2019 Lebanese Revolution

ENDING THE YEAR WITH HOPE

WEEKS 8 - 10

annd
Arab NGO Network for Development
شبكة المنظمات العربية غير الحكومية للتنمية

Political Updates:

The protests in Lebanon have continued since the eruption of the Revolution on 17 October 2019, with unprecedented levels of violence during the reporting period. Please refer to ANND's News Bulletin I for information on the first month of the revolution, and News Bulletin II for further socio-economic and fiscal analyses, as well as an update on the three following weeks. Since the resignation of the government on 29 October in response to the protestors' demand, the President failed for almost two months to host the parliamentary consultations to nominate a new Prime Minister (PM), hopefully capable of forming a new government that pleases the protestors, as well as the different and entrenched political components. This was on one hand due to the deep conflicts present among the different political parties on the ideological and practical levels including the diverse visions of the economic, fiscal and social situations, and on the other hand, due to the inability to envision the form the upcoming government will take, either a government formed by technocrats, techno-politicians, or solely politicians.

Following two adjournments, the mandatory consultations took place on 19 December, and concluded with the assignment of Dr. Hassan Diab as PM. The designation was highly denounced by protestors who refused the process of the nomination as well as the profile of Hassan Diab is not perceived as an independent figure, and who is believed to have certain close ties with some political parties, which constituted the majority that nominated him. Certain political parties and components also refused his profile for similar reasons, and for lacking the Mithaqiyya [Charter] by not gaining the majority/or enough of the Sunni votes during the parliamentary consultations.

Since his appointment, Diab has put strong efforts in trying to form a government before the end of the year, with ultimate claims of pleasing the protestors by nominating technocrats and independent ministers. However, sectarianism that is rooted in the system and among politicians has obstructed for years the formation of an effective government capable of taking the necessary measures to overcome the economic and financial crises within a clear vision, and will probably do the same this time. This main fact will remain contested by the protestors who will celebrated the new year in massive revolts and festivities, while on the lookout for any attempts of forming a deceptive government.

Socio-Economic Updates:

The economic and social conditions have become direr with the worsening financial and liquidity crises. The informal and illegal capital controls arbitrarily enforced by banks have continued to tighten, further imposing restrictions on individuals who are not even able to freely withdraw their money and salaries from the current and savings accounts. With the increase demand of foreign currency (USD) in this very dollarized country, the real price of 1 USD in the market has been hovering around 2000 LBP, much higher than the official rate of around 1507 LBP. This difference has increased the rate of inflation and the prices of all goods, and hence decreased the purchasing power of households, especially whose earnings are made in the local currency.

With the increased fears of losing their savings and money, and the potential restrictions the banks might further impose, protestors have continued to organize strikes inside and outside banks across the country, as well as in front of Banque du Liban (BDL) in a very structured manner. They are demanding one, a clear, fair and legal control of the capital, which excludes small depositors, two, the burden to be carried by big depositors and those who have made fortunes as a result of the financial engineering, and three to restructure the public debt and negotiate with lenders, mostly local banks.

Human Rights Violations:

The postponement of the parliamentary consultations from 9 to 16 December, and later to 19 December was coupled with increased incidents of violence and clashes among protestors, supporters of political leaders, and the security forces and army. The most violent clashes were recorded between 10 and 16 December: on 10 December, protestors toured in their cars outside the houses of the previous Ministers of Public Works and Transport, denouncing the poor infrastructure that has caused enormous rain floods on main roads and the highways, which locked citizens for hours in their cars; this is when protestors were attacked ferociously by men dressed in uniforms of the Internal Security Forces, but who are indeed affiliated with some political parties. The cars were vandalized, and protestors were dragged out and beaten indiscriminately, including journalists.

