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I- Introduction

The question that everybody keeps on asking is: is there still a way out of the current crisis or are we going to fall into an abyss with an intense deterioration of all economic indicators that may lead us to consequences nobody want to talk about? A summary of the current economic situation will help us analyze the sustainability of the current situation. Then we will try to find a way out of the crisis with the least damage to the economy.

The protests accelerated what was already a deteriorating economic and financial environment. The protests on the street created a panic among the population with the resignation of the Prime Minister Saad Hariri being the cherry on the top. Hence when banks opened following 14 days of closure, people rushed to withdraw and/or transfer their deposits into dollars or outside the country.

Hence the banks were obliged to adopt some restrictions in order to maintain financial stability for the longest possible time. When there is a rush on banks, it is obvious that the latter cannot serve all their depositors at the same time as they have already placed the money received from depositors through loans, or buying government bonds or central bank Certificate of deposits. On top of that, the banking system had already lost part of its foreign assets since 2011 as the balance of payments remained in the red for more than 8 years. Moreover the BOP deficit accelerated during the past two years.

The current economic and financial situation can't be but transitory as the downfall accelerated by the protests, making the economic and financial situation unsustainable. The restrictive measures adopted by banks will make it less likely for capital to flow into the economy as investors will become worry about the risk of being unable to withdraw money from the system. Hence it will be more and more difficult to attract money and the economy will have to rely on its own existing stock of foreign assets to finance its imports of goods and services. Imports will decline as a result, however it will continue to constitute the major drain on foreign assets.

Another source for deposits' drain is cash withdrawals from banks. People are withdrawing as much cash as they can, in both currencies LBP and USD, to counter the restrictive policies of banks. Then, being unable to transfer cash outside the country, this money is kept in safe boxes at homes. It is estimated that the amount of cash withdrawn from banks in the past 2 months has amounted to more than USD2.5 billion.

Anyway, the successive governments since 1990 were never able to restore investors' confidence level to where it was before the war started. Dollarization rate never went below 50% and most of the time interest rates on LBP were much higher than their US counterpart. During the episodes of shocks like in 1995, interest rates went up to 38% while in 2005, 2006, 2008, and more recently, Credit default swaps (CDS: these are an insurance against the risk of default of the Lebanese government. When their price increased, it means that the risk of default is going up. Theoretically, the five years CDS should be equal to the difference between five years Lebanese Eurobonds and five years US bonds) crossed the 1000 basis points.

As demonstrations continue, banks restrictive policies will remain in place and the repercussions of both on economic growth are substantial. Companies' turnovers have fallen by more than 50% in October, depending on the sector. The impact in November is anticipated to be larger than the previous month as banks froze their facilities for individuals as well as for companies and reduced credit cards limits. So consumption and imports are de facto declining and traders are feeling the heat.

The result is an economic recession combined with a liquidity drought that is unsustainable beyond the short term. Either a government is formed and the country is put on the right track of reforms, or the restrictive policies will increase and the parallel exchange market will see a larger depreciation of the Lebanese pound. The cash economy will flourish as depositors will avoid putting money at banks.

So the million dollar question remains: if a government is formed, is there a way out without a haircut on deposits, a restructuring of government debt, and devaluation? The most urgent issue is to restore investors' confidence in order to be able to levy the restrictive measures of commercial banks and for capital to start flowing in again. A way out can be found without a haircut on deposits and devaluation, but a restructuring of government debt especially in Lebanese pounds is preferable in order to reduce the burden on public finances.

The first step before getting into any future economic plan is to form a government. This government has to be formed quickly and according to the Lebanese constitution, it has to get the support of the majority of parliamentarians. However and beyond parliament approval, the government has to gain the confidence of people on the streets, but most importantly it has to get international recognition as trustworthy and cooperative. Hence debating the composition of the new government is like debating the sex of angels. Technocrats, techno-political, or purely political, is non sense, as the most important, besides being approved by the international community, is for the government to be coherent, and hold responsibility for its actions, in order to be productive and start immediately to tackle the current economic and financial crisis.

If a government with international support is formed, then resolving the current economic woes will become easier. An inflow of deposits from the GCC governments of USD7 billion to USD10 billion as deposits at the central bank will also be very vital to support confidence as BDL will be able to pump dollars in the market, and banks will relax capital controls in few months' time. Of course this will be conditional on the government adopting an ambitious yet credible comprehensive economic reforms plan for the upcoming 3-4 years.

As capital controls will be maintained in the near term, the banking system has to move into reducing interest rates in order to limit the increase in its foreign currency exposure. A drastic reduction in interest rates is advisable on both dollars and LBP deposits. The interest rate differential will have to decline to a quarter or half a percentage point as it is the case in economies with pegged currencies. This step will lead to a reduction in the cost of funds for Banks, especially in USD at a time where capital inflows have been reduced to negligent levels. Banks will then move to reduce interests on corporate debt and start to provide loans again to businesses.

The central bank has already issued a circular ordering the banks to increase their capital by 20 percent by mid-2020. Many scenarios are debating the fact that this may not be enough as these scenarios are considering a haircut on deposits. Our scenario is based on restoring the confidence in the banking sector and the economy at large, which will make this recapitalization enough for the current period. Any recapitalization that goes beyond this level will necessitate a better environment in order for banks to be able to attract investors.

In order to accelerate the recovery process, it will be advisable for the new government to bring onboard the International Monetary Fund as soon as possible. The importance of an IMF program is that it will play as a catalyst for capital inflows. The IMF will agree with the government on three years Extended Fund Facility (EFF), which will consist of an economic program agreed with the government including a timeline with quarterly evaluation by the IMF. It will also entail a package that could go up to few billion dollars with quarterly disbursements if the review by the IMF mission is positive on the implementation of the reform program. Once the IMF gives a green light for the disbursement, international donors will do the same. Hence the IMF will act as a leverage to attract capital from abroad. If the IMF program will disburse USD3 billion over 3 years, it is expected that this money will attract more than USD10 billion over the same period. It is important to note that citizens need to sacrifice in the short term, while gradually getting better public services over the medium term.

