked in Lebanon before that date in construction, agriculture, the environment, gas pumps, and industry.

There is no doubt that the improvement in the trade deficit will translate into surplus production and more work opportunities. These opportunities will favor Lebanese workers because working foreigners will take advantage of it to normalize the conditions of their jobs.

This first decline in unemployment cannot be very important in absolute terms, but it has two notable advantages: the first is that it reverses the upward trend of unemployment; the second is that it will be almost immediate.

Pattern 15 Decrease in Unemployment

- Result of:

- Decrease in trade deficit
- Increase of the local market share of national production
- Foreign Direct Investment in the production sectors



Impact on:

- Reverse of the trend towards frictional unemployment
- Increase of work force ★ at present 45% ★ benchmark 65%
- Economic recovery

3 – Expansion of local investments

Local investments depend on the same value chain: - Improved productivity - Reducing the trade deficit - Increased production - decreasing unemployment. The renewal of the machinery fleet, the updating of management equipment, the investment in marketing and R&D would be initiated without delay as soon as the chain becomes operational and/or well-founded expectations of its operation are perceived.

A =	Improved Productivity, Reduced Trade Deficit, Increased Output, Lower Unemployment
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Pattern 16 - Rise of Domestic Investment

- Result of:

- Decrease of trade deficit
- Debt stabilization
- Judicial reform



- Impact on:

- Stabilization of unemployment
- Economic growth (step 1)

4 – Foreign Direct Investment

Today there are fewer and fewer limits on foreign investment, especially that investment in general is no longer dependent on local savings but on global investment opportunities.

Lebanon has always been a pro-FDI field. In the past, the production sector has hosted many industries that have fled nationalizations in the region. Subsequently, the land and financial sectors attracted many investors who shunned the production sector due to a lack of profitability given country risk.

Improved productivity and justice reform will both improve the profitability of production sectors that have become exporters again and reduce country risk. This combination should bring FDI back to the production sectors. Note that for an investor in the financial sector, there would be dozens for any sector of the real economy.

B =	A + Debt Management, Country Rating, FDI in Production Sectors
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Pattern 17 - Foreign Direct Investment

- Result of:

- Judicial Reform
- Decrease of foreign trade deficit
- Tax stability



- Impact on:

- Job creation
- Enhancing export
- Economic growth (step 2)

5 – Public-Private Partnership

Like everywhere else in the world, the PPP has its privileged domain, which would be poorly managed by the state and/or where the citizen would be poorly served by the private sector. The law paving the way for this task was eventually enacted after years of cogitation in 2017. Yet the experience was positive in Lebanon. The telecom sector fell de facto in this area after the termination of contracts with the concession companies and their replacement by management contracts. It is true that tariffs are among the most expensive in the world, however they are a quasi-tax since the state derives more than 15% of the tax revenue.

Of course, other areas may have other objectives. State participation may be for economic, fiscal or social purposes in particular; and in all cases private participation is likely to improve the management and help in achieving of the allotted objectives.

Without the independence and integrity of justice, foreign partners capable of ensuring the necessary technical progress would find it difficult to enter the public-private partnership; it is doubtful whether domestic firms do it and embark on such an adventure.

The fact remains that the PPP offers a huge opportunity both for technology transfer and for job creation, independent of the modernization and expansion of private sector enterprises. The State is planning a public investment, financed by CEDRE, of \$4 billion over 10 years, or \$400 million per year, in addition to the contribution of the private sector.

Assuming an average investment of \$400 million per year, the creation of new jobs in the production sector would be the equivalent of 40,000 new jobs per year.

It would normally take 3 years for unemployment in Lebanon to fall to its frictional level as of the cruising speed of the program. The problem is that the process of setting up a PPP business is very long and may take 2 to 3 years until the time of hiring. It would be wise to launch as many projects as possible as soon as possible, and to reduce the time of the creation process.

C =	B + Judicially Reform, PPP, Frictional Unemployment, Technological Transfer, R&D
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Pattern 18 - Public Private Partnership

- Result of:

- Debt control
- Budget equilibrium
- Aggregate demand



- Impact on:

- Likely to reach frictional unemployment (combined with Investment rise and FDI)
- Economic growth (step 3)

6 – Job Creation – Extension of the Work Force

The consolidation of frictional unemployment through PPPs will certainly have a beneficial effect on the labor force, which is currently in the order of 45% of the working-age population, while the benchmark in prosperous economies exceeds 65%

Present Situation		Target	
Current Population	4,200,000	Current Population	4,200,000
Population between 15 and 65 years old	2,800,000	Population between 15 and 25 years old	2,800,000
Work Force 45%	1,260,000	Work Force 65%	1,820,000
Current Unemployment	250,000	<i>Frictional Unemployment</i>	<i>90,000</i>

Working Population	1,010,000	Working Population	1,630,000
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Recurring unemployment weighs heavily on the labor force. In general, the closer unemployment gets to its frictional level, the more it encourages, because of opportunities and wages, new waves, which had hitherto shunned the job market, to offer their services.

