

The Evaluation of Current Lebanon Economic Status

Part 1) Trends and issues

I. This part deals with whether the currency valuation can be sidelined from the crisis and if its devaluation can be slowed amid the challenges posed by the transitional period. Currently, the Central Bank is left with the most dangerous tool to face such a situation: printing more money to cut losses. The fundamental difference between Lebanon's current crisis and that of the 1980s is the unprecedented amount of losses in the financial sector. In the 1980s the reason behind printing money was to finance the public sector that was severely hit by the war.

A) Factors that are stabilizing the exchange rate:

a) Absorption of losses in the financial sector plays the biggest role - every day that passes the “real” value of deposits in dollars get replaced with “fake” value in Lebanese Lira (L.L.). This unorganized operation led to the absorption of the accumulated losses in the financial sector. But this came at the expense of the depositors who lost at least 80% of their deposits' worth.

b) Treasury deficit – the deficit did not go below 5500 billion L.L. in 2020 despite the crisis. It is expected to reach 6200 billion L.L. according to the estimate of the draft of the 2021 budget. The government relies heavily on the Central Bank to fund this deficit, which requires additional injection causing a further accumulation of currency in the market.

c) Foreign account deficit – while there is an accumulation of currency in Lebanese Lira there's a contraction in the supply of foreign currencies because of the deep-seated flaw in external balance. Despite a decrease in imports to its lowest level in years the trade deficit is still high, same for the current account deficit (between \$3.5 and \$4 billion in 2020). In addition, the balance of income amounts to more than 1 billion \$, tourism and travel expenditures \$1.7 billion, and the money transferred by workers to external accounts makes up no less than \$3 billion.

d) Emergent realities – such as banks unrightfully resorting to the local market to secure the requirements of the circular 154¹, additionally the Central Bank stopped providing currency exchange houses with dollars through the platform² early this year.

¹ https://www.bdl.gov.lb/files/circulars/154_en.pdf.

² The Central Bank of Lebanon Issued on June 29, 2020 a new statement announcing the official launch of the electronic exchange platform in collaboration with the Syndicate of Money Changers in Lebanon in an attempt to regulate the exchange of US Dollars against Lebanese pound/lira (LBP), through the electronic application called “Sayrafa.” The statement indicated that the exchange rate fluctuated between LBP 3,850-LBP 3,900 for the first day and all needed liquidity was secured at these prices.

B) Emergency Measures:

If the goal is to control the fluctuation in the exchange rate in the short term then this requires dealing with all the factors mentioned above, along with a daily intervention by the central bank. However, more importantly the focus should be on the following:

a) Depositors have a right to get their money in the same currency they deposited them in, or its equivalent in Lebanese Lira based on the real value of the exchange rate (in the free market). However, since the financial sector does not have enough dollars to cover these withdrawals (estimated at around more than \$4.5 billion per year). A mechanism was put in place, which entails converting dollar deposits to Lebanese Lira at a fixed exchange rate dictated by the Central Bank (the platform rate is 3900 L.L), which also increases Lira injection in the market. The way to absorb the effects of paying foreign currencies in Lebanese Lira forces a change in the current mechanism. Below is the suggested alternative mechanism:

- Keep in place withdrawal limits and lift them if the situation gets better.
- Clients get 70% of their accounts in Lebanese Lira on the current bank exchange rate³ (with the possibility of increasing this rate as the situation gets better) and 30% in dollars.
- The Central Bank covers the equivalent of the required minimum reserve (15%) of the value of these transactions in dollars, which ensures safeguarding the required reserves within the bounds specified by the cash and loans law.
- The commercial banks also cover 15% of these transactions in “fresh” dollars.

b) Decrease the budget deficit to the lowest level possible - while focusing on decreasing expenditures that require pumping cash in the market, and focusing on increasing revenues that absorb liquidity.

c) Decrease the current account deficit to the lowest level possible in order to reach trade balance.

