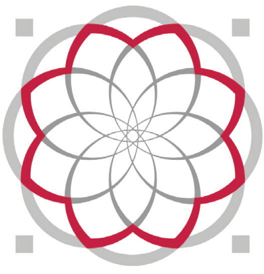

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Arab NGO Network for Development
شبكة المنظمات العربية غير الحكومية للتنمية

IMF and Lebanon:

Making the vulnerable pay the price

Policy brief

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In recent years, the International Monetary Fund has been giving increasing attention to inequality. This has materialized by its fiscal monitor report in October 2017 entitled "tackling inequality" where it explicitly called for more progressive taxation systems. The report notes that "in developing economies, fiscal redistribution is much more limited, reflecting lower and less progressive taxation and spending and greater reliance on regressive indirect taxes", it further adds that "at the top of the income distribution, marginal income tax rates that increase with income levels can achieve greater progressivity" (IMF, 2017a). The report even states, in a very timid manner through a footnote that can go unnoticed that the reduction in inequality may lead to a higher growth (IMF, 2017a). This development in the IMF discourse is welcome, but it is yet to be concretized, especially for developing countries as IMF policy recommendations in many of them suggest other conclusions than the one stated in the said fiscal monitor. In this regard, a brief review of IMF policies and recommendations for Lebanon can help us shed light on their impact on inequality. Therefore we examined the published Article IV report for Lebanon (2006 – 2016) and attempted to assess what they mean in terms of income and social inequality.

Income Inequality:

The IMF's supervisory role exercised on Lebanon under Article IV mainly focuses on macro-economic and macro financial stability, as well as public debt management and reduction. The main focus of IMF policy recommendations have centered around monetary and fiscal policies to enable Lebanon to preserve macro-financial stability through the Central Bank policies and the banking sector in general, as well as debt reduction through "fiscal consolidation" to prevent public debt from bloating any further. From this point of view, the IMF never addressed the fundamentals of the Lebanese growth model and only treated inequality from a narrow instrumental point of view which is to "generate political support for the needed fiscal consolidation" (IMF, 2010). This expression has been repeated in all Article IV reports since 2010.

According to the IMF, the traditional drivers of growth in Lebanon are real estate, construction and tourism (IMF, 2014, 2015, 2016). Lebanon witnessed periods of high growth from 2008 to 2010 where "real GDP rose 9 percent in 2009 backed by a confidence rebound and large capital inflows, which fueled activity in the construction, tourism, commerce, and financial services sectors" (IMF, 2010). The appraisal of the fund affirmed that the economy has performed "remarkably well". Nevertheless, the IMF did not note that this period of "buoyant economy" (IMF, 2010) was not the fruit of the authorities' sound policies. On the contrary, it was a by-product of the financial crisis that hit the globe causing deposits to flow into the country to reap profits from high interest rates and the different financial policies employed by the Central Bank and lauded by the IMF. The latter only commended the authorities for shielding Lebanon from the crisis. Adding to that these drivers of growth are also drivers of inequality as the fruits of this performance only accrue to a minority. This is particularly striking for real-estate and construction activities which were fuelled not only by deposit inflows but also by Central Bank's circular 313 subsidizing housing loans. This is illustrated through several aspects: first, the inflow of deposits caused the skyrocketing of real estate prices enabling developers to make extraordinary profits. Second, public institutions directly contributed to inflating these profits through a mechanism of reverse redistribution using subsidized housing loans, thus, channeling public funds to finance real estate development and banking. Third, bank deposits reached 360 percent of GDP with heavy concentration in the hands of few depositors illustrating the inequality effect of the adopted monetary policies based on attracting foreign deposits. In fact, 0.8 percent of depositors control 51.8 percent of deposits, and 60.5 percent of depositors control 0.5 percent of deposits (IMF, 2017). Nevertheless, the IMF in its reports continues to support the adopted monetary policies, especially high interest rates in the name of maintaining the currency peg.

Upon the outbreak of the Syrian crisis, the Lebanese GDP plummeted as the "traditional divers of growth" were severely affected (IMF, 2014). The fluctuation between extraordinary growth and recession demonstrated that exogenous

factors are the main influencers to economic performance in Lebanon. Nevertheless, the IMF never proposed measures to remedy this situation. Fiscal consolidation was the main cure proposed by the IMF to address vulnerabilities over the years. Thus, during high periods of growth, the Fund called for counter-cyclical policies, and during periods of recession it called for pro-cyclical policies, as austerity remained the guiding of such policies. This inconsistency, not only contradicted the fund's own predicaments calling for counter-cyclical fiscal policies (IMF, 2017b), but also may have contributed to further inequalities.

The IMF's repetitive calls for fiscal consolidation and adjustments consist of several main measures that led to deepen inequality. The fund has insisted that one of the main causes of fiscal vulnerabilities is the public wage bill. Thus, it insisted that Government's plan in 2006 for fiscal consolidation through "the containment of the wage bill over the medium term through limiting government hiring, freezing wages in real terms, and reviewing the salary and benefit structure" (IMF, 2006) was consistent with staff's recommendations. Furthermore, the recently released statement for the Article IV mission stated that "there is scope to contain personnel spending and undertake a civil service reform. This would reduce expenditure rigidity and create fiscal room to strengthen the social safety net to increase protection of the vulnerable" (IMF, 2018). Thus, the IMF is proposing to reduce personnel spending, i.e. pushing public servants to unemployment. Furthermore, in previous years, it had cautioned the government regarding the implementation of the new salary scale for public sector workers insisting on the need to continue to freeze wages. Public sector wages haven't been adjusted since the early nineties and their real value has decreased over years as a result of inflation. The IMF even went further and implicitly called for the non-adoption of public budget in view of avoiding deficit. The 2011 Article IV report stated that "staff argued that implementing the budget would interrupt a decade-long record of primary surpluses and a reduction in the debt-to-GDP ratio since 2006. This would send a negative signal to markets at a time when public finances are increasingly coming under scrutiny around the world and thus risk jeopardizing macroeconomic stability" (IMF, 2011). These kinds of calls were repeated in several reports supporting the Government spending based on the 2005 budget, which undermines democratic and parliamentary oversight on the government that was spending without a legal basis from 2006 to 2017.