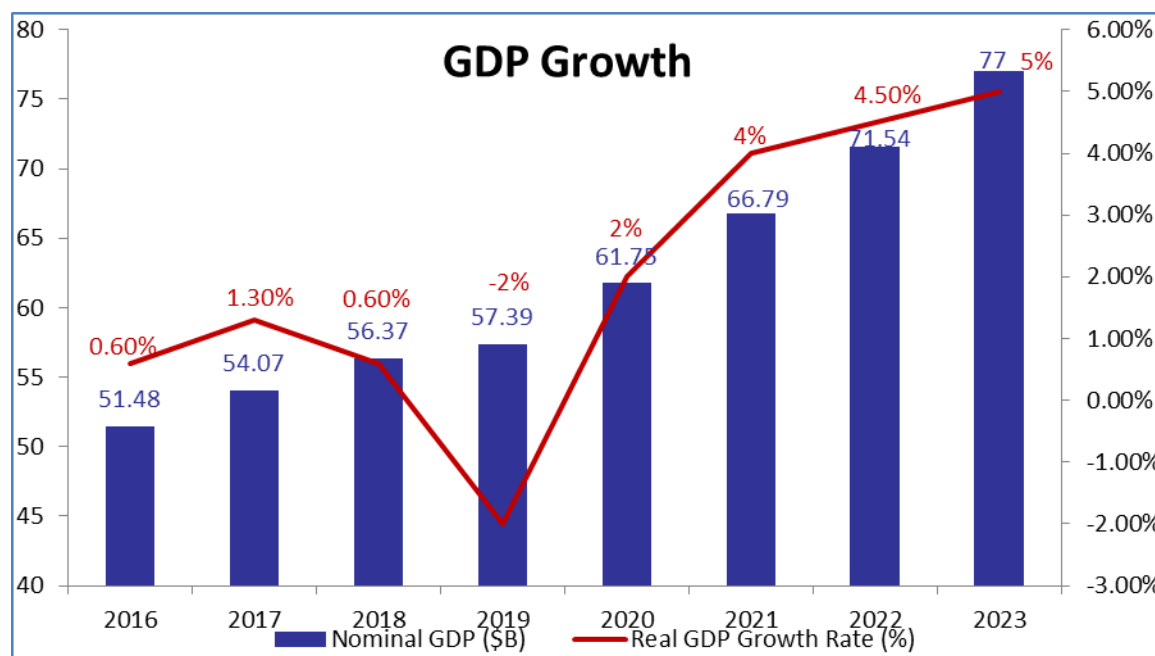
II- Economic Reality

Over the past few years, Lebanon has been facing increasingly challenging economic and financial conditions on the back of contradicting policies and paralyzed governments with reforms eternally remaining in the pipeline. Economic growth has been very low— averaging close to null over the past three years including the current year— with macroeconomic vulnerabilities rapidly increasing as capital inflows dried up and Lebanon continued to rely on a consumption- and import-driven growth model. In particular, fiscal policies and projections were unrealistic especially with the boost in wages and salaries of government employees before 2018 elections, and the increase in taxes that hit the private sector in an already weak economic growth environment. This has led to a surge in the FY 2018 fiscal deficit to 11 percent of GDP, pushing public debt to 151 percent of GDP. This fiscal policy, in addition to the structural composition of the economy fueled the current account deficit to 18-20 percent of GDP last year; however this time without capital inflows that used to close the gap in the past. Lackluster progress in structural reforms continued to hamper investment, allowed inefficient public enterprises to linger, and a large informal economy to expand.

The government's slow reaction and/or wrong policies adopted to face the systemic imbalances led to increased macroeconomic deterioration. While some adjustment policies were adopted since the start of 2018, these fell short of the comprehensive reforms needed to ensure macroeconomic stability. Despite some monetary policy tightening, the external sector imbalances kept on deteriorating. Similarly, fiscal deficit in the first half of 2019 remained significant despite its decline compared to the previous year; however arrears were accumulated towards three main counterparts, namely private hospitals, contractors, and Social Security. Finally, the government didn't agree on any tariff increases in the power sector, which may have helped reducing quasi-fiscal losses. Sizable financing from the banking sector, especially the central bank at advantageous rates, provided critical financing relief, but also deferred the urgency to tackle the underlying problems.

On the back of weakening confidence, economic activity has slowed considerably, and the country went into stagflation. High-frequency indicators, including the purchasing managers' index, cement deliveries, construction permits, real estate transactions, and motor vehicle sales, have continued to deteriorate, confirming a marked slowdown in economic activity. In addition public investment and construction have contracted owing it to cuts in government development spending. Growth is estimated to have declined to 0.6 percent in 2018 and will go into negative territories this year, following the eruption of demonstrations on October 17. Real GDP growth is expected to register a negative 2 percent, as lost confidence led to capital control, which in turn, hurt traders' activity and increased non-performing loans at banks. Consumer inflation has decelerated markedly to 2.77% by August 2019 compared to 6.29% during the same period last year. It is expected to substantially increase in the last quarter of the year as the

appearance of a parallel exchange market where the dollar is being traded above 1700LBP/USD has led to a jump in consumer prices of imported goods.



Government has tried to contain the fiscal imbalances during 2019, but it has accumulated arrears.

2019 budget was approved by parliament in July of the same year, which left 5 months to implement the new budget with the embedded tax measures. During the first 7 months of the year, fiscal deficit had declined by 21.7 percent year on year to reach USD2.4 billion with the primary balance registering a surplus of USD577 million or 1 percent of GDP. Nonetheless, this primary surplus masks an underlying unrecorded spending as government has accumulated arrears of at least 1 percent of GDP in the first 7 months of the year. Due to recent events, the overall fiscal deficit is expected to widen to 8.5 percent of GDP against a budget target of 7.6 percent in FY 2019 as revenues will remain constant despite the increase in taxes approved in the budget and expenditures will decline by 6% compared to 2018.