Point of Discussion: Controlling the exchange market and controlling the supply and demand of this market, via direct and strict monitoring of the foreign bank accounts, leading to what is referred to as import control. Knowing that right now Lebanon cannot get external cash-flow in the desired amounts, it can confine the spending of what is left from the reserves on essential goods and goods that do not have a local alternative.

³ Currently at 3900 LL (there are three exchange rates in Lebanon, the official rate; 1500, the platform rate used by banks: 3900, and the black market rate: 9350 according to the report (23rd of February 2021), and 12650 on the 18th of May 2021)
- The Lebanese Lira has lost almost 90% of its value since the beginning of the crisis in 2019.

II. The effects of COVID-19 pandemic

A) COVID-19 pandemic related developments

Lebanon has been living in a state of emergency since March 2020, witnessing multiple lockdowns in an attempt to contain the effects of the pandemic.

B) Noteworthy events concurrent with the pandemic

- a) Sanctions on Lebanon and Syria by the United States, limiting international transfer of money and crippling Lebanese Syrian trade.
- b) Currency devaluation.
- c) Government stopped paying Eurobonds.
- d) Crisis in the banking sector - losses of the central bank amount to \$53 billion, and losses of commercial banks amount to \$83 billion according to the Ministry of Finance. Additionally, \$5.7 billion were reported as smuggled out of the country between December 2020 and February 2021.
- e) Beirut port explosion – losses due to the explosion have been estimated to be between \$6,620 and \$8,095 million.
- f) Deterioration in the availability and quality of infrastructure and public services.
- g) The ongoing repercussions of the Syrian crisis.

C) Economic and social effects of COVID-19 pandemic

1. Effects on the private sector

The private sector makes up 88% of the Lebanese economy.

- Direct effects
 - A 45% decrease in sales within the private sector in 2020 (United Nations Economic and Social Commission for West Asia/ ESCWA).
 - Lay-off of 23% of the employees in several sectors. This number reaches 40% in the construction sector and 30% in hotels and restaurants (ESCWA).
- Expected effects
 - International Labor Organization (ILO) expects that only 19% of economic institutions in Lebanon will be able to last amid COVID-19 measures and economic situation.
 - The main challenge these institutions will face, regardless of their size, is the decrease in consumer purchasing power and an instability of the exchange rate with an upward trend. Another challenge are the restrictions on the circulation of foreign currency and a decrease in the level of available liquidity.
 - Large enterprises are in a better situation than small to medium enterprises. The latter have a grim future ahead if they do not undergo digital transformation.
 - The World Bank estimates that employment and Gross Domestic Product (GDP) will continue decreasing for every 6 months during the service and tourism industry remain closed.

- The financial sector is doing worse given the pressure imposed by COVID-19 pandemic on non-financial institutions. It is expected that doubtful loans are likely to increase which dictates on banks, already suffering from a lack of liquidity, to increase their procurement because of the decrease in asset quality.

2. Effects on employment

According to the World Food Program almost 30% of Lebanese who were working in the first 4 months of 2020 lost their jobs due to COVID-19 pandemic and 23% of them underwent a salary cut of 23%. ESCWA reports that 23% were fired as a direct result of COVID-19 pandemic. The ILO reports that unemployment reached 37%. Temporary layoffs were mostly reported in the education sector and service activities. Permanent layoffs were mostly reported in the construction, manufacturing, and entertainment sector. The Lebanese workforce is around 1,590,000 (43.3 % of the population, made up of 78% Lebanese workers, whereas the rest are Syrian immigrants and foreign workers). Almost 365 to 588 thousand workers have lost their jobs because of COVID-19 pandemic in the first half of 2020. Those still working the majority said their salaries had shrunk because of fewer working hours. Important to note that the majority of workers in the private sector had their salaries already shrunk before COVID-19 pandemic due to the economic downturn.

3. Effects on living conditions of households

The previously mentioned effects of COVID-19 pandemic on the private sector and employment explain the decline in the living conditions of households.