The IMF did not only tackle public sector wages, but also warned against minimum wage adjustment for private sector workers calling for "limiting government interference in private sector wage setting" (IMF, 2011). The fund also deemed that "high remittances and education costs contribute to voluntary unemployment by keeping reservation wages high" (IMF, 2011). In other words, the IMF called on job seekers to demand lower wages in view of reducing unemployment. The views on wages in the public and private sectors, if implemented, do not only lead to further income divide in the country, but also demonstrates that the IMF did not concern itself in addressing the issue in a meaningful way. In 2014, the top 1 percent of Lebanese controlled 23.4 percent of income, the top 10 percent controlled 57.1 percent of the income, while the bottom 50 percent controlled 10.6 percent of total income in Lebanon (Assouad, 2017). The IMF policies on wages and reducing personnel cost in the public sector in order to reduce deficit and better service public debt would mean reducing the income share of the bottom 50 percent and channelling them to the top 1 percent who also control deposits that finance the government.

Social Inequality:

In its quest to guide the Lebanese authorities on preserving macro-financial stability and debt reduction, the IMF addresses the Lebanese social protection systems in several ways. As mentioned before, the IMF calls the Lebanese government on strengthening safety nets, especially the World Bank funded National Poverty Targeting Program (NPTP), in order to harness support for fiscal consolidation measures. It specifically calls on reforming the electricity sector and public sector in general as well as reforming private and public sector pension systems. These two sets of recommendations will highly weaken both informal and formal social protection systems in Lebanon.

The cost of the electricity sector is due to the structure of its labor force, the majority of which consists of clientalist hiring, as well as the subsidies reducing the consumption bill. Moreover, "inefficiencies" in the public sector and the significant wage bill are partly due to clientalist

distributive practices to strengthen loyalties to the ruling parties. Such practices constitute an important pathway to provide a degree of social protection while consolidating political and sectarian loyalties. In the post-war period, and following the freeze in public sector employment, there has been a mushrooming in informal employment in state institutions in the form of hiring daily workers. They present a case of a highly vulnerable employment, where workers are paid by day without benefiting from social security or any other labor right. In some cases, the number of daily workers has surpassed those of civil servants in some public institutions (Kobaissy, 2012). Clinetelism generated by sectarian welfare functions as an informal redistributive and protective mechanism replacing state welfare and fiscal redistribution (Abdo, 2018). This manifests itself in health care provision, employment and education. Ignoring these realities, the IMF staff "underlined the need to implement electricity reform to improve service provision and reduce the EdL's drain on the budget, embark on strengthening social safety nets" (IMF, 2015). This trade-off proposed by the IMF illustrates the way it overlooks the dynamics imposed by the Lebanese political economy through recommending a simple reallocation of resources. Such measures would increase unemployment, reinforce vulnerabilities and could not be treated with reinforcing the already flawed social safety nets programs. The IMF could have proposed a universal social protection system based on rights rather than only targeting the extremely poor. Nevertheless this would require redistributive measures that the fund shies away from proposing.

Through tackling fiscal consolidation and inequality, the IMF insists on placing its costs on labour. It calls for reducing inequality through measures of reallocation and not redistribution. As mentioned above, it proposes to reallocate funds from one form of social spending to the other without approaching the shares of profit. Furthermore, in its quest to increase revenues, the fund insists on tapping on universal and flat forms of taxation through calling to reintroduce excise tax on fuel and increasing it on other products, as well as increasing the regressive VAT tax. Moreover, it proposes to the authorities to reform the pension system in both private and public sectors. For the former, it commends the proposal of the World Bank to replace the end-of-service indemnity with a proper pension system. Nevertheless, it does not mention that the mentioned proposal consists of a system of capitalization, and not solidarity, with defined contribution and not defined benefits. This would relieve employers and the state while leaving workers to uncertainty and risking their retirement where their benefits would be subject to economic volatility. Furthermore, the reform to the public sector pension would consist of reducing their benefits which are deemed high and draining the public budget. On the other hand, the only proposed tax measures that would affect profits are meagre increase on taxes on interest profit (from 5 to 7 percent) and corporate profit (from 15 to 17 percent) without proposing any measure of progressivity as advocated in its abovementioned fiscal monitor report. In this regard, the IMF wishes to place the burden of the fiscal consolidation on labour, while enhancing profits through transferring public assets to the private sector using privatization and private-public partnership. These proposals are pushed hoping that everyone would reap the benefits eventually, meaning reapplying the trickledown effect which has proved its failure.

Conclusion:

The IMF fiscal recommendations for Lebanon during the past decade would deepen inequalities if implemented. Moreover, the constant commendation to monetary policies and the blessing given to the Central Bank to devise economic policy away from democratic supervision has only lead to further concentration of wealth in the hands of depositors and real estate developers. Lebanon needs to implement counter-cyclical economic policies wider than the sole purpose of debt reduction and fiscal consolidation, but geared towards redistribution and establishing a strong universal social protection system that achieves both reduction of inequalities as well as sustainable and productive growth.

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