The weakness of the external position has widened in recent months. Although the trade deficit has narrowed marginally by August 2019 to 20 percent of GDP, down from 20.6 percent during the same period last year (the trade deficit would have been narrower at 16.5 percent of GDP in 2019 if it was not for the imports of mineral products that have increased by more than 64 percent to reach USD4.7 billion), the current account is expected to have remained in deficit of 18-20 percent of GDP. The balance of payments has recorded a deficit of USD4.5 billion in the first 9 months of the year compared to a deficit of USD1.3 billion during the same period last year. The BOP deficit is expected to reach USD 8billion by the end of 2019 for the following reasons:

1. We estimate that \$500M of debt related payments will go to foreign holders of Lebanese debt in the last 3 months of the year. The BDL has to pay around \$1.9 billion of debt related payments in foreign

currencies including Lebanese Eurobonds maturing at the end of November, Eurobonds coupons, and principal payments on bilateral and multi-lateral loans.

2. An additional \$2.5B to \$3B dollars of outflows from the banking system is expected as a result of the BDL providing the necessary amount of dollars for imports of wheat, food, fuel and medicine (for the last 3 months of 2019), the transfers abroad that took place before the eruption of the protests, and the ongoing cash withdrawal from banks, which are being kept under the pillow.

III- Pillars of reform

The government should aim at restoring confidence through economic sustainability and balanced growth. The strategy should be founded on three pillars:

1. **Macroeconomic stabilization along with poverty reduction.** This includes: Large reduction of the fiscal deficit over the coming 3.5 years (from the second half of 2020 till the end of 2023) through an effort to mobilize revenue that will generate 3-4 percentage points of GDP in gross additional tax revenue by end 2023 (it will be 1-2 percent on a net basis due to the privatization of Telecom in 2021), and a strategy for cost recovery in EDL; monetary policy will continue to aim at preserving the exchange rate peg for the moment as it is an anchor for confidence, and the negative impact from floating the LBP outweigh its positive impact on competitiveness and on the reduction of the current account deficit; The monetary policy will try reaching inflation objective of 4 percent or less in order to help in shoring up confidence; increasing social and development spending to protect the most vulnerable.
2. **Structural reforms with improving transparency and governance to strengthen public enterprises and institutions, and to foster higher economic growth.** This will include: improving public financial management through better collection and better control of tax evasion to achieve more fiscal discipline and greater budgetary transparency; reforming EDL and the tariff structure to ensure a balanced budget for the energy sector and better services; modernizing and corporatizing all the enterprises owned by the government in order to prepare them for privatization; strengthening anticorruption agencies such as the central inspection authority, and the court of audit; and improving the regulatory framework of investment and job creation.
3. **Adequate new financing from the international community to support Lebanon.** If such a program is adopted, the government will be able to catalyze new external financing from official and bilateral partners, which will help closing the financing gap and allow reforms to work.

IV- Macroeconomic framework

In the near term, economic activity is expected to remain subdued and 2019 will register a recession of 1.5%-2.5%. The high level of interest rates together with fiscal consolidation will constrain credit growth, incomes, and domestic demand in 2019 and the first half of 2020. A gradual increase in confidence as well as in public investment spending will offset some of the impact on the economy, while targeted increases in social assistance will help offset most of the impact on the most vulnerable.

Over the medium term, real GDP growth is projected to improve gradually to stand between 4 and 5 percent assuming reforms are being implemented on a steady pace. As stabilization takes hold, CEDRE projects will start to move along with higher private sector investment. FDI will also increase and credit to the private sector will spur domestic demand. When the economy improves substantially, the pegged exchange rate will have to move into a crawling peg, as it was the case between 1994 and 1998 in line with economic fundamentals. The latter along with structural reforms will increase the competitiveness of Lebanese goods and services, and will provide an additional boost to domestic production not only through expenditure switching but also through exports.

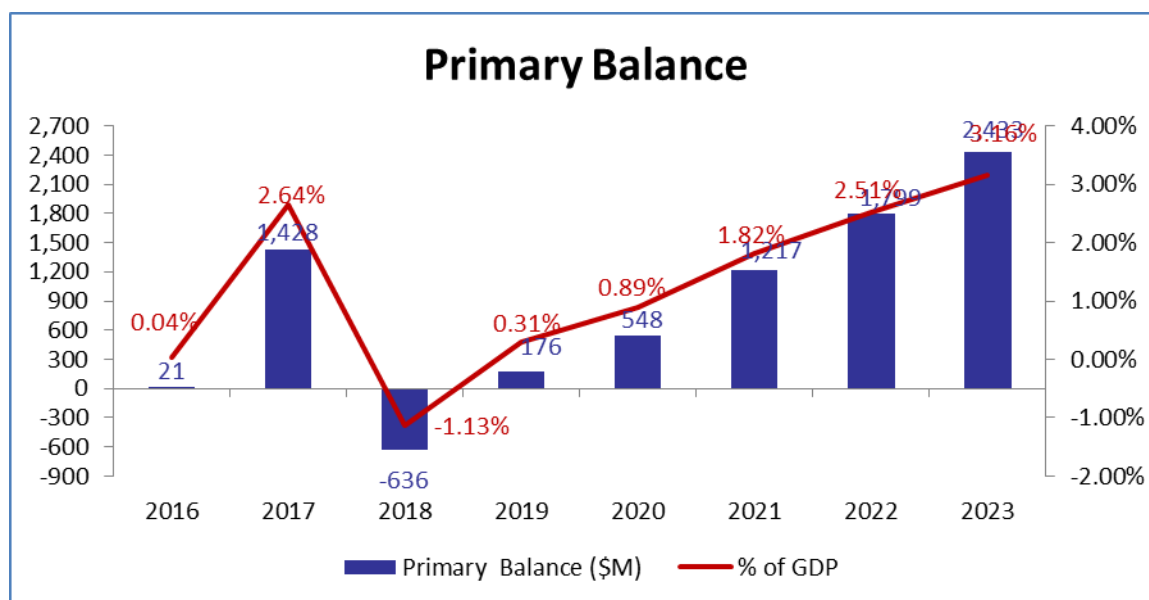
Inflation is expected to increase in the short term, and it already did, due to the capital control that is in place, obliging companies to use the parallel market in order to get foreign currency for their imports. Inflation is expected to hit 5-6 percent by end 2019, and more than 10 percent in the first half of 2020. However, an appropriate monetary policy, in addition to confidence restoration will be able to bring inflation down to around 3-4 percent in the medium term.