The value chain allows at this stage a structural change, that of valuing human capital, the effect of which is equivalent to a productivity multiplier and a substantial increase in the standard of living. Indeed, Lebanon has the most educated and experienced population in the region, which is enough to put to work that we have never been able to do, and what this program proposes.

D =	C + Working Population 65% of the Population of Working Age
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Pattern 19 - Job creation, Rise of Workforce

• Result of:

- Investment (including PPP)
- Foreign Direct Investment in production sectors
- Infrastructure program over 10 years



Impact on:

- Frictional unemployment ⁽¹⁾
- Increase of labor force ⁽²⁾
- Rise in standard of living
- Sharp decrease in the population under poverty line

7 – Reducing Inequalities

Lebanon is one of the most unequal countries in the world. An income of \$18,500 in Purchasing Power Parity per capita and a population below the poverty line of more than 37% make it probably the most unequal country in absolute terms.

This inequality has a triple implication: economic, social and security.

- Economic. Overall demand is all the weaker because incomes are unequal. This situation can no longer be corrected by investment since the wide-open financial markets have negated the link between national savings and investment. Today, investment depends on the

country's productivity and rating; and savings find their way through the local and/or international remunerative channels.

- Social. The phenomenon of inequality is global and undermining the most advanced nations as well as the developing countries. It is often forgotten that, in addition to capital and labor, there is a third essential factor for generation and the conservation of wealth, the state. The state is the property of all citizens, in the same way, without exception. This entitles you to a minimum of decent living that national income allows before any remuneration due to capital or labor.
- Security. The glaring inequality of income, especially when it falls below the living wage, justifies the bitterness of the citizen. Lebanon experienced a revolution 12 years after the Second World War, then 16 years later; since 1992 a 26-year period has passed and both political and economic indicators are not good.

A more egalitarian tax policy project with immediate partial achievements, clearly geared towards the final goal, can only extinguish the wick that smolders under the ashes. It is not enough for leaders and historians to give confessional explanations or regional strategy to believe that events would be independent of the suffering of the people.

E =	D + Fair Fiscal Policy, Inclusive Development
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Pattern 20 - Reducing Inequalities

- Result of:

- Fiscal policy
- Job creation



- Impact on:

- Raising demand on domestic production
- Promoting democracy and civil values
- Improve safety and respect of the law

8 – Increasing Demand of local product

While protection allocates a larger share of the local market to domestic production, it threatens in return the trade agreements and the benefits that Lebanese production derives from the countries with which we are bound by these agreements; improving productivity increases the local market share

attributed to domestic industry without reducing its export benefits; quite the contrary.

Add to this the fact that the competitive advantage obtained, whatever the means, is far from having a proportional impact on the market, the choice may be on factors other than price despite the "theory of rational choices".

It should be noted that protection and/or subsidy may be necessary to combat the oligopolistic or even monopolistic trend generated by the increasing returns of scale that favor large business at the expense of SMEs, as well as situations of imperfect competition that limit the theory of comparative advantages (Krugman: Theory of International Trade, 1979).

The protection adopted to compete on the domestic market must necessarily be time-limited, and disappear as soon as the causes that have caused it have disappeared, and/or that a sufficient number of firms have reached their optimum productivity level.

Low protection is usually enough to overcome the gap in an unfavorable economic environment that excludes local production from the market (10% to 15%). Moderate protection (15% to 25%) may be necessary for strategic products. Strong protection (25% to 40%) should always have a limited time frame for implementation, for example three years, and get back after to the normal rate. Beyond 40% protection has no economic justification, as it usually corresponds to 100% of the added value in the country.

The adjustment of the tariff is a technical and frequent function that the Higher Customs Council must assume; The Council of Ministers is too cumbersome to take on this responsibility.

Pattern 21 - Raising Demand on Domestic Products

- Result of:

- Job creation
- Reducing inequalities



- Impact on:

- Local Investment
- Foreign Direct Investment
- Public Private Partnership

9 – Stabilization/Amortization of the Public Debt

The question must be asked: why debt servicing amounted to \$5 billion in 2018, or 31.5% of public spending, when the national currency has been

pegged to the dollar for 25 years and has been as stable as the U.S. currency?