ESCWA's research concluded that in the first 5 months of 2020:

- 62% of families had their salaries shrink due to COVID-19 pandemic;
- An increase in poverty from 27.7% in 2019 to 55.3% in 2020 with 23.2% on the lower bound of the poverty line.

These indicators do not take into consideration the already declining purchasing power of the salaries given the economic crisis.

Expectations:

A decrease in individual consumption for families by a third, with no further decrease in the poverty line:

- The nominal income for most workers and employees remains the same leading to a decrease in consumption in light of a lack of evidence on any income changes.
- Increase in poverty line in L.L. by half on average as a result of the 50% increase in the cost of living between December 2019 and May 2020 (according to the index of consumption prices by the directory of central statistics).

However, all these numbers remain in the realm of estimation due to a deep change in the consumption pattern of the majority of the population and the presence of at least three different foreign exchange rates.

According to a study conducted in 2020, at 8000 L.L. /USD, salaries should be increased by at least 1 million L.L. per person in order to maintain the same purchasing power as that of 2012. Based on this study the poverty line of a family of 5 is 4 million 117 thousand Lira.

Poverty per person per day in \$ based on all exchange rates:

- \$22.2 based on the official exchange rate;
- \$8.7 based on the platform rate;
- \$4.2 based on the black-market rate.

It is worthy to note that the percentage of families that have enough savings to counter the effects of COVID-19 for a longer time is 21%, and that the richest 10% lost almost 40% of their savings.

When reading into indicators regarding living standards it is important to stop at two essential dimensions for both medium and long term.

a) The social dimension

Increase in wealth hoarding, thus affecting the social balance, given that Lebanon is one of the countries doing worst in regards to wealth distribution.

The percentage of the richest population decreased from 10% in 2019 to 5% in 2020. As for the poor, the percentage jumped from 27.9% in 2019 to 55.2% mid-2020.

b) The economic dimension

The middle class shrunk from 57.1% in early 2019 to below 39.8% mid 2020. The middle class is particularly important, its impoverishment and its push towards immigration makes reconstruction efforts and development of the country very difficult.

4. Effects on general economic situation and the government

The constant closing of the country because of the COVID-19 pandemic simultaneously occurring with the devaluation of the Lira and the financial crisis have led to an unprecedented downturn in economic index, some of these indexes are:

- Decrease in overall revenue by 20.2% between November 2019 to November 2020. Had the overall expenditure not decreased simultaneously due to the country's decision not to pay the Eurobonds, in addition to a delay of investment expenditure, the deficit would have been bigger.
- Increase in deficit of balance of payments from \$5 billion up until November 2019 to \$10.2 billion up until November 2020. One of the factors that affected this deficit was a 23% to 36% decrease in remittances. In 2019 remittances made up 14% of the GDP (\$7.4 billion).

- Decrease of foreign reserves at the Central Bank from \$30.2 billion in December 2019 to \$19 billion in December 2020.
- Economic contraction from -6% in 2019 to -20 and -25% in 2020 (International Monetary Fund/IMF and World Bank/WB estimates). Nominal GDP decreased from \$52.5 billion to \$18.7 billion.
- Decrease of travelers passing through Rafik Hariri Airport by 71% - airplane activity decreased by 61.3% in 2020.
- Daily losses due to the pandemic are estimated at \$50 million per day. In case of a 100-day closing between March 2020 and February 2021 this account to \$5 billion in losses in the GDP.
- Fear of stagnation given the deteriorated economic and financial situation which got worse due to COVID-19 pandemic.