The fiscal deficit is expected to decline in line with the adoption of several revenue, expenditures, and financing measures. The deficit will go below 3 percent of GDP in 2 years' time as the authorities' broad-based tax policy and administration reforms take hold. These measures will place general government debt on a declining path, reaching 120 percent of GDP by FY 2024, after peaking at 155 percent of GDP in FY 2020.

The current account deficit is expected to widen after narrowing to less than 10 percent of GDP on a year-on-year basis in the last quarter of 2019 and the first quarter of 2020. Initially, import demand will be contained by the capital control measures, but then imports will increase again driven by more capital inflows and higher demand. At the same time structural reforms should help a gradual export recovery, underpinned by competitiveness gains from better infrastructure and new investment. Increasing remittances and FDI flows, as well as multilateral and bilateral creditor financing will provide financing in the coming years.

V- Fiscal Policies

The fiscal program should focus on putting the debt on a sustainable path by diminishing fiscal deficit on the back of strengthening revenue collection efforts and lower spending while creating space to support social and development spending. Given Lebanon's low tax ratio, the fiscal should be centered on administration reforms to increase revenue through better collection policy and well targeted increase in taxes, while providing better services to citizens, in order to raise the tax to GDP ratio by 3-4 percentage points by end 2023; However total revenue to GDP will end 2023 at 21.7% as privatization of the telecom companies will reduce short term income for the government (In tandem with the privatization of the Telecom, government revenues will have to be increased in order to keep their ratio to GDP constant as there is around 1.7 percentage points of GDP that will be lost due to privatization). Expenditures will remain under control as a result the primary surplus will increase from an estimated 0.3 percent of GDP in 2019 to 3.2 percent of GDP in 2023. The overall fiscal deficit will decrease from a projected 8.5 percent of GDP in 2019 to zero percent of GDP in 2023. Moreover, the government should stop accumulating any kind of arrears. Old arrears should be paid through the issuance of government treasury bills to concerned parties, and new budgets will have to include better spending management and forecasting in order to avoid the accumulation of future arrears.

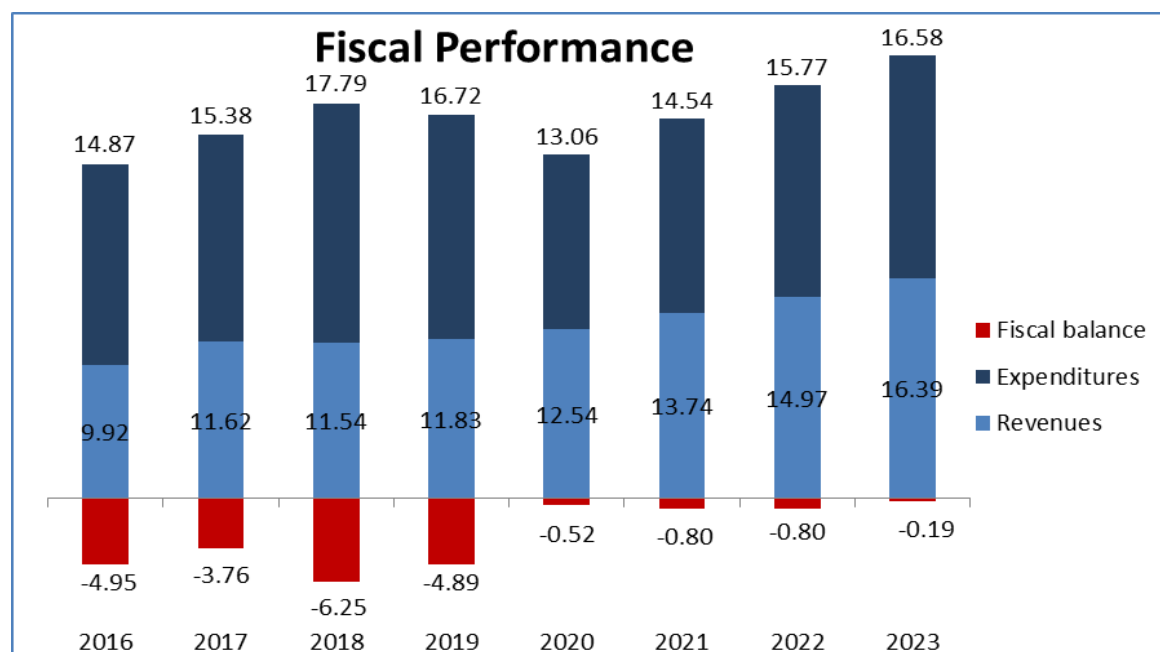


Being able to increase government revenues to GDP ratio throughout the next 4 years is a great achievement for Lebanon. As tax evasion is large in Lebanon, it is not an automatic thing to assume an increase in tax revenues that match the increase in nominal GDP, especially during high growth period coupled with somehow an increase in GDP deflator. Hence a lot of collection effort is needed with some tax measures in order to have an increase in tax revenues that outperform the increase in nominal GDP.

The FY budget 2020 approved by the government and sent to parliament includes a 0.6 percent deficit without any tax adjustment. However this low deficit is a one off time due to the contribution of mainly the BDL and to much lesser extent commercial banks through the provision of financing at 1% to the government. The budgets for future years should include fiscal measures and a drastic reduction in EDL deficit. The most important issue is that the primary budget balance will turn into positive territories from 2021 onwards. If the government adopts the measures outlined in this paper, an adjustment to the current version of 2020 budget has to be made.

The budget for 2020 comprises an increase in social safety nets spending. The program for poverty reduction in coordination with the World Bank has been expanded to include more families in need. When the government starts the implementation of more fiscal measures, an adjustment, towards an increase, should be considered for the most vulnerable in order to alleviate the impact of a restrictive fiscal policy.

A sustained effort over several years should be put in place aiming at revamping tax policy and tax administration. With low tax compliance in Lebanon, as tax evasion reaches around 2.5 percent of GDP and an estimated 30 percent of the GDP value is in the informal economy, in addition to uncollected bills in the energy sector, the potential improvement in tax revenues is huge and could reach 4 percentage points of GDP. Tax policy and tax administration measures should center on broadening the tax base while maintaining a low tax rate, aiming to ensure progressivity of the tax system.



Tax policy reforms will help improve government revenues substantially in the near term. Measures include removing exemptions and preferential treatment to reduce distortions in the tax system and broaden the tax base. These include the removal of VAT exemptions, except for basic food, a measure that will significantly improve revenues. It is also important to put a floor on gasoline prices as these prices are

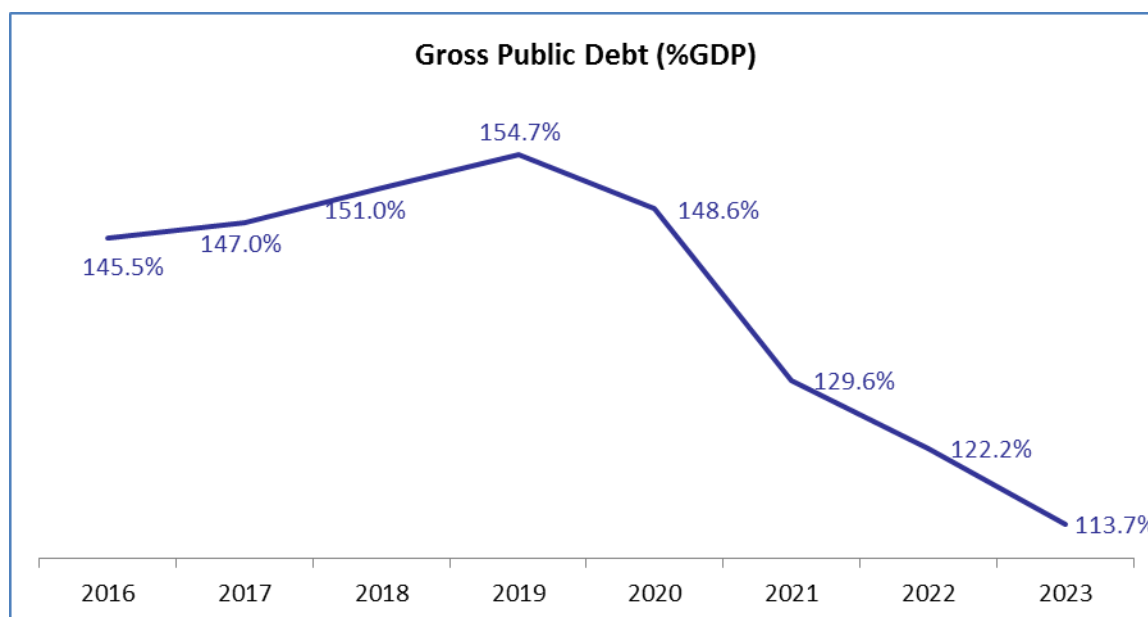
the lowest when compared to similar emerging markets. In addition, other tax policy measures include: further strengthening taxation on real estate especially on high value properties and empty apartments, increase the taxes on the infringements on maritime properties, and ensuring equivalent taxation of all sources of income in order to reduce the rentier behavior by investors.

Tax administration reforms will strengthen tax collection ability over the medium term. Legal penalties for noncompliance should be increased, but at the same time an American based way of settlement should be provided to companies. Companies should be able to negotiate with the department of justice to reduce the penalties rather than bribing the tax comptroller and banking secrecy has to be lifted on all employees at the ministry of finance. Measures to install e-government at the ministry of finance should be accelerated; a lot of work has already been done. Finally, the government should stop granting further tax amnesties.

VI- Public Debt Restructuring

Public debt restructuring is essential if Lebanon wants to get out of the vicious cycle of debt and deficit and put the debt to GDP ratio on a sustainable path; however it should not include a haircut on the principal of the debt. By restructuring the debt, it is not meant a haircut on the debt as it will de facto lead to a haircut on deposits, even if it is the one held by the central bank only. The idea of the BDL writing off its holding of government debt in order to substantially reduce the stock of debt, as the BDL holds close to USD38 billion of Treasury Bills and Eurobonds, is not a viable option. Any decline of this magnitude in BDL assets, will have to lead to a decline in its liabilities, meaning a haircut on banks deposits at BDL, which will result in Banks having to do a haircut on their customers deposits.

Hence the restructuring of government debt has to entail lengthening the maturity of government debt while drastically reducing interest rates on the debt for the coming 3 years. Of course this decline will hit the banking system profits for the upcoming few years. However it is the least painful compared to any other measure that will help getting out of the current crisis. In our scenario, we considered a decline in the effective interest rate on government debt to 1 percent in 2020, 2 percent in 2021, and 3 percent in 2022 and 2023. Interest rates will go back to market rate starting 2024. This decline in debt service will help the government reduce total deficit, at a time when tax measures and expenditure tightening will help boosting the primary surplus. In our scenario, public debt to GDP ratio will decline from 154.7 percent at end 2019 to 113.7 percent at end 2023.



VII- Social Safety Nets

The social safety nets program put in place since 2007 is a good one and should be expanded, with the help of the World Bank, to cover more families as unemployment has increased drastically following the Syrian refugees' crisis. Lebanon lags well behind peers and other emerging markets in poverty reduction and especially in inclusive growth, with people living below the poverty line estimated at 33 percent of the population in 2018. Programs targeting poor people in Beirut and its suburbs should be put in place in addition to boosting agriculture and agro industry in the rural areas to reduce the extreme poverty there and reduce urbanization. The poverty reduction strategy should be aimed at reducing inequality and supporting the economic empowerment of women.

The ministry of social affairs is the responsible entity for coordinating social policies and will have to work with the ministry of agriculture, the ministry of industry and international stakeholders, for the implementation of a comprehensive social policy. The latter will have to include conditional and unconditional cash transfer programs, creating cooperatives in rural areas and encourage farmers to join these cooperatives while providing technical assistance to these cooperatives, as it will help increasing the negotiation power of farmers.

If the government adopts tax measures other than the ones mentioned above, it will have to boost its social assistance program by:

- Providing a one off disbursement of LBP 300,000 to the most vulnerable in order to protect them from the impact of tax policies.
- Strengthening financial inclusion by launching an initiative to reach the goal of having one account for every woman and boosting girls' educational enrollment (by

providing grants to families enrolling their girls in schools, and it should be done the same for boys in the most vulnerable part of the society) and their participation in the labor force afterwards.

- Conditional cash transfers as well as unconditional cash transfers are an effective way of reducing poverty. Out of 142 countries that distribute cash transfers, compiled by the World Bank, 70 percent are implementing unconditional cash transfers and 40 percent went to conditional payments, whereby recipients must fulfill certain criteria in order to get paid. These criteria comprise, among other things, children's school attendance, up to date vaccinations, and regular visit to healthcare centers by pregnant women.

Rural Development

In Lebanon, and in fact all over the world, there is a huge need to sustain rural development. Keeping people in their villages will help reduce traffic in cities due to urbanization. It will also reduce pollution and help sustaining agricultural activity that is essential to achieve the goal of self-sufficient food policy by governments.

The problem in Lebanon lies mainly in the fact that international standards are not respected. Regarding the latter, Lebanon is unable to export most of its agricultural crops due to the overuse of pesticides, which is not in conformity with European standards. Moreover, the export subsidy program that was backed by IDAL didn't orient the farmers on the need to change their crops towards higher value added agricultural products. More than 30 percent of Export subsidy program goes to the export of potatoes.

Another issue that hinders the development of the rural society is the small size of farms that will makes it more costly to invest in machinery and equipment and it will make the return on investment less interesting. In Lebanon the average size of farms is 13.6 dunum or 13600m² (Bekaa 29 dunum and Mount Lebanon is 6.6 dunum), compared to an average farm size of 150000m² in Europe and 4440000m² in the US. With a small farm size there is no economies of scale and staying competitive will be difficult. So when you have a small farm, you don't have the power to influence the price; and in general the large traders and retailers are the ones who will get most of the profit. Most of the owners of small farms are by definition part time farmers and therefore it is more difficult for them to concentrate more time on their farms. The majority of the crops in Lebanon are low yielding crops where it is more difficult for a Lebanese farmer to compete with others like Syrians or Egyptians (The example of potatoes is striking one). More than 90% of farmers in Lebanon are not part of a cooperative. So they don't have any bargaining power.

Concentration of resource use and output to large size farm is advancing across countries. In OECD countries, there is a clear tendency towards farm size expansion. However this is uneven across time due to factors driving structural change (e.g., policy reform, farm demography, market condition and technological change).

There are some incentives from some organizations but these remain limited. There is a need for general government policy.

1. Farmers orientation towards high value added commodities
2. Subsidize these high value added products
3. Make the farmers go up in the chain of production: for example through cooperatives. This is why there is a need for farmers to get together in cooperatives.
4. Educate farmers to move to organic food, which have higher market value.
5. Linking the farmers to the agro industry through the cooperatives in order to improve the bargaining powers of these farmers.
6. The government should help farmers or small agro-industrialists opening foreign markets through a learning process from the standards they need to abide by to the markets they can access.

VIII- Structural Reforms

Structural reforms are essential in any government program to spur investment and job creation and reaching a balanced growth and human capital development. The government will have to instill a policy to strengthen governance and transparency and an improved business environment in order for Lebanon to realize its full economic potential. Lebanon ranked 143 out of 190 countries in the International Finance Corporation's Doing Business Indicator for 2019, with Lebanon's best ranking on the property registration sub-indicator at 110. The major weaknesses are lengthy procedures in all sub-indices and a major weakness in the implementation of the rule of law to enforce contracts. The government has recently introduced a major overhaul to the code of commerce, which constitutes a good step forward, however not enough in the current circumstances.

In order to tackle the structural problems of the country, it is important to analyze the size, shape and responsibilities that we want the government to provide. Without having an ideological background on the type of government and society, and it should not be taken as a taboo, it is important to lessen the Lebanese government role to the maximum. The issue is that we have to accept that we are living in a third world country. And in these types of countries, the rule of law and government management of public enterprises, do encompass major inefficiencies due to political interference and impediments linked to cronyism. If we were living in a Scandinavian country or in France, I would vote for a welfare state because the government is efficient and is providing its citizens with all the needed services at a very high quality against imposing high tax rates on their income.

Moving from a third world country to a first world country does not happen overnight. Singapore had an "enlightened dictator" and it took the country 30 years to climb up the ladder. Therefore when understanding the fact that fighting corruption and restoring the efficiency of the public sector is not an easy task, we can accept to streamline the government and give the private sector a more important role, while ensuring the right regulatory framework. This is the ideal solution for Lebanon in the current circumstances, until we reach our target to become a developed country.

1- Energy Sector

The government has already prepared an ambitious plan to reform the energy sector, aimed at addressing inefficiencies and eliminating losses in EDL, but this plan should be accelerated and a regulatory authority should be appointed as soon as possible. Structural weaknesses in the energy sector have remained unaddressed since 1993, and they include but are not limited to pricing policies, technical and non-technical losses, and supply and demand management. If the government delivers the improvements needed, it can make Lebanon's energy sector an engine of growth rather than a burden on the economy. Tariffs are below the production costs, which are exorbitant as EDL is using fuel to produce electricity, hence indicating implicit subsidies provided by the government. The latter has already started to

address these shortcomings through the electricity plan that was put in place with the help of the World Bank.

Structural milestones in the electricity plan should be put in a schedule with monthly updates to the public and to the council of ministers. The plan has to include the steps to implement on different fronts in order to get to a 24/24 electricity by end 2020 or mid-2021, at the latest, while having a profitable company. EDL should get into a public private partnership in order to improve its management by bringing in a strategic investor on a revenue sharing basis.

The government should adopt a policy that protects, to a certain degree, low-income households from an increase in energy prices. The increase in tariffs for households consuming up to 200 kwh per month has to be minimal, if any, compared to the increase for higher tranches. Manufacturing industries should also benefit from low tariffs to reduce their input costs in order to encourage exports. The use of gas for producing electricity in the near future by using Floating Storage and Regasification Units (FSRUs) will help solve this problem by reducing the cost of producing electricity. Hence EDL will be able to reach its targets through a lower increase in tariffs.

Power sector reform in a nutshell

Saying that with the accumulated deficit of Electricité Du Liban (EDL: the government owned power generating company), we would have built many electricity generation plants is a populist declaration that is deviating concentration from the real problems of EDL. Any new production facility will be in deficit with the current situation of the electricity sector and the current tariffs structure. Even if we auctioned a new power generation facility, this entity will need fuel to function, especially in the absence of FSRUs, and will be in deficit as the cost of production is higher than the pricing of Electricity to users. The average cost of producing electricity is around 15 cents/kwh at EDL.

Moreover technical losses due to transmission, stealing electricity, and uncollected bills will add substantial amount to the deficit. Technical and non-technical losses amounted to 38% of the generated power. Transmission losses reached 17 percent while distribution losses due to stolen electricity and uncollected bills registered 21 percent in 2018. Hence adding these costs to the generation costs will lead to a total cost of 21 cents per kwh.

When comparing the average tariff rate set by EDL with the actual cost of producing electricity, the situation becomes clearer. The average tariff rate for EDL power was set in 1994 at 9.5 cents per kwh and was never changed since then when the price of an oil barrel was at USD20. Comparing this tariff to the cost of 21 cents per kwh, the deficit of EDL will go up to more than USD1.3 billion.

The roadmap put in place by the ministry of energy in cooperation with the World Bank is a good one. The roadmap will comprise: (i) reducing the cost of producing electricity through the establishment of FSRUs and the shrinking of technical and non-technical losses; (ii) providing electricity 24/24 in the near term; (iii) Increasing the tariffs for higher tranches in order for EDL to start making profits and be self-sustainable.

However it may be more appropriate to introduce some adjustments in order to better the plan. Experts are aligned on the fact that Lebanon needs one FSRU and not two let alone three. The only reason that justifies having two FSRUs is if the cost of laying of gas pipelines from the north (Deir Ammar) to the south (Jiyeh) of the country is equal or higher than the cost of an FSRU. The other remark is the long time it is taking to appoint a new board for EDL and the regulatory authority for the sector. These should be appointed as soon as possible, at the latest one month after the formation of a new government.

The efforts deployed by the ministry to date, to reduce technical and non-technical losses are important. The ministry started the implementation of the Transmission Masterplan endorsed by the government in 2017 with the most critical part of the plan, namely the Mansourieh part, already in place. The ministry is also ahead of the plan in reducing non-technical losses by improving collection and decreasing electricity theft from the grid.

2- Education

The Lebanese government is spending large amounts of money on education, without being able to provide its citizens with adequate quality. The number of teachers in public schools is high and reaching alarming levels without providing the right quality to students. Overall pupil to teacher ratio stood at 7:1 in Lebanon's public schools (for Lebanese students), while it is at 21:1 in the private sector. Public schooling embraces weak quality control and frail teaching that need to be reformed urgently. Restructuring the existing public schools is fundamental as many are non-efficient and only increase the education costs. The repetition rates are much higher at public schools than in private schools and dropout rates are also important, especially at the primary level.

Lebanon needs to go for a twinning with a developed country like Finland in order to put in place a model school; however the government will continue to finance public schools. As the country has failed to create a high educational level at public schools, the government can turn to the best educational system in the world these days, namely the Finnish system. A model school managed by the Finnish (or any other developed country system with excellent public education) has to be shaped and all other public schools have to be benchmarked against this school. If public schools are not capable of matching the level of this model school, then the Finnish will be given the opportunity to manage all the other public schools. In this case, the government will be paying for public education but it will be providing its citizens with an upgraded service that the users will surely appreciate.

Least but not last, the education system should be overhauled to fit the needs of the labor market. Education should start to be more focused on the knowledge economy and vocational education. A partnership should start to emerge between the Lebanese public education institutions and the stakeholders in the different Lebanese sectors in order to cater the education towards the needs of the economy.

3- Health

On the health front, the country will have also to turn the private sector to manage public hospitals. It showed that appointing boards to public hospitals is not enough to ensure a better performance especially that most of the time the financing is not adequate. Treating public hospitals the same way the government is paying private hospitals is the only solution to improve public health services. The government should provide the management of the public hospital to foreign entities from the developed world with key performance indicators out in place to measure the performance of these entities.

Turning to the private sector for management will help the government get out of the current high cost – low quality of public hospitals. Healthcare expenditure reached USD4.39 billion in 2018,

representing 7.6 percent of Lebanon's GDP. In addition, per capita spending on health was calculated at USD640; high by regional standards. Government healthcare expenditure constituted 51 percent of the total or 4.1 percent of 2019 GDP with the private sector holding the remaining 49 percent share. The market is forecast to grow by 4.5 percent in 2019, reaching USD4.59billion by 2023. Spending on healthcare is expected to reach a value of USD5.90B, experiencing a local currency CAGR of 6.1% in US dollar terms.

4- Telecommunication

The main issue in telecommunication sector is to set a medium term goal in order to put Lebanon on the map of major advanced economies in the sector. The goal will be to rank among the top three countries in the world having the fastest broadband fiber optics internet connection. What is more important than having this connection is to widen it to cover the whole country and especially the rural areas. It is important to reduce the cost of starting a business related to the knowledge economy by not having to incur the costs of implementing the business in Beirut. Providing the right infrastructure for the skilled Lebanese labor should be a top priority for the government.

The telecommunication sector still has a long way to go, as the poor infrastructure of the sector keeps on hindering the quality and speed of internet connections. Even though fiber optics is already installed in big cities but not yet operational, Lebanon actually relies on copper cables to have access to the internet. However, these cables have limited capacity in terms of data transfer and speed. Based on the latest data released by Akamai, a global provider of content delivery network services, the average connection speed in Lebanon stood at 1.8 Mbps in Q2 2016, compared to 4.0 Mbps in Egypt and 4.3 Mbps in Jordan. South Korea topped the list with an average connection speed of 27.0 Mbps and was trailed by Japan (17.2 Mbps) and the United States (15.3 Mbps). It was also noticeable that, while the global average connection speed grew by a yearly 14 percent in Q2 2016, Lebanon's slipped by 0.8 percent over the same period.

Another major issue faced by the ICT sector in Lebanon is the lack of competitiveness due to the government's tight control over the sector. Despite the sequential declines in communication prices since 2014, the fact that both telecom companies Alfa and touch are publicly owned entities, operated by private companies for the benefit of the government, creates a sort of duopoly agreement between the two companies. According to World Bank sources, "limited competition in telecommunications and broadband is stifling growth of the sector. The fixed-line and broadband market sees the dominant position of Ogero, while the mobile sector, unlike most countries in the world, is under the control of the government." Besides inhibiting growth and innovation, government control is keeping tariffs high and limiting product differentiation. According to Arab Advisors Group, Lebanon ranked 17th in 2015 out of 19 Arab countries in the Cellular Competition Intensity Index.

5- Fighting corruption and improving competition

Anticorruption has to be strengthened. A coordination committee between the different institutions dealing with anticorruption has to be put in place. All government's employees or in government related institutions have to lift banking secrecy on their accounts in Lebanon and abroad. Auditing of these accounts has to be performed by the committee and related agencies.

Currently, there is a competition law but there is no enforcement of the law, especially on politically backed oligopolistic sectors. A competition Authority has to be created and will coordinate with the regulatory authorities in different sectors.

The Lebanese industrial or agro-industrial private sector has to be protected against unlawful competition. This competition is harming the local productive sector through under-invoicing of imports especially from Turkey and China. Besides these countries, the government may also provide protection for domestic producers against competition from other countries. However a different approach to customs has to be adopted. Both ministries of industry and the ministry of economy have to identify the domestic sectors that should be given some protection and will have to look into the details of which domestic products are being at risk in order to take the right decision.

A case in point for showing the right way of protecting domestic products will be the wine industry. The protection of domestic wine should not entail increasing custom duties by an ad-hoc percentage on all imported wine. Rather it should put a minimum tax of USD10 dollars on any imported bottle of wine as the Lebanese wine price in Lebanon vary between USD5 and USD 50 dollars per bottle. So it is the low cost imported wine that is causing harm the most to the domestic wine. Hence a percentage increase of the customs duties on imported wine will not serve the purpose. A minimum charge in this case is the solution.

The Judicial system has to become independent. The government has to pass a law to provide independence to the judicial system. The supreme judicial council has to be elected by the judges. At the same time, banking secrecy has to be lifted on judges in order to be able to fight corruption in the judicial body.

6- Privatization

The government has to initiate the privatization process of the Telecom companies. The higher council for privatization will have to coordinate with the Telecom Regulatory Authority (TRA), which has to be appointed as soon as possible, in order to prepare for the privatization of the two telecom companies.

The best privatization strategy will have to bring in both citizens and strategic investors along with the government. It will serve three purposes: to develop capital markets, to give ordinary people a stake in the company to be privatized, to ensure better management and higher future profits by bringing in a strategic investor. This strategy is based on the fact that the government will do an IPO for a certain percentage of the company open to the public. Therefore people will get a share of the profits while the strategic investor

and the government will divide the remaining share. The government will continue to collect the taxes on the sector and will keep a share in the company; however it will be a minority share.

Saying that the government should not privatize companies that are providing large profits to the Treasury is not an accurate statement. The privatization of the telecom companies will help reduce government debt by more than USD6 billion in one shot (in our scenario, the privatization of the two mobile companies will take place in 2021), in addition to the fact that it will enhance the management, and will reduce political interference. Services will improve and prices may decline while key performance indicators will be set for the companies to implement government strategy, mentioned above, in the telecom sector.

7- Other structural reforms

The other structural reforms that the government will have to undertake are summarized below and will entail improving the management of public enterprises by strengthening their governance, transparency, and efficiency in order to prepare these entities to get in a partnership with the private sector:

- **Increasing transparency in all public enterprises or semi-independent public institutions.** There should be an external audit for all the institutions that were not previously under the umbrella of the Court of Audit, even those that have to be liquidated: Council of the South, Council for Reconstruction and Development, the Displaced Funds, Casino Du Liban, Middle East Airlines, Electricite Du Liban... All public enterprises that will remain in the hands of the government and won't be privatized will have to go under the supervision of the Court of Audit.
- **Provide a better legal framework for public enterprises to simplify the process of privatization.** The authorities will have to present to parliament the necessary laws in one year time that will modernize and clearly define the role of the government as owner, regulator, and shareholder of these public enterprises.
- **Issue implementation decrees for passed laws.** There are a large number of approved laws by parliament for which the government didn't yet issue implementation decrees. Some of these laws has been passed in parliament years ago and implementation decrees haven't been issued yet, which means that these laws are still not applicable yet. These comprise important laws such as the trade law and the government has to set a time frame that won't exceed 6 months in order to issue the implementation decrees for all approved laws.

- **Improve the business environment:**
 - Trading across borders has to be improved while fighting corruption. Modernizing the processes for imports and exports related activities is crucial to shorten the time needed and reduce bribery and tax evasion. This will include reducing custom-related processing time and reducing hours to prepare import/export documents.
 - Enforcing contracts time has to be shortened. Currently the rule of law is not well enforced and when it is, the time needed is 720 days. The amount recuperated is 31% of the claimed value and the judicial processes remain archaic most of the time.
 - Streamlining Procedures to start a business. The government should move forward in simplifying procedures by adopting e-registration and streamlining the required documentation as it needs currently 15 days, 8 procedures, and costs 42% of income per capita to start a business.

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