Moreover, on the nights of 14 and 15 December, the security forces clashed with the supporters of political parties who provoked and attacked them in different ways. On the same nights, security forces arbitrarily attacked protestors gathered in Beirut, and fired tear gas and rubber bullets against them, in retaliation against the acts of some. These two days of violence were concluded by the arrest of 23, some of whom showed signs of torture after their release. More than 76 protestors reported a form of attack, either by security officials or as a result of the rubber bullets fired against them; and more severely, a few reported being dragged inside the parliament place and beaten by the security forces at the parliament. A few reported the theft of money, legal documentation or phone.

Violence continued until the night of 16 December, with the supporters of political parties attacking the protest squares in Beirut and the South, and burning down tents and cars. This has come in response to a video, probably intentionally spread on social media, of a young man from Tripoli cursing the Shia faith.

Lebanon Under the Tutelage of the International Monetary Fund? Cases from other Arab Countries

On 17 October 2019, demonstrations took place in several Lebanese cities as the result of an acute economic and fiscal crisis in the country due to the failure of the financial and economic policies pursued for decades. On the monetary level, the Lebanese state adopted the policy of fixing the lira since 1997, provided that one dollar equals about 1,500 Lebanese pounds.

This policy constituted a burden to compensate for the price difference between the dollar and the lira while the country was not economically productive. The central bank, Banque du Liban (BDL) spent the hard currency available to maintain the exchange rate and resorted to borrowing from private banks, and thus the domestic debt increased. Public debt currently amounts to roughly 86 billion USD (excluding the financial dues of public institutions including the National Social Security Fund), equivalent to 150% of GDP. The current crisis was manifested in a significant decline in the usable cash reserve in the last two years, reaching 19 billion USD in the current year, compared to 25.5 billion USD in 2018. Experts attribute this decline to the decrease in individuals' deposits (the diaspora) as the result of lack of confidence in the local economy, along with declined investments from the Gulf. Recently, Fitch Ratings downgraded Lebanon to CC, one degree before default. This led some political officials to talk about the limitations of internal solutions, and the urgent need for external financing by the International Support Group for Lebanon, the Cedar Conference, or others. In this context, the Lebanese Prime Minister discussed on 12 December with the Worldbank and the International Monetary Fund (IMF) the possibility to technically assist Lebanon in formulating a rescue plan to save the economy from a deeper crisis. This has been also echoed by some Lebanese economists who are even calling to resort to IMF funding.

To better understand the IMF programs and their repercussions, this article will review the results of the IMF interventions in some Arab countries in the eighties of the last century, and will shed the light on the reform programs implemented in Egypt and Tunisia after the Arab Spring, including the public policies recommendations and their social and developmental impact. This analysis is based on papers prepared by the Arab NGO Network for Development (ANND) through its constant monitoring since 2011 of the IMF programs in the Arab region.

The history of the IMF in the Arab countries

After the Arab countries witnessed economic growth and improvement in social indicators during the sixties and seventies of the previous century, the eighties witnessed an economic decline due mainly to the drop in oil prices and a decline in investments. This crisis led to the adoption of structural economic reform programs that were supervised by the IMF and the WorldBank. The reforms were predicated on the "Washington Consensus" principles, which represented the standard package for developing countries wracked by crisis, including: stabilization measures and reduction of government spending, imposition of new tax policies, unfair trade liberalization, and privatization of state-owned companies. Through this intervention, the IMF has become an essential partner in policy-making in the Arab region. The IMF reforms and measures were of a purely economic nature based on the theory of the Trickle Down effect, which provides that economic growth and the promotion of business and investments will lead to economic growth in the short term and will benefit society by creating job opportunities at the long run. Numerous studies have shown that economic structuring programs have stimulated economic growth in some Arab countries, but have widened the inequalities and exacerbated poverty among fragile social groups.

Consequently, the IMF conducted a critical review of its economic approach, which was reflected in 2011 after the Arab uprisings. As such, the Fund's intervention began to address social inclusion and social protection networks in order to protect social groups from the negative repercussions that accompany the Fund's policies. Was this change in the IMF narrative reflected in a real change? What were the results of the programs implemented by the IMF after the Arab Spring?