We are in a vicious cycle where the stability paradigm justifies high interest rates, and interest rates justify high debt servicing. An Impact study should demonstrate the collateral damage to investment and employment.

We arrive after 25 years of stability to this paradoxical situation where the state issues 10-year eurobonds at 7% while the 10Y T-Notes of the US Treasury are issued at 1.7% for the same period. Obviously Lebanon is not the United States, so why the peg to the dollar? In order to reduce debt service, it is compulsory that an independent body assumes responsibility and focuses its management on this target, without being subject to other conflicting objectives.

Amortization of debt is neither impossible nor desirable. The service it has rendered to date is probably disappointing, while public opinion is only aware of the service of the debt, ignoring the "crowding-out effect" on the production sector that it has caused and which would be more harmful than the annual expenses it has incurred to the budget.


Working on debt amortization is first of all to rationalize debt service, which can only be planned and executed in a state-of-the-art manner from an administration free of any conflicting obligations, a self-sustaining independent administration as described above.

Some sources believe they will use hydrocarbon revenues to be off-the-clad debt; this in order to preserve these revenues from possible squandering in the context of state spending, or in deduction of the revenues that the State used to collect. I do not think that is a wise choice. Rather, the rational option would be to introduce hydrocarbon revenues into the Budget revenues and allocate debt servicing and planned depreciation to expenditures.

This does not exclude debt for profitable projects (PPPs) whose amortization is ensured by project revenues; or useful investments whose amortization justifies being included in government spending after ensuring the expected development (infrastructure necessary for inclusive development).

The combination of these two movements determines the dynamic amortization of the debt and is part of the management of the competent authority.

Pattern 22 - Stabilization / Amortization of the Debt

- Result of:
 - Debt Management Unit ⁽¹⁾
-  Impact on:
- End of crowding out effect ⁽²⁾
 - Budget equilibrium

10 – The Budget Balance


Fiscal balance is mandatory but must remain an effective tool for economic policy. Some flexibility at the end of the decade saved the United States and Europe from a crisis as violent as in 1929

It is a mistake to distinguish the "primary balance" from the general budget, because it means that the slippage in debt service is tolerable. That is not the case. The perverse effects are exactly the same regardless of the origin of the deficit.

On the other hand, if a tax cut or a surplus of expenditure is necessary in times of crisis, the deficit must be considered in the medium term, for example within a 5 to 8 years horizon, at the end of which the balance is restored. The first period of deficit conditions must provide recovery quickly enough for the return to normalcy in the best conditions without a resurgence of unemployment.

The European Union has admitted a flexibility of around 3% of GDP, in reference to Maastricht. This has proved insufficient, the states have not achieved a real recovery to date confirmed by a reduction in unemployment.

Pattern 23 - Budgetary Equilibrium

- Result of:
 - Establishment and control of the budget according to the rules of art ⁽¹⁾
 - Reduce debt service
-  Impact on:
- Tax stability
 - Sustainable Development

11 – Promoting Democracy and Civic Values

The synergy developed by the six initiatives described before largely achieves the wish of the citizen and as such resembles a plebiscite of public opinion for a situation long desired.

The various economic, social, security and political aspects of these initiatives represent the civic values that citizens would like to promote in the country.

Corruption is severely punished by Lebanese law. We have to complain about the non-enforcement of the laws. Before multiplying the initiatives and/or revising the texts it is necessary to ensure their strict application.

Justice reform should prioritise this goal. Law enforcement must cover all areas, not just corruption.

It is hoped that this initiative would be necessary and sufficient to curb corruption. It could be implemented immediately without waiting for probably unnecessary measures.

Pattern 24 Promotion of Democracy and Civil Values

- Result of:
 - Judicial Reform
 - Reducing Inequalities

12 – The path to Inclusive Development

So far we have avoided talking about development to prevent confusion with reform that favors time and energy deployed to achieve change; development is driven by other priorities.

Many development measures have been set aside for fear of delaying reform, and even defeating it. Yet inclusive development dominates all action, it is both the ultimate goal and the *raison d'être* of reform.

Pattern 25 - The Path to Inclusive Development

- Result of:
 - Reform
 - Budget Equilibrium

Reform plan

A =	Productivity , Trade Deficit, Unemployment <10%
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B =	A + Debt management , Country rating, FDI production sectors
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C =	B + Justice , PPP, Frictional Unemployment, Techno Transfer, R/D
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D =	C + Work Force 65%
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E =	D + Fair Tax Policy , Inclusive Development
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