D) Recommendations to contain the crisis

a) ESCWA

- Impose a wealth tax of 5.9% or 3.6%, which will be used to contain poverty.
- Establish a regional fund to support Lebanon and help it overcome its distress.
- Implement procedures to ensure social security, health security, and food security to the most harmed individuals.
- Fix the banking crisis as soon as possible.

b) ILO

- Support mechanisms that enforces the organization of the labor market.
- Implement a vibrant market policy in order to support employment and earning.
- Put in place a system for unemployment and another emergency one in order to support salaries temporarily either directly or through the employers.
- Put in place a system of cash transfers to marginalized communities to cover their essential and urgent needs in order to maintain the lowest level of purchasing power needed to help economic institutions to keep producing and revitalize trade activity.
- Urgently implement a system of cash transfer to marginalized communities to cover their urgent needs in order to maintain the lowest level of purchasing power needed to help economic institutions to keep production going and revitalization of the commercial movement.
- Support enterprises by postponing debt, fine and tax payments.
- Apply in the medium term an employment policy that takes into consideration both supply and demand in the labor market.
- Reconsider the entire economic framework to transition from a rentier economy to a more diverse productive economy.
- In the medium term, create job opportunities through increasing investment in the infrastructure that requires extensive skills.
- Develop national dialogue between all factions including ministries and syndicates and chambers of commerce and industry.

- The implementation of financial reforms in order to contain the deficit and the restructuring of the faltering financial sector are a priority at this stage.
- Reform the social security system to also cover additional factions like workers in the agriculture sector and business owners.

c) IMF

- Widespread digitization to allow people to work from home, which leads to dynamism and lenience in the work market.
- Push for the restructuring of the human capital by adapting the education system to innovation and technology.
- Review the current system of subsidies.
- Focus in the coming period on supporting small enterprises by facilitating access to loans and incentives.

III. Decrease imports: possible scenarios and their effect on the trade balance

1) Decrease in the level of imports by 44.7% yearly between 2019-2020. Exports also decreased by 15% from \$4.4 billion for the first 11 months of 2019 to \$3.74 billion for the same period in 2020. As a result of these developments the trade deficit decreased from \$13.9 billion in 2019 to \$6.4 billion in 2020.

2) The current crisis in Lebanon led to the decrease in the level of the majority of imports, the biggest decrease is noted in fuel import – it decreased by 52.9% between 2019 and 2020, followed by transportation vehicles specifically tourist cars whose import decreased by 71.7% during the same period.

3) Multiple approaches:

a) Decrease the level of import of non-essential goods:

- Specify the import level of essential goods that cover people's essential needs that are subsidized by the central bank.
- Use the subsidized basket published by the Ministry of Economy and Commerce as a reference for essential products and food commodities and some of the goods used in the agriculture and industrial sector.
- Separate between essential food, medical, and fuel goods and other goods.
- Put constraints on the import of other commodities in order to make sure there is no additional escaping of currencies outside of the country.

- 1st scenario: multiple scenarios based on decreasing the import of non-essential goods by 20%, 40%, and 50% with the level of export remaining the same. As a result, the trade deficit decreases between 21%, 35%, and 41%.

- 2nd scenario: this scenario assumes the decrease in import of non-essential goods as stated above, with an additional decrease in import of essential goods by 5%, 10%, and 15%. As a result, the trade deficit decreases by 25%, 43%, and 54%.

b) a comparison between average import per person in Lebanon with similar countries.

Classification of income levels in Lebanon:

- In 2020 the GDP fluctuated between \$33.4 billion (WB) and \$18.7 billion (IMF). Accordingly, the individual share of the GDP fluctuated between \$4,900 per person and \$2,750 per person (calculated for a population of 6.8 million on Lebanese territory, including Syrian immigrants and Palestinian refugees. The average individual share of the GDP between both estimates is around \$3800).
- According to the above numbers Lebanon is classified as upper middle income according to the WB, and lower middle income according to IMF.
- The list of non-petroleum countries classified as low and high middle income (Egypt, Morocco, Tunisia, Algeria, Jordan, and Lebanon) shows that Lebanon scored the second highest in terms of average import per person (Jordan the highest). Lebanon can adopt the scenario of Jordan, Morocco and Tunisia, whereas it can maintain its ability to cover essential needs, in addition to a percentage of other non-essential needs. Lebanon can improve its trade balance by around \$650 million (following the Jordan scenario) up to \$2.7 billion (following the Morocco scenario).