Egypt and Tunisia's Experiences

In November 2016, the IMF lent Egypt around 12 Billion USD to ensure macroeconomic stability and support inclusive growth. The objectives of the loan included correcting the trade imbalance, re-encouraging competition, stimulating growth and creating job opportunities. The loan was accompanied by a project of reforms implemented by the Egyptian government as part of the Extended Fund Facility, which included a wide range of reforms on a public policy level, such as:

- **Liberalizing the Egyptian pound exchange rate and subjecting it to market determinants, which led to a significant devaluation of the currency. The devaluation had a positive impact on investors, but it led to an unprecedented rate of inflation (30%), and an increase in the prices of imported materials, whereby costumers had to bear the burden of the currency devaluation in a country that relies heavily on imports of food and agricultural products.**
- **Raising the value-added tax from 10% to 13%, excluding on the primary foods. This raising this tax contributed to reducing the purchasing power of the middle and poor classes.**
- **Lifting subsidies on basic commodities to reduce government spending. This led to an increase in the price of oil from 30% to 47% in November 2016, which greatly affected the prices of food and transportation as well as the price of medicines.**
- **Fixing the wage bill as one of the basic recommendations of the IMF to ensure financial stability, and this was done in Egypt through the approval of Law 18 of 2015 that allows the Egyptian state to terminate contracts or reduce wages to 50% after evaluating the performance of employees. This law turned the Egyptian state into an administrative body looking on reducing costs without taking into consideration the social impact on employees.**

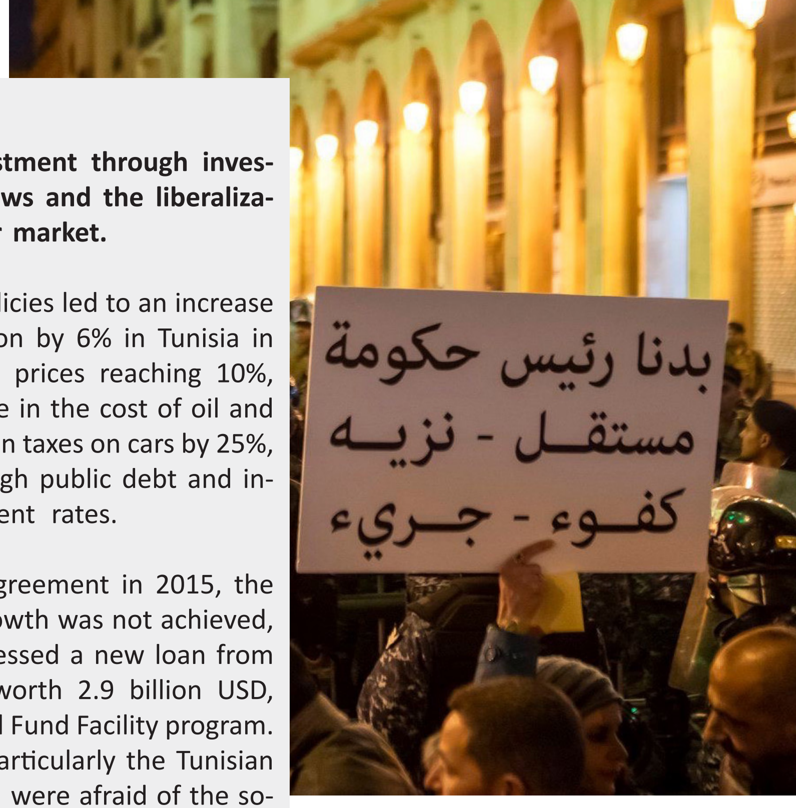
It should be noted that the spending cuts mainly aim to secure the payment of debt maturities. However, while the IMF also indicates that the sums saved must be allocated to social protection programs that target the poor and the elderly, the part related to social protection remains the weakest and the least obligatory under the IMF's programs.

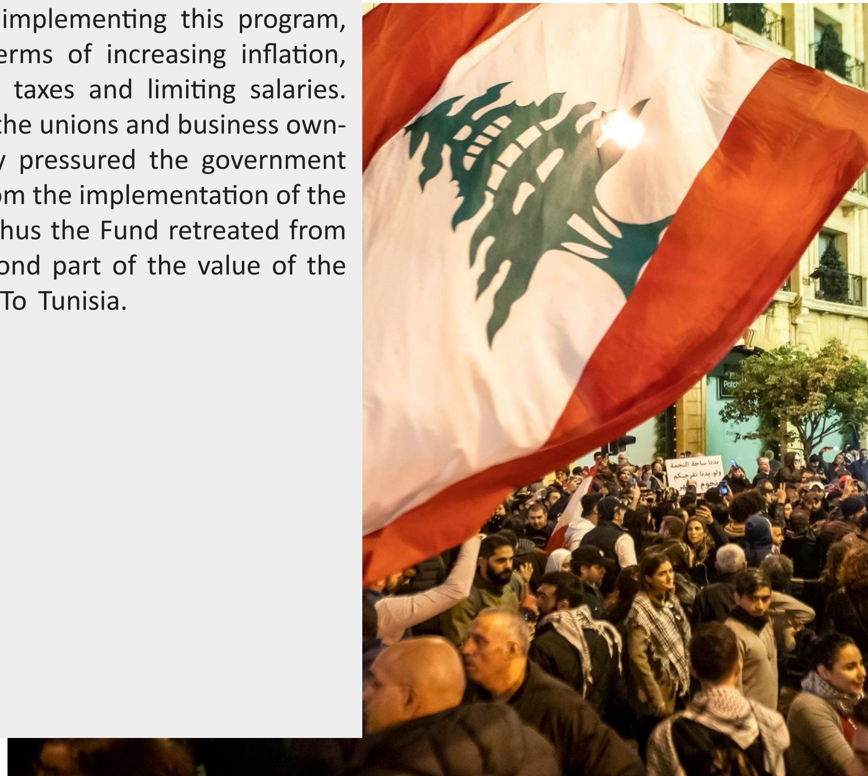
As for Tunisia, the Tunisian government's negotiations with the IMF led to signing the Stand-By Agreement during the month of June 2013. The IMF discourse in the Tunisian case gave great importance to the social aspect and to addressing unemployment as priorities for intervention. However, upon signing the agreement, these claims turned into economic structural reforms similar to the typical packages of the IMF recommendations, and specifically included:

- **Reducing public spending on wages and subsidies.**
- **Reforming the tax system by increasing indirect taxes and reducing taxes on investors.**
- **Privatizing the state-owned companies.**
- **Supporting investment through investor protection laws and the liberalization of the labor market.**

Once again, these policies led to an increase in the rate of inflation by 6% in Tunisia in 2013, with a rise in prices reaching 10%, as well as an increase in the cost of oil and electricity, and a rise in taxes on cars by 25%, accompanied by a high public debt and increased unemployment rates.

At the end of the agreement in 2015, the desired economic growth was not achieved, and thus Tunisia accessed a new loan from the Fund in 2016, worth 2.9 billion USD, through the Extended Fund Facility program. The Tunisians, and particularly the Tunisian General Labor Union, were afraid of the social effects of implementing this program, especially in terms of increasing inflation, raising indirect taxes and limiting salaries. Consequently, the unions and business owners successfully pressured the government to withdraw from the implementation of the program, and thus the Fund retreated from paying the second part of the value of the loan allocated To Tunisia.





Lebanon and the IMF

As for Lebanon, the country never received a loan from the IMF, even during periods of wars and occupation. However, the fund had an impact on economic policy-making in Lebanon through the article IV report, which is an annual report issued by the fund and provides economic and financial policy recommendations to the country. The fund supported the exchange rate peg, but warned for some time of the high cost of fixing the exchange rate of the lira. The Fund also considered that the financial engineering adopted by the BDL are not sustainable policies, and on the contrary that they increase economic and financial risks. Moreover, the IMF had a role in encouraging the shift in tax policies from direct taxes to value-added taxes in order to ensure financial stability. The IMF also highlighted the inflation in public sector employment, and focused on the importance of privatizing the electricity sector, suggested selling some public sector assets, and encouraged partnerships between the public and private sectors and restructuring and rescheduling the debt that may affect depositors.

Hence, resorting to the IMF to secure technical assistance may not provide new solutions. Most of the recommendations submitted by the fund were presented to Lebanon in the past and taken into account by previous governments, but in the event that the fund's financial assistance is requested, the financing that can be granted to Lebanon is estimated at 4 billion USD, given Lebanon's share in the fund. This loan may at best contribute to solving the monetary crisis temporarily, but in reality, it will be a follow-up to the borrowing policy adopted since 30 years, and more severely, it will increase the share of external debt, which is associated with economic conditionality, the consequences of which may be disastrous on broad social strata in Lebanon. Such an option is unacceptable in light of the unstable political situation and the loss of Lebanese confidence in their governments. A decision at this level, with potential serious social repercussions requires:

- **A government that has the confidence of citizens and the ability to negotiate with external partners and to prevail the public interest over the interest of the ruling elite.**
- **A long-term economic and social policy that addresses the root causes of the economic meltdown to avoid falling into the trap of external borrowing and its conditionality on the long run.**
- **Enhancing the means of national dialogue, and the participation of social groups in understanding the results of the IMF programs, so that there is active participation in taking these decisions, whereas imposing those measures on the people will persist political instability.**
- **Instant and immediate solutions that take into account the fair distribution of burdens through the application of progressive measures.**
- **Fighting corruption in all its forms, halting waste, tax and customs evasion by enhancing transparency and the independence of the judiciary and regulatory agencies.**

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Lebanese Banking Sector in the midst of the Financial Crisis: The Snowball Effect

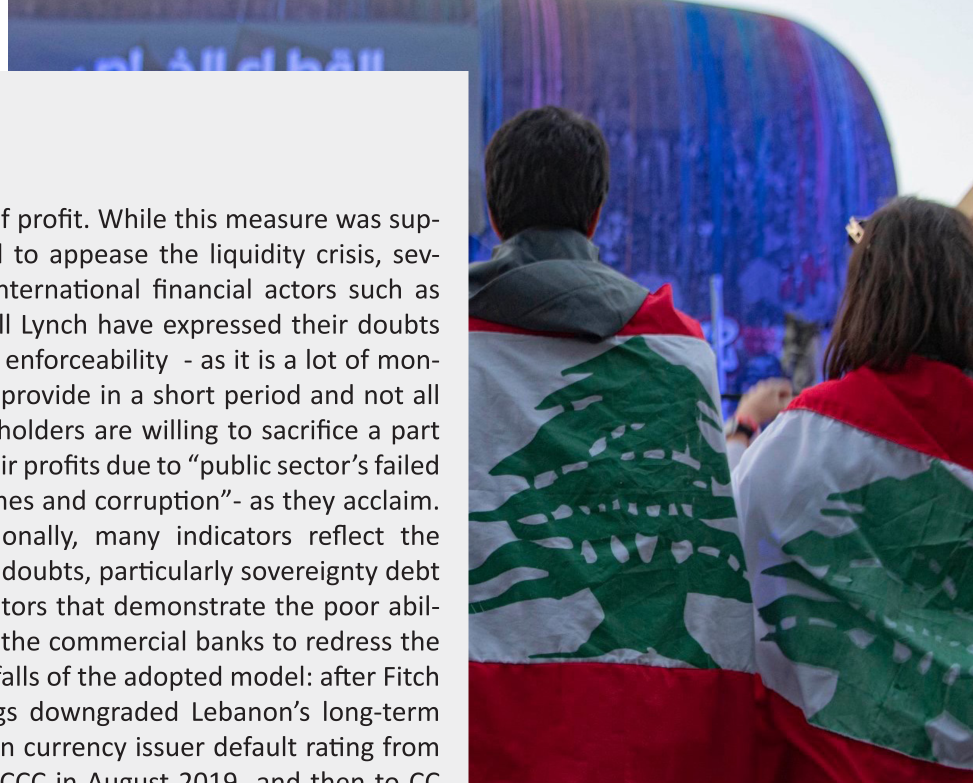
Lebanon has witnessed, since 17 October 2019, first of a kind countrywide non-sectarian protest. The uprisings emerged in response to the government's failure to find solutions to a multidimensional crisis that has been facing the country for years, tainted with a stagnant economy, high levels of unemployment and endemic corruption coupled with sectarian ruling. The financial crisis is at the heart of the problem and it is materialized by an important liquidity trap and a loss of trust in the overall banking sector, leading to a comprehensive economic crisis. The rapid escalation of the financial crisis, or to be more precise, its tangible manifestations pose several questions on the process that led to it and on the possible ways to remediate its socioeconomic effects.

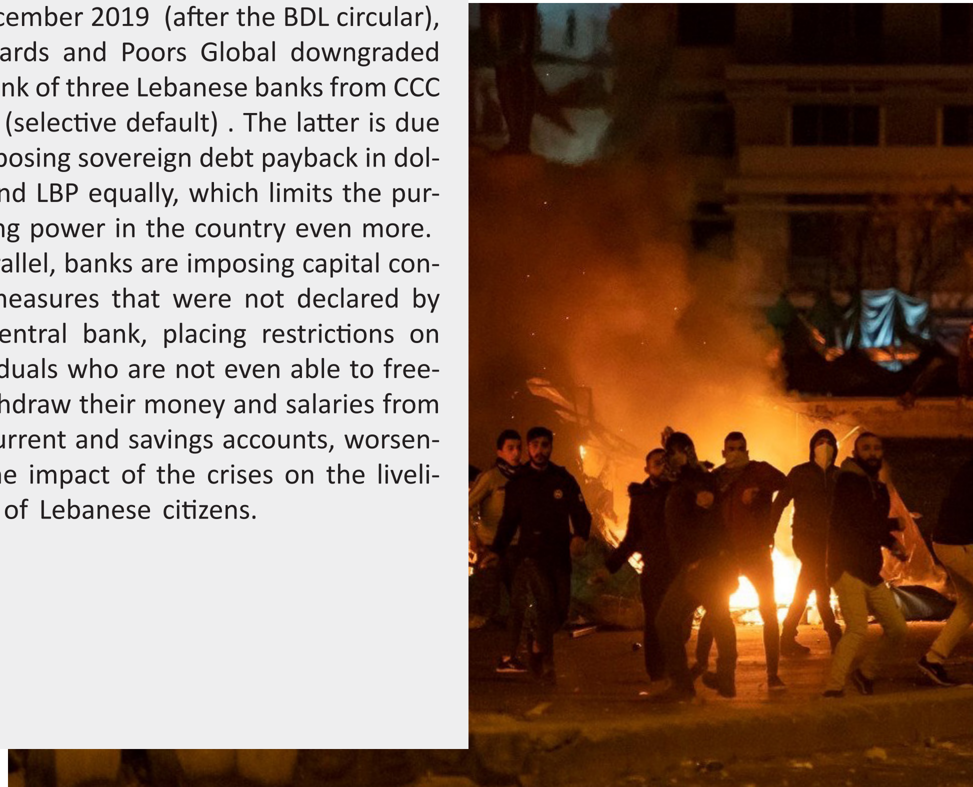
The foreign currency vacuum

During the last couple of years, the central bank (Banque du Liban – BDL) has adopted measures of financial engineering that primarily rely on the absorption of foreign liquidity flow and the shrinking of commercial loans, which lead to the increase of frozen deposits in both commercial banks and the central bank. However, how were those schemes implemented? Since 2016, the central bank rebought bonds from the commercial banks in Lebanese pounds and paid an average of 139% of the original price (meaning the price of the bond in addition to half of the interest gains that it would have achieved on its due date); consequently, commercial banks have gained 39% of immediate profit in average. In exchange, commercial banks have bought bonds in dollars and deposited certificates issued by the central bank with the same value of what the central banks had initially purchased in Lebanese pounds. The mentioned set of transactions is the major tool used to replenish the central bank reserves in foreign currency and is what allowed banks to incentivize more deposit savings in Lebanese pounds by offering tempting interest rates. Whilst heavy lending to the public sector became the "comfort zone strategy" for commercial banks, private sector lending became costlier and the internal commercial wheel slower. Several indicators speak volumes about the negative impact of the abovementioned monetary policy on Lebanese trade, more precisely the track movement of cleared checks indicating the decrease in liquidity: value and volume of cleared checks in LBP are higher than cleared check in dollars between 2016 and 2018 and the volume of returned checks in dollars increased in the last quarter of 2019.

"Band Aid" solution: is it effective?

Due to the aggravation of the crisis in the last quarter of 2019 and to the October Revolution, the central bank issued a circular on 4 November imposing an increase in the commercial banks capital by 20% through cash advance in dollars (10% before the end of 2019 and the other 10% by the end of June 2020), a prohibition on the distribution of profit. While this measure was supposed to appease the liquidity crisis, several international financial actors such as Merrill Lynch have expressed their doubts on its enforceability - as it is a lot of money to provide in a short period and not all shareholders are willing to sacrifice a part of their profits due to "public sector's failed schemes and corruption"- as they acclaim. Additionally, many indicators reflect the same doubts, particularly sovereignty debt indicators that demonstrate the poor ability of the commercial banks to redress the shortfalls of the adopted model: after Fitch Ratings downgraded Lebanon's long-term foreign currency issuer default rating from B- to CCC in August 2019 and then to CC in December 2019 (after the BDL circular), Standards and Poors Global downgraded the rank of three Lebanese banks from CCC to SD (selective default) . The latter is due to imposing sovereign debt payback in dollars and LBP equally, which limits the purchasing power in the country even more. In parallel, banks are imposing capital control measures that were not declared by the central bank, placing restrictions on individuals who are not even able to freely withdraw their money and salaries from the current and savings accounts, worsening the impact of the crises on the livelihood of Lebanese citizens.





To which extent should banks be held accountable?

While the described crisis is directly linked to the financial engineering schemes adopted by the central bank and in coordination with the government, all mentioned financial and rating indicators demonstrate the fragility of the fiduciary responsibility of commercial banks and raise questions about their prudence in employing citizens' money wisely for the last three decades, and not only since the schemes started in 2015. While commercial banks pin the blame on the level of corruption prevailing in the public sector, they have kept on investing most of their capital in sovereign debt and not as proportionally in the Lebanese private sector, in order to benefit largely from the gain in interest rates: banks invest 6.1x their capital in sovereign debt versus 2.1x as loans to the private sector . This pattern of behavior is noticeable since the start of the pegging of the dollar in 1997 and is highly linked to the level of bonds and loans given to politicians and people linked to the political ruling class in Lebanon.

Consequently, public claims stirred by the uprisings that target the ruling class should always keep in its accountability lens the banking sector as a main component, as well as the adopted financial paradigm, in order to promote and place pressure on sound and rights based financial alternatives.

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The Arab NGO Network for Development works in 12 Arab countries, with 9 national networks (with an extended membership of 250 CSOs from different backgrounds) and 23 NGO members.

P.O.Box: 4792/14 | Mazraa: 1105-2070 | Beirut, Lebanon. Tel: +961 1 319366 - Fax: +961 1 815636

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