Part 2) Reports and programs

Challenges for the agriculture labor market in Lebanon:

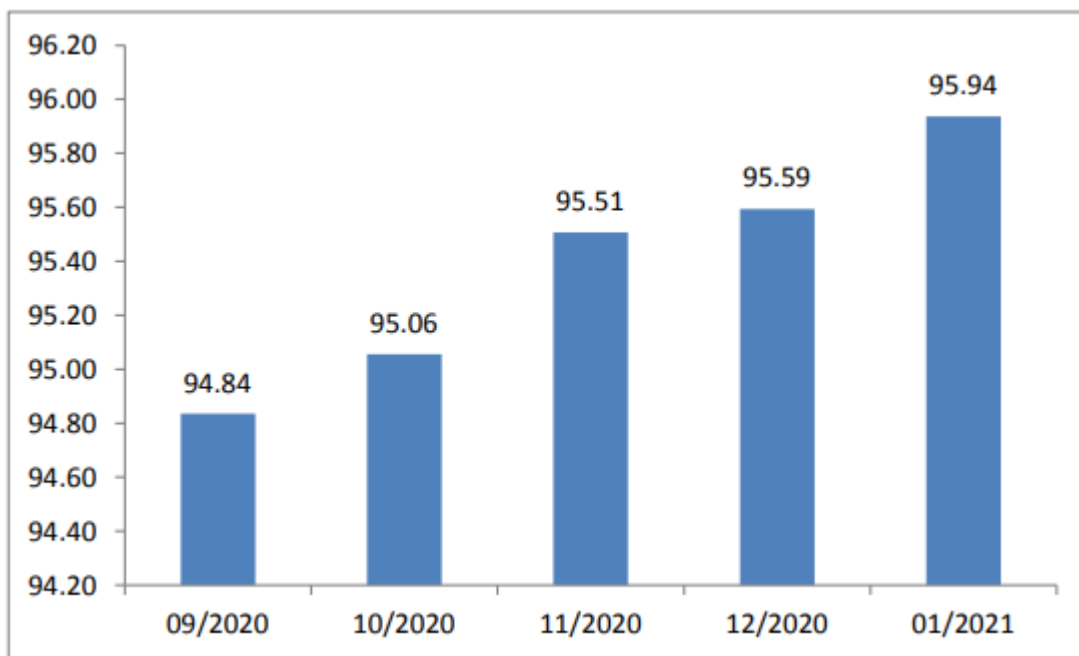
- a) Absence of new data.
- b) Difficulty facing employment. Several studies have discussed the need for skilled and well-trained employees.
- c) Mismatch between levels of skills in different parts of the agriculture sector.
- d) Skills acquired through training programs at technical agricultural schools do not match the skills required by the sector.
- e) Few students are going into agricultural studies.
- f) The ministry of agriculture is still incapable of securing the required funding to support the education of technical agriculture.
- g) Additionally, there is also a threat to the employment mechanism that does not always hire people based on their skills, the salaries offered in the sector are low, and the working conditions are hard.
- h) COVID-19 pandemic has increased the challenges facing agricultural education and training, the difficulty of teaching online was a big challenge.

The World food program released a summary of policies meant to develop the Lebanese agricultural labor market:

- a) Reinforce information systems related to the labor market in the agriculture sector. Conduct studies to use different methods, in addition to analyzing supply chain and identify required, both technical and non-technical skills. Focus on other important aspects such as marketing and management.
- b) Reinforce technical agricultural schools, in order to make available a wide scope of training. Increase coordination between agricultural schools and farmers to develop curriculums, increase specialties, and training.

Part 3) Comprehensive Economic Metrics:

Total Public Debt:



Foreign currency reserves of Banque du Liban:

