



# THE IMF AND LEBANON: THE LONG ROAD AHEAD

An assessment of how Lebanon's economy may be stabilized while battling a triple crisis and recovering from a deadly blast

Lebanon is extremely unequal and has been rocked by massive protests in recent months. The country is facing a financial crisis and is in talks with the International Monetary Fund (IMF) about a potential bailout programme. Other IMF programmes in the region have focused on austerity and have driven increases in poverty and inequality. A business-as-usual approach by the IMF in Lebanon could have serious and far-reaching adverse impacts. Any potential policies pushed by the IMF in Lebanon must first be shown not to impact negatively on economic and gender inequalities, and must be drawn up transparently in consultation with local communities, civil society organizations and social movements.

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Cover photo: A protestor destroys a bank's ATM using a large rock during clashes between protestors and the Lebanese Internal Security Forces in Hamra, Beirut on 14 January 2020. Photo: Tariq Keblaoui/Oxfam.

# EXECUTIVE SUMMARY

A 'triple crisis' initiated by the popular uprising on 17 October 2019, followed by defaulting on Eurobond payments on 7 March 2020, and then the outbreak of COVID-19 two weeks later. On 4 August 2020, a deadly blast causing damage to a third of Beirut when a warehouse at the port containing 2,750 tonnes of ammonium nitrate exploded. All of these disasters have driven Lebanon into uncharted territory and towards socio-economic collapse. The post-civil-war economic model, deemed by many to be the largest Ponzi scheme ever implemented,<sup>1</sup> championed a rentier economy and favoured the real estate and banking sectors. It is now nearing its end. Decades of neoliberal economic policies, elite capture and widespread corruption in the public sector have resulted in staggering levels of inequality, unsustainable public debt and burdensome debt-servicing that constituted 97% of tax revenues between 1994 and 2010.<sup>2</sup> In 2019, Transparency International's Global Corruption Barometer Index, in which Lebanon ranked the worst in the region, found that out of 1,000 respondents 41% stated they had bribed a public official, and 68% believed that most or all government officials were corrupt.<sup>3</sup>

In the last few years, Lebanon has experienced a consistent balance of payments deficit for the first time in its history. This deficit was exacerbated in 2019 by significant capital outflows and a shortage of deposits, primarily from expatriates. This and the ever-increasing trade deficit, which is depleting foreign currency reserves, has stretched the currency peg policy to its limit. The local currency (the Lebanese pound, LBP) has lost 70–80% of its value against the US dollar (USD) on the black market, resulting in a massive decrease in the real-world value of the income of most residents in the country. These rapid developments are occurring in the context of enormous and unprecedented popular movements and protests that began in October 2019 against the inequality and corruption produced by the current economic and political system. In May 2020, the Government of Lebanon formally requested the assistance of the International Monetary Fund (IMF) to bail out the economy as it continues to tailspin.

While Lebanon has been receiving the IMF's advice for decades through Article IV reports, this formal request for assistance will possibly be the first step on a path towards negotiating a bailout deal with the IMF, which will undoubtedly entail committing to far-reaching policy reforms and austerity measures. This request, and the potential loan programme looming over the country, has sparked popular opposition due to a fear that the negative impacts of potential conditionalities, which are often observed in other contexts, will also affect Lebanon. Looking at general policy reforms stipulated in IMF lending programmes and policy recommendations prescribed in past Article IV reports on Lebanon, these conditionalities might include tough fiscal consolidation measures to reduce public spending and increase government revenues, such as reducing the public wage bill, privatizing public services, removing electricity subsidies, freezing public sector employment, introducing higher indirect taxes, and other measures that would have serious impacts on the most vulnerable people.

Negotiations with the IMF have officially started, with the Prime Minister, Minister of the Economy, the Central Bank Governor and other high-ranking officials involved in the talks. The numbers being used in the negotiations, which were published in the government's economic reform plan, point to a very large currency mismatch of \$63bn, more than 120% of GDP. This mismatch was established following the analysis of the aggregate balance sheet for the Lebanese financial sector, commercial banks and the Banque du Liban (BDL) combined.<sup>4</sup> The Government of Lebanon, through its economic reform plan and various statements, has announced that reform is only possible if it receives \$10bn from foreign entities. Moving forward, it is expected that if the government can secure a consensus among the various political factions in the country and complies with most or all of the conditions set out by the IMF, it will ensure the flow of foreign aid. It has been reported that the meetings with the IMF – of which there have been more than fifteen so far – are focusing on the details of the economic reform plan prepared by the government, the

restructuring of the financial sector, the reforms needed in the public sector, and the central bank and capital controls.

In a country where more than 70.6% of wealth is owned by 10% of the population,<sup>5</sup> the measures imposed by the IMF will have an indisputably disproportionate impact on the working class and will only widen an already inflated wealth gap, leading to debilitating economic and social inequalities. A business-as-usual approach by the IMF will have serious and far-reaching adverse impacts for Lebanon. Although the IMF's Director of Communications has said that the reform plan should try to avoid negatively impacting those living in poverty and the middle class,<sup>6</sup> the IMF in Lebanon will need to put this into practice and ensure that the burden of austerity falls on the shoulders of rich people. In doing this, there will be many challenges, including how to apply such policies while taking into consideration the dire inequalities already present in the country. Households in Lebanon that have witnessed their income dwindle and shrink should not be expected to sacrifice further. Therefore, a potential IMF programme should also aim to reduce extreme inequalities in Lebanon. This could be achieved through progressive taxation, greater accountability and increased social spending, and ensuring labour rights, gender rights and minority rights are reflected in the IMF's reform plan. To achieve this the plan needs to include:

- Tax measures that do not further shift the tax base to indirect taxation. Instead, the focus should be on enhancing progressivity, including introducing a tax on extreme wealth, specifically large deposits, as the banking system and secrecy laws have been the main vehicle of deepening inequality in Lebanon. If Lebanon had in 2010 introduced a tax on net wealth at a rate of just 2%, by now it would have raised \$12.8bn – more than enough to cover the loans pledged (but not yet disbursed) at the CEDRE funding conference in Paris in 2018, or the equivalent of 82% of its total foreign debt service payments since 2011.<sup>7</sup>
- Support for the government to lay the foundation for universal social protection and significantly increase social spending on health and education through establishing participatory, binding and transparent criteria and outcomes for social spending floors that are agreed with citizens.
- Policy recommendations focused on building labour market institutions and supporting workers in the informal sector, notably promoting policies that reduce inequality, such as the establishment of a living wage, gender equality in the workplace, protection of workers' freedom of association and collective bargaining.
- Measures that go beyond increasing women's participation in the labour market and instead focus on improving their employment terms and conditions as well as fair incorporation into the economy.
- Strong governance measures and genuine consultations with civil society organizations, workers' organizations and communities, giving them a place at the negotiation table. However, fighting corruption should not be used as a pretext for privatization and other policies that exclude civil society organizations and impacted communities in general.
- The Fund's support for a restructuring negotiation between Lebanon and its private creditors, in a collective effort to bring the country's debt back to a sustainable level. Private creditors should also pay their fair share towards the reform plan, as they have benefited from the now crumbling economic model.

# 1 INTRODUCTION

Lebanon is currently experiencing a multifaceted and unprecedented crisis at various interconnected levels. A popular uprising erupted on 17 October 2019 when a package of indirect taxes was announced by the Government of Lebanon. A wave of protests followed, with protesters demanding the resignation of the Cabinet, formation of a neutral government, early parliamentary elections and greater socio-economic reforms and social justice. As a result, the country was stuck in political deadlock for several months.

As well as the uprising, the ongoing economic and financial crisis is increasingly manifesting its effects and threatening the livelihoods and safety of people in the country, with 220,000 jobs lost between October 2019 and January 2020.<sup>8</sup> A survey conducted by the International Labour Organization (ILO) showed that, prior to the lockdown imposed in response to the coronavirus pandemic, most of the Lebanese and Syrians surveyed were working without written contracts, paid leave, social security or health coverage. Only 11% of respondents had worked during the lockdown period studied, and the share of Syrian refugees that had been permanently laid off was twice that of the Lebanese residents.<sup>9</sup> In recent years, Lebanon, for the first time since its independence, has been experiencing a significant balance of payments deficit and increasing capital outflows, putting more and more strain on the 22-year-old currency peg in what is a highly dollarized economy.<sup>10</sup> As a result, the current account deficit stood at a staggering 23.6% of gross domestic product (GDP) in 2018 and fiscal deficit at 11% of GDP.<sup>11</sup> These problems have spiralled sharply since October 2019. Furthermore, the COVID-19 pandemic has made the outlook for Lebanon bleaker, as the country's GDP is set to contract by at least 12% in 2020.<sup>12</sup> The depletion of foreign exchange reserves and the alarming change in macroeconomic indicators experienced in the country has led the government to seek the support of the International Monetary Fund (IMF or Fund) through officially requesting a financing programme to support the government's reform plan.

Using the support requested from the IMF, the government is hoping to reverse the pattern of considerable capital flight that Lebanon has been witnessing for the last few years and which was exacerbated by the 17 October 2019 uprising. In 2019 alone, deposit outflows amounted to \$12bn.<sup>13</sup> During the uprising, banks closed for weeks for the first time in history and imposed informal capital controls, fearing a run on deposits. These controls mainly affected small depositors who are not connected to politicians and bankers. As a result, people were not able to access their deposits and firms could not access finance to continue imports and sustain themselves. In a country where the top 10% of the population control 70% of the wealth, while the bottom 50% control only 5% of the wealth,<sup>14</sup> such crises have an indisputably disproportionate impact on middle- and low-income families, widening an already huge income and wealth inequality gap and leading to debilitating economic and social inequalities.

## DEFAULTING AND INFORMAL CAPITAL CONTROLS ON SMALL DEPOSITORS

The unprecedented crisis outlined above resulted in Lebanon defaulting on its debt for the first time in its history. Lebanon was due to repay a \$1.2bn Eurobond on 9 March 2020, while another \$700m matured in April 2020 and a further \$600m in June 2020.<sup>15</sup> Overall, the country has defaulted on \$4.4bn that was meant to be repaid in 2020.<sup>16</sup> Defaulting on this debt added a new layer of challenges, as these bonds do not include a collective action clause to attract buyers. Thus, the country is now facing legal action by private creditors. Lebanon's debt burden, long among the largest in the world, is now equivalent to nearly 170% of its GDP.<sup>17</sup> The government is aiming to negotiate with creditors to restructure the rest of its foreign currency debt, which totals \$31bn, using IMF support in the form of a loan programme.

To make matters worse, Lebanese banks, fearing a run on deposits that would destroy the banking system, have limited the amount that can be withdrawn in US dollars (USD), even if depositors have accounts in the currency. In October 2019, banks started restricting withdrawals to a few hundred USD a month, and this amount has decreased further since – as of April 2020, accessing USD via the banks has become almost impossible, and transferring it abroad is difficult as well. These restrictions have been considered a form of de facto capital control imposed by banks,<sup>18</sup> mainly on small depositors. Many now fear that their savings are at risk, despite government assurances to the contrary.

**Box 1: A loss of faith in banks and the government – comparing the financial collapses of Lebanon and Argentina**

When unofficial capital controls were established by banks in Lebanon in the autumn of 2019, the case of the Argentinian financial crisis in the early 2000s was constantly brought up – pundits and frustrated citizens offered a cautionary tale of where the country might be headed. In December 2001, Argentina’s Economy Minister, Domingo Cavallo, announced the implementation of the ‘*corralito*’: the imposition of capital controls on depositors’ accounts so that they could only withdraw ARS 250 per week (around \$179).<sup>19</sup> The *corralito* placed a strain on the national currency, and happened alongside massive capital outflows by those who were well off, resulting in the collapse of Argentina’s currency and economic model. The official peg of ARS 1.4 to \$1 had in practice been ARS 1 to \$1 since 1991, and the unofficial/actual exchange rate was three times higher.<sup>20</sup> If you were to replace a few dates and Argentina with Lebanon, it would be as though we were discussing the period between 17 October 2019 to the time of writing. The financial crises brought about harsh criticisms from citizens of both countries, aimed at economic institutions and symbols that were previously treated as untouchable, namely local banks. When street protests broke out in both countries, numerous bank branches were vandalized and destroyed while other nearby businesses were largely left untouched. The IMF and Argentina have had a longstanding relationship that dates back to 1991, but a 2018 survey showed that the institution was not viewed favourably by the majority of its citizens. Instead, it is perceived as an enabler of the country’s poor economic performance.<sup>21</sup>

Both countries have faced recurrent crises of trust with respect to their governments, regulators and banks, and the IMF can and should learn from its failures in Argentina. The IMF will need to tackle the widening inequality gaps in both countries or risk giving more wealth to the richest 10%, while the majority of Lebanese and Argentinians are driven further into poverty.

This unprecedented economic and monetary crisis is the result of decades of neoliberal economic policies, policies that drove hundreds of thousands of people across the country on to the streets in mid-October 2019 to protest against the political and business elite and demand social justice and an end to corruption and sectarianism. Banks were a key target for protestors, as they imposed de facto capital controls on small depositors while people with connections were able to transfer their deposits abroad. This has prevented many small clients from withdrawing USD to meet their basic needs in a highly dollarized economy, where more than 70% of deposits are in the currency.<sup>22</sup> More importantly, banks were accused of being a cornerstone in the economic and political system that people were demonstrating against.

The COVID-19 outbreak in Lebanon has resulted in new difficulties for both the economy and people living in Lebanon. A national public health emergency was announced on 15 March 2020, with most public and private institutions forced to close except for pharmacies, supermarkets, bakeries, essential food shops and key factories. Checkpoints run by the Lebanese army, Internal Security Forces and municipalities were installed to ensure that protective measures (e.g. wearing gloves and masks) were taken and that movements were restricted to urgent journeys. The COVID-19 pandemic is therefore straining business opportunities and the economy. Because of these road closures and containment/partial lockdown measures, micro, small and medium

enterprises (MSMEs) that rely on daily/monthly profits to survive have been and will continue to be drastically impacted. In addition to this supply chain disruption, the fact that Lebanon has a large informal business sector means most employees do not have a signed contract ensuring legal protection, meaning they will be further dragged into poverty.

The national public health emergency has now been extended until the end of 2020. Since the start of the outbreak in Lebanon, the government has only implemented a plan that includes distributing food parcels and a one-off payment of LBP 400,000 (less than 60% of the monthly minimum wage) to the most vulnerable and affected Lebanese families, with 187,500 families benefiting from the first phase.<sup>23</sup> This plan lacks continuity and sustainability, as food parcels and one-off payments will not solve the deep inequalities in the country. In this regard, it is worth noting that the government did not request IMF support through emergency financing instruments deployed by the IMF to support countries' responses to the pandemic without conditionalities. Lebanon could have followed in the footsteps of Tunisia, Jordan and Egypt and benefited from this Rapid Financing Instrument. The government is also looking to scale up social safety nets for the most vulnerable families through a loan from the World Bank to help fund its economic reform plan; however, this plan is yet to be consolidated and confirmed, as the government is currently in negotiations with the IMF for a possible loan to help repair its economy.

On Tuesday 4 August at 6.07PM, two explosions took place at the Port of Beirut, which is situated at close proximity to residential and business areas in the heart of the city. The blasts were caused by 2,750 tonnes of ammonium nitrate stored unsafely in a warehouse. The explosions have had a devastating impact on Beirut and the country, and their consequences will have a long-lasting impact on a city already suffering from an economic, political and health crisis. To date, more than 200 people have been reported dead, with seven people still missing and more than 6,000 injured. Some 40,000 buildings were affected, with 3,000 residential structures seriously damaged as well as the strategic grain silos containing 85% of the grain stock for the country.<sup>24</sup> More than 70,000 workers are estimated to have lost their jobs as a result of the explosions, with direct implications for over 12,000 households, and 178 public and private schools were damaged.<sup>25</sup> It has also been reported that approximately 81,000 of those affected are women of reproductive age (15–49 years), including 24,000 adolescent girls.<sup>26</sup>

Countries and international organizations mobilized to help Lebanon the day following the explosions. On Sunday 9 August, a donors' pledging conference was hosted by France and the UN. While only the opening session was public, statements released after the conference indicate a large mobilization from 36 governments and institutions, collectively pledging €253m in aid. Further aid is expected, as French President Emmanuel Macron has announced a second donor conference in October aimed at rebuilding the city and alleviating its economic crisis.<sup>27</sup> French efforts have also been directed towards taking the necessary actions to secure the pre-conditions for an IMF loan programme.

## 2 THE CRUMBLING OF AN UNEQUAL ECONOMIC SYSTEM

### FISCAL INJUSTICE HAS CREATED A RENTIER ECONOMY

The post-war economic system ushered in in the 1990s adopted a template neoliberal reform agenda based on enacting the policies perceived as necessary to attract foreign investment to fund reconstruction. This consisted mainly of significant tax reforms, specifically slashing corporate income tax, alleviating taxes on personal income for the wealthy and generous tax incentives and exemptions to try to attract deposits. For instance, the progressive corporate income tax (starting at 6% and going up to 50% on top marginal incomes) was eliminated and replaced with a meagre 10% flat rate. The same thing happened for movable capital, with the tax on income from interest being eliminated. These drastic measures led to the collapse of fiscal revenues, which propelled the government to increase personal income taxes and corporate income taxes slightly in 1999 and then again in 2018, including indirect taxes.<sup>28</sup> Furthermore, import tariffs were slashed rendering them, on average, between 0% and 5%, one of the lowest in the region.<sup>29</sup> In sum, the fiscal system in the country was reformed to rely on indirect taxes, meaning that today they constitute nearly 70% of the country's tax revenues.<sup>30</sup> It is very apparent that the tax system is biased towards rentier-based activities<sup>31</sup>, as tax on interest was only introduced in 2003 and Eurobond interest income was exempt until 2017. The same applies for capital gains tax on real estate, which was only introduced in 2017.<sup>32</sup> As a result, insufficient fiscal revenues and the existing tax structure have contributed to a bloated banking system in which deposits reached 280% of GDP in 2016,<sup>33</sup> and where banks hold most of the public debt. Furthermore, the real estate sector has grown exponentially, with 70% of foreign direct investment (FDI) going into the real estate and the residential sectors by 2010.<sup>34</sup>

#### **Box 2: Ghana and Lebanon – crumbling economies that relied on borrowed growth**

Ghana and Lebanon were once viewed by the IMF as resilient economies that, with necessary reforms and continued support, could experience growth while neighbouring countries struggled.

In the midst of the 2008 global financial crisis, Lebanon defied all expectations and was projected to see its economy grow.<sup>35</sup> A 2009 IMF survey found that in Lebanon, 'A full-blown debt crisis was averted because banks could resort to their large liquidity buffers to hold on to government debt and had every incentive to do so as their financial success is closely tied to that of the government. Compared with typical emerging market debt crises where an investor run triggers a downward spiral of government bond prices, this setup has helped soften the impact of confidence losses and has bought time for the situation to turn around and liquidity to resume.'<sup>36</sup>

In 2019, the IMF found that Ghana had a favourable economic outlook that was supported by sensible economic policies, a boom in extractive industries and a safe banking system.<sup>37</sup> While economic growth was the main point of discussion when reviewing Ghana's fiscal performance, rising levels of inequality in the country, as a result of 10% of the wealthiest Ghanaians being responsible for 32% of the country's consumption, were often ignored.<sup>38</sup>

While the early indications of economic collapse were more gradual in Lebanon, from the beginning of 2020 both countries' situations were raising alarm bells among their lenders, due to their circumstances being highly likely to lead to the countries defaulting on their obligations.

In order to avoid an economic catastrophe, Ghana was able to raise \$3bn by issuing Eurobonds to stabilize the economy, which is nearly the exact amount that the Central Bank of Lebanon issued in 2018 to help rescue its own economy. Unfortunately, Lebanon was not able to avoid defaulting, unlike Ghana, and in March 2020 the Government of Lebanon declared that it would not honour its payment obligations. Lebanon failed to capitalize on building a resilient economy during periods when the potential for growth was high, due to an over-reliance on borrowing from international lenders and financial engineering by the banking sector to maintain the status quo.

The global economic outlook is bleak in the foreseeable future as a result of the implications of the COVID-19 pandemic, so if Ghana does not seize its current opportunity it is likely to face a similar fate to Lebanon when its next payments are due.

## PUBLIC DEBT, BANKS AND REGRESSIVE REDISTRIBUTION

### **Box 3: Inflation and angry protestors – how a loss of trust in the system reshaped Greece’s and Lebanon’s political landscapes**

The honeymoon period after Greece’s long-awaited adoption of the euro as its currency in 2001 was short-lived. Three years after changing its currency, it was confirmed that Greece had misrepresented essential data that was required to meet the Maastricht criteria<sup>39</sup> and join the Economic and Monetary Union, but it did not face any sanctions from international lenders.<sup>40</sup> International lenders continued to provide loans to Greece, which were used by the government to service its debt. Similarly, the international community has always been cautious about placing trust in Lebanon’s government due to its notorious corruption, weak governance and constant instability. While concerns were expressed by many stakeholders, both countries borrowed in order to maintain an economic model that could not be sustained. By 2009, worrying changes to economic indicators began to appear and Greece experienced soaring inflation, high unemployment and extremely limited spending. Unpopular austerity measures led to street protests and resulted in the election of a new Prime Minister in 2014.

The events that have followed, and will continue to follow, the unprecedented popular uprisings that began in Lebanon on 17 October 2019 mirror the experiences of Greece and started after the country’s debt was no longer manageable. In contrast, however, Greece was able to avoid defaulting due to being bailed out by international lenders, and as recently as 2019 the country was commended by the IMF for recovering from its economic crisis and classified as being among the best performers in the eurozone.<sup>41</sup> In 2020, both countries’ respective economies have been severely hit by the COVID-19 pandemic and they will need to rely on international lenders to cope with their poor economic performance. The collective neglect by all stakeholders to properly address many of the decades-long structural issues that impede economic growth will result in cyclical collapses that will widen inequality gaps and drive more people into poverty.

Over the last few decades in Lebanon, speculation has enabled a small number of individuals to make huge profits, as most of the debt payments went to private banks in the form of interest payments on treasury bonds.<sup>42</sup> The escalating debt has been a source of increasing inequalities in Lebanon and has exposed who has benefited the most from the prevailing system. The share of public debt held by banks reached nearly two-thirds in the 1990s,<sup>43</sup> and it is estimated today to be nearly 43%.<sup>44</sup> Indeed, interest rates went up to as high as 40% on untaxed treasury bills, helping the banking sector’s assets grow by 25% between 1993 and 2000 and increase nearly eightfold between 1993 and 2013.<sup>45</sup> In addition, between 1993 and 2018, banks’ net profits increased from \$63m to a whopping \$2bn,<sup>46</sup> representing a 3,000% increase. This was

compounded by the fact that the equity value attributed to shareholders in the three biggest banks increased by 55% between 2011 and 2018,<sup>47</sup> a period during which GDP growth averaged 1.34% annually. This has fuelled inequality because the owners of the banks are among the richest and best-connected people in the country. In this regard, it is worth noting that in the post-war era many bankers started to hold cabinet and parliamentary seats. A recent study revealed that major banking families that have a member who has held a cabinet position (e.g. prime minister, minister, etc.) hold at least \$7bn in bank equity.<sup>48</sup>

As a result of the above issues, public debt became one of the most explicit, regressive redistribution measures in Lebanon: between 1994 and 2010, debt service constituted, on average, 38% of public expenditure and 97% of tax revenues.<sup>49</sup> In other words, almost the totality of taxpayers' money went towards paying creditors, with banks being among the most important of them. The structure of deposits is telling of the staggering inequalities in the country: as of 2018, 0.8% of accounts (24,421 accounts) controlled 51.8% of deposits (\$85,286bn), while 60.5% of accounts (1,749,104) controlled only 0.5% of deposits (\$935m).<sup>50</sup> Bank secrecy laws, the meagre tax on interest income, and the absence of tax on wealth only contribute to these alarming inequalities concealed in deposits.

The post-war system failed to deliver sustainable growth for the country. On the contrary, public debt has escalated and the economy has been rendered entirely dependent on the constant inflow of deposits through high interest rates, speculative real estate and remittances, which at times have reached as high as 20% of GDP.<sup>51</sup> This neoliberal logic married with the sectarian governance of the country was a perfect recipe for elite capture. Bankers and real estate developers took high office, including cabinet and parliamentary seats.

## INADEQUATE SOCIAL SPENDING: PRIVATIZED BASIC SERVICES FOR THE FEW

Corruption, low fiscal revenue and low public investment have left the country with deteriorating infrastructure to the point that many households have been pushed to buy water and electricity from private informal suppliers to compensate for the shortage in public provision. According to the World Bank, in 2008 households spent a total of \$330m on privately generated electricity and nearly \$230m on privately provided water.<sup>52</sup>

The country has had its share of international aid and loans through various donor conferences; nevertheless, the principles of aid effectiveness, particularly ownership, have hardly ever been met. Notably, Oxfam's research has shown that aid has not been given based on a nationally owned plan, although the government has had multiple duplicate plans.<sup>53</sup> Moreover, endemic corruption has prevented proper monitoring of spending and allocation of funds and influenced agreements with donors. Indeed, corruption is a central feature of the current economic and political system and has been described as 'the lubricant of a political economic pact that serves as the lynchpin of the post-war power-sharing arrangement'.<sup>54</sup>

The Lebanese political and economic system has historically contributed to high levels of inequality. In turn, the inequality gap has also manifested itself in the structure of public spending, which clearly shows that elite capture is a government priority. While debt servicing swallowed 32% of public expenditure in 2019, health expenditure stood at 3.1% and education at 8.9%.<sup>55</sup> In addition, geographical and social factors also play a significant role. Inequalities between the country's centre – Beirut and Mount Lebanon – and its periphery – North and South Lebanon and the Beqaa Valley – are rooted in decades of neglect, whereby the agricultural sector has been neglected vis-a-vis the services sector in the capital and its surrounding areas. Some of these factors have contributed to the current economic and political situation in Lebanon, including gaps in investment and a lack of funding earmarked for social protection, which remains a privilege for the few. The country still lacks one comprehensive social protection framework, leaving people to resort to private insurance; an estimated 45% of the population are uninsured. The only social

insurance that is offered is through a centralized contribution fund that is solely available to people employed in the formal sector. Most people do not benefit from this social insurance, as it is estimated that at least 55% of employment in Lebanon is informal.<sup>56</sup> Furthermore, at least 35.6% of jobs in Lebanon are considered high-risk in relation to coronavirus transmission, meaning the people in these jobs will suffer the most. On top of this, the impact of the expected decrease in remittances due to the pandemic will be huge, as remittances from abroad constitute the main source of income for 10% of households in Lebanon.<sup>57</sup>

In sum, the fiscal policies in Lebanon during the post-war era have placed a burden on the working class and disadvantaged populations through prioritization of the interests of the ruling elites. This has been reflected in a taxation system that favours rich people and in the focus on developing the banking and services sectors at the cost of the industrial and agricultural sectors. Today, Lebanon is one of the most unequal countries in the world, a country where 1% of the population, or nearly 37,000 individuals, controlled 23.4% of income in 2016, and the top 10%, or 371,000 individuals, controlled 57% of income, while the bottom 50% of the population controlled only 10.6%.<sup>58</sup>

Social spending traditionally constitutes very little of the national budget. A major characteristic of the country's social security mechanisms is that those most in need are the least covered. This is the case for health insurance, where 45% of people are not covered by any type of insurance.<sup>59</sup>

Lebanon's education system is defined by a very large private sector that is only marginally subsidized through government allowances. According to a report by the World Bank, total government expenditure on education is about \$1.2bn annually (approximately 2.45% of GDP and 6.4% of total public expenditure).<sup>60</sup> While government expenditure in absolute terms has gone up since 2005, education expenditure as a percentage of total expenditure has decreased by 17 percentage points during the last decade, which threatens access to education for the most vulnerable communities, hence contributing to increasing the gap between rich people and poor people.<sup>61</sup>

Inequality is aggravated by the ongoing economic crisis, which has led to a de facto devaluation of the national currency. The official peg of \$1 equalling LBP 1,507 only exists on paper, and in practice the USD is being traded at an all-time high, of over LBP 9,200 as of the beginning of July 2020,<sup>62</sup> and continues to be traded at over LBP 8,000 as of October 2020.<sup>63</sup> This means the LBP has lost over 85% of its value in a matter of a few months. Alongside this, the consumer price index (CPI) has increased by 74%, with the prices of goods increasing between 25% and 75% in March 2020 in comparison with March 2019.<sup>64</sup> As Lebanon relies heavily on imports to meet its needs in terms of food and other essential items, the devaluation of the LBP has impacted imports of goods and raw materials, causing shortages in essentials such as fuel and leading to prices doubling to tripling in the markets. The price inflation threatens the livelihoods of hundreds of thousands of residents who make their income in LBP.

As Lebanon faces the worst economic crisis since its independence in 1943, with inequalities and poverty significantly deepening, IMF support is being advertised as the only lifeboat available to the country. However, many experts and grassroots groups who led the recent uprising are expressing growing concerns about the potential impact of an IMF loan programme on inequality and the livelihoods of the most vulnerable people in the country.

# 3 IMF OVERVIEW, FUNCTIONS AND CRITICISM

## WHAT IS THE IMF?

The IMF is an international financial institution that works on promoting global economic stability and growth, as per its stated mandate. Today, the IMF is considered one of the world's most powerful influencers, norm-setters and knowledge holders within the international financial sector. The IMF is made up of 189 member countries that constitute the governing body to which the organization is accountable and provide funds to the IMF through a quota subscription. According to the IMF handbook, in return for subscription, the IMF provides members 'with macroeconomic policy advice, financing in times of balance of payments need, and technical assistance and training to improve national economic management'.<sup>65</sup> The purpose and function of the IMF are further outlined in Boxes 4 and 5.

### **Box 4: The purpose of the IMF**

As detailed in Article I of the IMF Articles of Agreements, the IMF's policies and practices are guided by the following six purposes:<sup>66</sup>

1. To promote international monetary cooperation;
2. To facilitate the expansion and balanced growth of international trade;
3. To promote exchange stability;
4. To assist in the establishment of a multilateral system of payments;
5. To help members to correct their balance of payments by making the general resources of the Fund temporarily available to them under adequate safeguards;
6. To shorten the duration and lessen the degree of disequilibrium in the international balances of payments of members.

### **Box 5: The IMF functions**

According to the IMF handbook, the IMF has eight functions that support its mandate.<sup>67</sup> These are the following:

- 'Surveillance over members' economic policies;
- Financing temporary balance of payments needs;
- Combating poverty in low-income countries;
- Mobilizing external financing;
- Strengthening the international monetary system;
- Increasing the global supply of international reserves;
- Building capacity through technical assistance and training;
- Dissemination of information and research'.

## A BRIEF HISTORY

Many of the concerns being raised in Lebanon regarding the prospect of IMF involvement through a loan programme stem from the historical role of the IMF and experiences of its interventions throughout the past few decades. For example, the IMF has been perceived as spearheading aggressive neoliberal reforms throughout the world, and particularly in the Global South. Indeed, the current role of the IMF and its expected involvement in Lebanon has come a long way from its original mandate when the organization was founded in 1944. The initial purpose behind its creation alongside the World Bank was to rebuild and stabilize the international economic system in the aftermath of World War II. The IMF's mandate was to maintain exchange rate stability and adjust member countries' external imbalances. Its role was also to provide short-term loans to countries facing short-term balance of payments crises.<sup>68</sup>

Expansion of the IMF's scope began in the early 1980s and continued into the 1990s, when governments of lower- and middle-income countries began defaulting on their debts. This pushed the IMF to shift its focus from exchange rate and balance of payments management to structural reform and financial stabilization management.<sup>69</sup> The policies adopted by the IMF as a result of this crisis were largely inspired by the 'Washington Consensus', a standard recipe of 10 policy prescriptions centred around liberalization, privatization and deregulation,<sup>70</sup> the adverse development effects of which are long-lasting<sup>71, 72</sup>

During this period, the IMF gained its notorious reputation as a result of using its status as the 'lender of last resort' to push countries towards implementing deep neoliberal reforms. These policies were implemented through what was known as structural adjustment programmes (SAPs), which were also pushed by the World Bank. Thus, the Fund moved from providing short-term loans to correct moderate exchange rate adjustments in high-income countries to providing long-term loans to restructure economies in lower- and middle-income countries wracked with economic crises. In return for the money, the IMF required countries to implement structural reforms to their economies, such as reducing public expenditure, liberalizing trade, implementing investment and capital controls, and deregulating and privatizing government-owned enterprises.<sup>73</sup> Whereas these conditionalities were meant to prepare the foundation for economic growth and ensure governments were capable of servicing their debts,<sup>74</sup> they were far too often prescribed in a 'one-size-fits-all' fashion, irrespective of the countries' unique contexts and with little consideration for long-term development goals. While Lebanon never underwent an SAP, its neighbouring countries in the region had their share of IMF-supported restructuring programmes, notably Egypt and Jordan, which witnessed significant social unrest as a direct result of the conditionalities imposed by the Fund in the 1980s and 1990s. In fact, during that period, SAPs came under heavy criticism around the world for many reasons, including: being undemocratic in their design and implementation; disproportionately cutting social spending while increasing taxes that place a heavier burden on poor people; slashing budgets for the education and healthcare sectors; failing to acknowledge the institutional weakness of lower-and middle-income countries and maintaining their dependency due to high debt servicing bills; widening the gender gap; and increasing the inequality gap by deeming inequality essential to economic growth.<sup>75, 76, 77</sup>

These policies have continued in different forms over the years, gradually moving away from structural reforms towards fiscal consolidation.<sup>78</sup> Despite ongoing challenges and criticism, the IMF has continued to be relevant as an international lender. Its role was especially important during the 2008 global financial crisis, when it provided loan arrangements amounting to \$225bn within 18 months of the crisis.<sup>79</sup>

In more recent years, the IMF has had a positive change of rhetoric on the negative impact income and gender inequalities have on economic growth.<sup>80</sup> The Fund has gone a long way in terms of recognizing the negative impact of SAPs on increasing global inequalities and challenging several aspects of common economic thinking through multiple innovative research pieces. Its recent body of research has found that growth is harmed by inequality and neoliberal policies, that redistribution can drive growth, and that economically equal countries are countries

with higher levels of gender equality, stronger trade unions and greater bargaining power for workers. Under the leadership of Christine Lagarde (from 2011 to 2019), the IMF also undertook more research on the impact of gender inequality on growth and development, providing more empirical evidence on the negative correlation between the two.<sup>81</sup> It has even made commitments to support the Sustainable Development Goals (SDGs), including to 'deepen gender inclusion' in pursuit of SDG 5. The 2010/2011 uprisings in the Middle East and North Africa (MENA) region accelerated the IMF's shift in thinking. Indeed, after 2011 the Fund returned in force to the region with the mandate of supporting countries in their transition to democracy. Since then, the IMF has provided loans to Tunisia, Morocco, Egypt, Jordan and Iraq. However, whether these monumental changes in rhetoric will translate into effective policies in practice remains highly debatable, as many studies suggest otherwise.<sup>82</sup>

## Structural imbalances of power

For many, the IMF has historically been perceived as an instrument that advances the interests of the US and European economies, which continue to dominate decision making at the Fund. In fact, one of the main criticisms directed towards the IMF is 'the political expediency of important shareholders in its decision making and choice of interventions'.<sup>83</sup> This criticism is largely a result of the IMF's quota system, through which member countries' voting power and access to the IMF's financial resources are determined by their financial commitment to the IMF and relative position in the world economy.<sup>84</sup> Over time, this has led to major political power imbalances within the IMF governance structure, including the structural under-representation of the South in decision-making processes and the continued promotion of interests of countries with the greatest voting power. According to the Bretton Woods Project (2019),<sup>85</sup> the under-representation of the South is further aggravated by an informal agreement between the US and European countries to ensure that the IMF and World Bank are always led by a European and US national, respectively.

## A neoliberal approach to economic growth

The conventional macroeconomic policy model that the IMF promotes has historically comprised: (1) fiscal consolidation measures (austerity measures), including cutting the public wage bill, cutting social spending and privatizing state assets and essential services; (2) the introduction of higher taxes on consumption, such as raising VAT and other regressive taxes; (3) the reduction of corporate taxation and trade tariffs; and (4) the introduction of flexible labour market arrangements and the dilution of collective bargaining.<sup>86</sup> This approach has been heavily criticized by many for failing to address the root causes of financial crises; causing a decline in economic activity, consumption and public revenues; undermining labour rights protections; and increasing inequality.<sup>87</sup> Critics argue that the IMF's conditionalities typically and systematically weaken labour rights and other socio-economic rights, such as the right to social security, healthcare, education and an adequate standard of living.<sup>88</sup>

There is extensive literature showing a positive correlation between income inequality and the IMF's prescribed policies. Forster, Reinsberg and Stubbs (2019)<sup>89</sup> argued that income inequality in countries that received an IMF loan increased by an average of 6.5% a year for three years after the implementation of the intervention.<sup>90</sup> And despite the Fund's recent efforts to operationalize its inequality agenda, Oxfam's 2017 evaluation<sup>91</sup> of the IMF's main initiative to introduce inequality analysis into its policy recommendations revealed that at that time, there remained significant gaps between rhetoric and actual policies promoting lower inequality. For example, Oxfam found that progressive tax policy advice was still done on an ad hoc basis, implementing or raising VAT was still a signature recommendation despite its distributional impact, and the link between the labour market and inequality was not explored. As for the IMF's advice on social spending, Oxfam described it as being 'characterized by a tendency to see it as a band-aid to compensate for the negative effects of other measures', rather than promoting it as key policy against poverty and inequality.<sup>92</sup>

## Widening the gender gap

The IMF's programmes and policy recommendations arguably remained gender-blind from the Fund's inception up until 2013, after which the IMF started engaging with gender equality as an 'emerging issue' that impacts and is impacted by the macroeconomy. Since then, the IMF has taken major steps towards recognizing the importance of gender equality in achieving economic growth. However, as is the case with income inequality, the IMF still has a lot to achieve in order to fully operationalize gender equality. This should involve expanding its focus from promoting women's labour force participation to mainstreaming gender into the design and implementation plans of its policies and programmes.<sup>93</sup> Currently, many conventional IMF-prescribed policies that are not directly focused on gender can have a negative impact on gender equality.<sup>94</sup> For example, cutting the wage bill of the public sector, a large employer of women in lower-and middle-income countries, is correlated with increased unemployment levels among women. Another example is the promotion of VAT, a consumption tax borne by all consumers that disproportionately impacts lower-earning taxpayers, an important group of whom are women working in low-paid jobs or in the informal sector.

## The IMF in Lebanon

On 1 May 2020, Lebanon officially sought the IMF's financial assistance in light of its escalating financial crisis, a first for a Lebanese government.<sup>95</sup> After defaulting on its foreign currency debt in March 2020, Lebanon hopes to secure \$10bn of IMF support, which is seen as a rescue package and last resort. One day prior to requesting the Fund's assistance, the Lebanese government published its economic recovery plan, which will form the basis of the negotiations with the IMF.<sup>96</sup> We can expect the IMF financing to be given on the condition that strict fiscal consolidation and structural adjustment measures are put in place, the political and economic implications of which are yet to be fully understood. Nevertheless, the published Article IV Consultations reports on Lebanon give strong indications of how the prospective programme might be designed.

## ARTICLE IV AND LEBANON

In non-borrowing countries such as Lebanon, Article IVs are a key instrument through which the IMF influences policy making, even though the advice is simply a set of recommendations and not mandatory. Thus, examining Article IV reports for Lebanon gives the best illustration of how the IMF has viewed and influenced policy making in Lebanon. In the passages below, we will examine the publicly available Article IV reports for Lebanon from 2006 to 2019. These were published on nine occasions, the last of which coincided with the day the Lebanese uprising erupted, 17 October 2019.

Through Article IV reports, the IMF provided policy advice to Lebanon aimed at achieving a sustainable public debt level and securing macro-financial stability. Throughout all of the reports from 2006 to 2019, the IMF identified key vulnerabilities facing Lebanon, mainly a high debt-to-GDP ratio and that 'high concentration of government debt in the banks' balance sheets heightens systemic risks'.<sup>97</sup> These issues were highlighted in all of the publicly available reports but with varying degrees of urgency. Indeed, the tone of the IMF became more alarmed in 2011 as the Syrian uprising began and deposit growth started slowing, thus increasing the risk of financial instability. According to the IMF, 'the structure of Lebanon's financial system, and the tight nexus between banks and the sovereign, make the economy dependent on the confidence of non-resident depositors. As noted above, deposit inflows are the key source of funding for the economy'.<sup>98</sup> In this regard, the IMF policy recommendations for Lebanon are now geared towards the gradual reduction of debt to decrease the reliance on non-resident deposit inflows. This is meant to be done, according to the IMF, through structural reforms based on fiscal consolidation. Over the years, Article IV reports have outlined key policy reforms that the IMF believes Lebanon needs to undertake to increase revenues and decrease expenditures. These recommendations

have addressed taxes, labour and social protection but with little consideration regarding the impacts on inequality beyond compensation through expanding safety nets.

## Revenue-raising measures: privatization and VAT

The Article IV report published in 2006 called on the government to ‘lock in a large upfront fiscal adjustment backed by vigorous privatization and reform’.<sup>99</sup> For years, privatization of state assets, such as telecommunications, was high on the Fund’s list of recommendations, although this was gradually displaced by a call for the government to enact and implement a public-private partnership framework, especially for capital investment. Alongside this, the preferred revenue measure advanced by the IMF has been tax increases, with a specific emphasis on VAT. In fact, all Article IV reports called for an increase in VAT and to expand its base and remove exemptions. The Fund initially recommended increasing VAT from 10% to 15%,<sup>100</sup> later proposed a gradual increase from 10% to 12% and then to 15%, but finally recommended a gradual increase from 11% to 15% and then to 20%.<sup>101</sup> These shifts in the IMF’s recommendations could have been made to accommodate the political difficulty of increasing a very unpopular tax in the country. Indeed, several studies have shown the regressivity of the tax and the impact of increasing it on poverty. In this regard, it was estimated that increasing VAT from 10% to 15% would increase the prevalence of poverty from 28% of the population to 50% in 2009.<sup>102</sup> The IMF now has to estimate the impact of making the VAT increases proposed in last year’s report, considering 50% of the population was living in poverty before the coronavirus lockdown and the subsequent economic impacts of the pandemic.<sup>103</sup> Furthermore, the Fund has called on the government to increase excise taxes on gasoline, tobacco and alcohol, as well as other indirect taxation measures.

### Box 6: The IMF’s Article IV Consultations

The IMF conducts its annual surveillance and monitoring of member countries’ economic and financial policies through Article IV Consultations. They are meant to identify and detect stability and growth risks that require tackling through policy change. The consultations involve IMF staff visiting government offices, the central bank and various stakeholders to gather information. Once completed, the report is discussed at the IMF’s Executive Board and submitted to the country’s authorities. This process is mandatory for all member states, regardless of their income and economic situation. Article IV reports are usually published on the IMF’s website after they go to the Executive Board. However, a member state has to approve the disclosure of the report. In the case of Lebanon, an Article IV report was not published for more than two years, with the Fund only putting out press releases after the consultations were concluded each year, in 2017 and 2018.

Through Article IV reports, the Fund has also called for the government to increase direct taxes, specifically to increase the tax rate on interest income from 5% to 7% and increase corporate income tax from 15% to 17%.<sup>104</sup> These reforms were indeed enacted by the government, but nevertheless they have had little impact in terms of redressing the regressive tax system in the country. In 2019, the Fund called for a further increase of the interest income tax to 10%.<sup>105</sup> While this is a step in the right direction, increasing this tax to 10% or higher could have had more impact in terms of revenue generation if it had been implemented prior to 2011, a time when deposit growth and inflows were soaring (e.g. in 2009 deposits grew by more than 23%).<sup>106</sup> Significantly increasing the tax on interest income prior to 2011, i.e. by more than the two percentage points suggested by the Fund at the time, would have generated more revenues from those who are well-off (0.8% of accounts control more than 50% of deposits).<sup>107</sup> However, the meagre increase enacted by the government took place in an environment of decreasing deposit inflows, which later transformed into an outflow.

## Compensation not redistribution

### Box 7: Floating the currency to keep the lights on

Although the timelines do not match, the anger of protestors in both Egypt and Lebanon has been a driver that has pushed both countries into largely uncharted territory. Decades of relying too heavily on tourism to fuel the economy, disproportionate spending on the salaries of public sector employees, high energy costs and poor fiscal discipline resulted in the political systems of Egypt and Lebanon being reshuffled when people's patience ran out and they took to the streets. In recent years, Egypt's economy has outperformed Lebanon's. In 2016, the former Managing Director of the IMF stated that, 'the liberalization of the exchange rate regime and the devaluation of the Egyptian pound were critical steps toward restoring confidence in the economy'.<sup>108</sup> However, confidence was not restored in the country's economy, resulting in a rapid rise in inflation, which placed a strain on vulnerable families who were struggling to make ends meet. Both countries were projected by Moody's Credit Agency to be among the most likely to be impacted by global financial tightening in the coming years.<sup>109</sup> In 2016, the IMF stated that Egypt would need to undergo fiscal reforms and address its struggling electricity sector if it wanted to ward off any external threat to its economy, and it advised Lebanon to do the same in 2020. As both countries' economies limped into 2020, the COVID-19 pandemic has increased the need for urgent reforms if there is any hope of avoiding collapse. The IMF is projecting a dismal year for the region, and while Egypt's economy is still expected to grow this year, growth is well below projections.<sup>110</sup> Both countries had to request support from the IMF in the spring of 2020 in order to help stabilize their economies, but with uncertainty around the tourism sector globally, it will not be an easy task.

While Article IV reports have called for more progressive taxation on a few occasions, the Fund's tax recommendations seem to pay little attention to inequality and redistribution. Its recommendations are more focused on neutralizing the private and public wage increases that were enacted in 2012 and 2016. Throughout the years, policies proposed in Article IV reports have targeted the most vulnerable and followed the logic of compensation rather than redistribution. This approach has also been witnessed in IMF recommendations in many other contexts, including other MENA countries.<sup>111</sup> The most vulnerable people are often mentioned in the context of a VAT increase, but also, and more importantly, in the context of eliminating electricity subsidy reforms. The latter, like VAT, is a signature IMF policy aimed at decreasing public expenditure. While electricity subsidies are costly and significantly dent the public budget, they remain the only universal social protection measure in Lebanon amid a fragmented social programme. Thus, in this context, the Fund notes 'the need to implement electricity reform to improve service provision and reduce the drain of Electricité du Liban (EdL) on the budget and embark on strengthening social safety nets'.<sup>112</sup> This compensation approach not only fails in addressing and reducing inequalities, but also remains insufficient. The 2019 Article IV report calls on the government to dedicate 0.5% of GDP to scale up targeted transfers to poor and vulnerable people, which would be funded by eliminating electricity subsidies (0.7% of GDP), while at the same time calling for an increase of VAT from 11% to 15% or from 11% to 20%.<sup>113</sup> These measures would deepen poverty, as mentioned above, with an increase of VAT to 15% translating into a poverty prevalence of 50%, an estimate made in 2009<sup>114</sup> during a better economic situation. Reaching this alarming poverty rate would also make compensation and targeting very challenging, if not impossible, as a significant portion of the population, if not the majority, would need a form of social assistance that would be better delivered under a long-term universal social protection system rather than safety nets that are not designed to benefit such a large proportion of the population. The importance of this is further underlined by the ongoing economic and social devastation. Addressing inequalities requires redistributive and progressive measures on the fiscal front, but also when it comes to labour policies.

## Wage freezes and containment

Over the years, the Fund has expressed its concern regarding the wage bill in the public sector and the pension scheme enjoyed by public servants. This has also been a flagship issue taken up by the IMF in the region. Article IV reports show the IMF has been involved in advising the government on the reform plans discussed at the Paris II and III conferences, plans that set forth nominal wage freezes and pension reforms in the public sector.<sup>115</sup> These reform plans have exacerbated social tensions in the country and led to significant labour movements that lasted for years, and demands for wage adjustments and increases. The IMF has expressed concerns about financing public sector wage adjustments and salary-scale changes, with the result that they have not been adjusted in line with inflation since 1996. Furthermore, the Fund has called for 'limiting government interference in private sector wage setting,'<sup>116</sup> referring to the increase in the minimum wage for private sector workers in 2012 following more than 10 years of non-adjustment. The IMF warned that the wage adjustment for private sector workers would harm competitiveness with other countries in the region. It is worth noting that these developments occurred within a context of stagnant wages, weak collective bargaining frameworks and weakened unions, not to mention privatized health, education and transportation systems. Indeed, both revenue and expenditure reduction policies would lead to exacerbation of the inequality crisis, while the IMF's response is exclusively concentrated on scaling up safety nets.

## Reforming without addressing structural inequalities

The government has not enacted all the fiscal consolidation measures proposed by the IMF in its Article IVs. Tax reforms have been very limited and consisted mainly of increasing VAT by one percentage point, increasing interest income tax from 5% to 7%, increasing corporate income tax from 15% to 17%, and other limited measures. Therefore, Article IV reports to date have mainly reiterated the bulk of the recommendations set out in 2006, with the only major change being in tone and urgency. In this sense, the recommendations have not strayed from the Fund's blueprint, except for consistently backing the currency peg. In addition, the latest Article IV reports on Lebanon do not reflect the significant shifts the IMF has undertaken during the past few years, mainly in terms of operationalizing gender and inequality analysis and concerns. Beyond reference to Syrian refugees, inequality and gender concerns have not found their way into IMF analysis, despite Lebanon being one of the most unequal countries in the region. In addition, the issue of corruption was only lightly broached in the 2019 Article IV Consultation report. Governance problems were also not prominent in the IMF's surveillance. This is illustrated by the fact that the IMF only began to sound the alarm in 2014 regarding passing a public budget, despite the fact that successive governments had been spending without a budget since 2005. Officially, the first budget to be passed since 2005 was in 2017.

The IMF has repeatedly warned of the extreme vulnerability of the Lebanese economy and its dependence on foreign deposit inflows. The report issued on 17 October 2019 warned that 'the economy and the financial system in particular are highly vulnerable and moderate negative external or domestic events can precipitate a fall in confidence and potentially an economic and financial crisis. Possible domestic events include the government's failure to achieve its fiscal targets and advance reforms, political infighting, and social tensions'.<sup>117</sup> Despite the repeated warnings, the IMF's policy recommendations have not addressed the fundamental issues faced by the Lebanese economy, which is highly dependent on capital inflows to maintain the peg and finance the economy. These inflows have traditionally been generated from tourism, real estate, remittances and attractive interest rates that bring in businesses. All of these channels are highly dependent on the regional and international environment and less on domestic factors. In this sense, the IMF has advanced its flagship fiscal consolidation, or austerity, policies in order to remedy the outcomes of an unequal and deficient economic model and structure.

## 4 CONCLUSION

The Article IV reports on Lebanon, especially the latest one issued at the end of 2019, give an indication of the main conditionalities and policies one could likely expect in an IMF programme for Lebanon. If this indication is accurate, the outline IMF programme for Lebanon is not likely to deviate much from the standard policy prescriptions that the Fund has backed in many countries, and specifically in the MENA region. It remains unclear whether the IMF's conditionalities for Lebanon might be different in light of its shift in rhetoric observed in the past few years and the current coronavirus crisis. In any case, an IMF programme for Lebanon ought to take into consideration that it would come after an unprecedented popular uprising that demanded social justice and an end to corruption and sectarianism, and will be implemented in a context of extreme inequality and poverty.

In this regard, the IMF's Director of Communications said that the reform plan should 'ensure that the burden of adjustment does not fall on the poor and middle class, while the proposed fiscal adjustment strategy is successfully implemented'.<sup>118</sup> Hopefully, the IMF will translate this thinking into shaping the potential programme around an equitable sharing of the burden. This means the wealthiest and all of those who benefited the most from post-civil-war economic policies and the banking 'Ponzi scheme'<sup>119</sup> should bear the bulk of the costs. This would be achieved through progressive taxation, greater accountability and social spending. Households in Lebanon that have witnessed their incomes dwindle and shrink over the last few decades should not be expected to sacrifice further. These issues ought to be at the heart of policy propositions and discussed at the negotiation table – reducing inequalities ought to be an objective of any potential loan programme. In order to achieve this, Oxfam in Lebanon sets out its recommendations on key issues in the sections that follow.

### TAX POLICY

In its latest Article IV report,<sup>120</sup> the IMF proposed tax measures that are intended to significantly increase indirect taxes such as VAT and excise on fuel, and remove VAT and other exemptions. In addition, a slight increase to the interest income tax was proposed. In this regard, Oxfam in Lebanon calls on the IMF to:

- Conduct an impact assessment for the proposed tax measures and how they will affect gender and economic inequality and poverty. Moreover, it must ensure that any VAT reform is accompanied by effective exemptions or zero ratings for the most vulnerable consumers and for products related to women's sexual and reproductive health. In short, the IMF and government must minimize the regressive impact of the tax changes.
- Move away from further shifting the tax base to indirect taxation, and instead enhance the progressivity of the personal income tax and corporate income tax. As well as this, the IMF should recommend significantly increasing the tax burden on rentier activities such as interest income, capital gains and property and eliminating tax exemptions for corporations.
- Include imposing a tax on extreme wealth in its policy recommendations, specifically on large deposits, as the banking system and secrecy laws have been the main vehicle of deepening inequality in Lebanon. If Lebanon had in 2010 introduced a tax on net wealth at a rate of just 2%, by now it would have raised \$12.8bn – more than enough to cover the loans pledged (but not yet disbursed) at the CEDRE funding conference in Paris in 2018, or the equivalent of 82% of its total foreign debt service payments since 2011.<sup>121</sup>

The above measures are particularly important not only within the context of long-overdue economic reform, but also in terms of the coronavirus response and recovery. They are in line with the IMF's recommendation to impose a 'solidarity surcharge' on high-income and wealthy individuals in response to the pandemic.

## SOCIAL SPENDING AND PROTECTION

We can expect the IMF's programme in Lebanon to consist of drastic fiscal consolidation measures, i.e. austerity, in order to reduce the budget deficit, which is estimated to be around 11% of GDP. Reports suggest that a prospective plan would require the removal of all subsidies, including on wheat and other essential goods. It is also expected that the IMF would require the elimination of electricity subsidies and transfers. In return, the IMF would likely propose ramping up the social safety net to alleviate the impact of removing the subsidies. While electricity subsidies are environmentally harmful and subsidies in general tend to benefit well-off households the most, they remain one of the rare universal social transfer measures in the country and have a significant positive impact on people living in poverty. The removal of such measures will also have the most impact on vulnerable people. Therefore, Oxfam in Lebanon believes that:

- The IMF's policy advice should move beyond a 'compensatory' approach to mitigating the negative distributional impacts of austerity measures. Removing electricity subsidies should be accompanied by reforms ensuring that services are improved and costs reduced. This will help prevent inequalities from increasing as the situation becomes ever more dire in Lebanon. Other reforms should be recommended too, such as an overhaul of the tax system to secure progressivity and fairness and providing quality, affordable basic services.
- Social safety nets would have limited effectiveness at a time where poverty rates are skyrocketing as a result of the financial and economic crisis as well as the coronavirus response. The issue with the compensatory approach of social safety nets is that it focuses on mitigating the harm done to those affected by the negative impacts of structural adjustments, rather than questioning the validity of the reforms themselves and adopting equality-oriented approaches to combatting poverty. Oxfam believes that the starting point should be a comprehensive understanding of the drivers of inequality, followed by interventions which ensure that the most vulnerable people are not merely compensated by means of safety nets, but are the main beneficiaries of reforms through the reduction of inequalities and enhanced basic services. Therefore, the Fund should move away from recommending measures to boost safety nets and towards a universal social protection floor approach in line with that of the ILO and the 2030 Agenda for Sustainable Development.<sup>122</sup> In doing so, the IMF should support the Lebanese government in developing an effective, inclusive, rights-based and fiscally sustainable social protection system alongside implementing the needed macroeconomic reforms. Oxfam in Lebanon calls on the IMF to put social policies on an equal footing with its macroeconomic commitments and to invest in supporting the Lebanese government in identifying and mobilizing resources to develop and establish the basis for a universal social protection framework. This framework should accompany individuals during their whole lives and focus on preventative measures to protect the livelihoods and well-being of the Lebanese population.
- Social spending on health and education ought to be increased, especially in light of the ongoing health crisis. In this regard, the IMF's social spending policy recommendations should focus on establishing participatory, binding and transparent criteria and outcomes for social spending floors that are agreed with citizens and different groups, especially women's rights organizations.

## LABOUR RIGHTS

Over the years, the IMF's views on labour rights and policies in Lebanon have been at best ambiguous. Based on its previous positions, it is possible we can expect IMF conditionalities related to containing and reducing the public wage bill; reforming pensions, especially for public sector workers, whose schemes are deemed too generous; and increasing the role of the private sector through making privatizations easier. On these points, Oxfam in Lebanon urges the IMF to:

- Ensure that any proposed public sector reform plans are reached in agreement with representative public sector workers' organizations and guarantee dignified working conditions for public sector staff. In this regard, the ongoing freefall of the local currency's value compared with the USD has significantly reduced the value of public servants' wages and pensions, as well as the end-of-service indemnity received by formal private sector workers. Thus, any measure ought to ensure that the impact of currency devaluation on workers in Lebanon is minimized in both the private and public sectors by establishing a mechanism for wage indexation to account for inflation. This should involve genuine social dialogue.
- Include policy recommendations focusing on building labour market institutions and supporting workers in the informal sector, notably promoting policies that reduce inequality, such as the establishment of a living wage, gender equality in the workplace, protection of workers' rights and collective bargaining. Active labour market policies are needed to boost employment, skills and capacity building. Fundamental employment rights, such as sick leave entitlement, job security and others are a crucial buffer for people impacted by the coronavirus crisis. Therefore, lessons learned ought to be translated into genuine change in order to enhance labour protection and not fuel informal labour and precarity.

## GENDER EQUALITY

Oxfam in Lebanon believes that gender considerations should be mainstreamed into the design and implementation of the IMF's programme in Lebanon. As such, the IMF must:

- Focus on the gender impacts of its macroeconomic policies and avoid pushing for policies that have been shown to have negative impacts on gender equality in other programmes in the region and globally.
- Ensure its advice goes beyond increasing women's participation in the labour market, and rather focuses on improving women's employment terms and fair incorporation into the economy. The IMF should encourage the Lebanese government to adopt gender-sensitive laws that protect women in the labour force and ensure that decent working conditions are guaranteed for both men and women.

## AID EFFECTIVENESS AND GOVERNANCE

The Fund mentioned the need to fight corruption in its latest Article IV Consultation report for 2019. The issue of corruption is systemic and cuts to the core of policy making in the country. Nevertheless, Oxfam cautions against using fighting corruption as a pretext for privatization and other policies that exclude civil society organizations and impacted communities in general. Thus, Oxfam believes that:

- The ongoing negotiation process should be transparent and accountable. The comments of the, IMF Communications Director and spokesperson, affirming the need for 'strong government ownership of its economic program, and support for [reforms] across the political spectrum and civil society'<sup>123</sup> need to be translated into practice, particularly since the government's reform plan presented to the IMF was not openly discussed either in parliament or with civil society organizations. Civil society organizations, workers' organizations and communities should be at the table and genuinely consulted, and their concerns included in any programme. Furthermore, it is important to disclose the credentials of those involved in the consultation process, in addition to all data, relevant information and processes.

## THE URGENT NEED FOR DEBT RESTRUCTURING

Debt restructuring and relief should be at the heart of any recovery programme that is put in place in countries in debt distress, as is the case for Lebanon. Overlooking the size and depth of a country's debt troubles is a disservice to the country and will only result in worse chances of

economic recovery. If debt is not dealt with, resources meant for social spending and coronavirus recovery will probably be channeled to repaying creditors, especially private ones, which will build up AAA-rated debt<sup>124</sup> with the Fund itself. Oxfam in Lebanon believes that:

- The IMF's intentions should be explicit in the potential agreements, ensuring transparent tracking of the purpose and use of the new funds it provides.
- Although the IMF already states that Lebanon's debt is unsustainable, it must accompany this with an invitation for an urgent debt restructuring to help the country return to being sustainable. At present, private creditors negotiate using their own names because, disgracefully, there is no integrated debt restructuring system or mechanism – a major flaw in the international system that weakens debtor countries' capacity to recover rapidly from debt distress. Oxfam considers that under the current circumstances it is a duty of the IMF to support a restructuring negotiation between Lebanon and its private creditors, in a collective effort to bring the country's debt back to a sustainable level. Private creditors should also pay their fair share towards the reform plan, as they have benefited from the now crumbling economic model.
- Any economic reform plan for Lebanon should have at its heart an equitable, fair and just recovery from the disastrous impacts of the current pandemic and the financial and economic crisis. In particular, it should focus on improving and investing in basic infrastructure; health systems; livelihoods for all residents, including migrants and refugees; and social protection. This will help to avoid an economic depression and a lost decade, especially for the youth of Lebanon.

# NOTES

Links were last accessed in August 2020.

- 1 In Lebanon, banks – with the support of the central bank – were giving high interest rates on USD deposits, although the currency is not printed in Lebanon. These high rates were given to large depositors, many of whom are part of the connected elite. The high interest rates were paid off using other depositors' money, thus the system relied on constant foreign currency inflows. When many of these inflows halted, it led to the system collapsing. See R. Berthier. (14 April 2020). *Grand Theft Lebanon*. Synapse. <https://www.synaps.network/post/lebanon-finance-economy-ponzi-bankrupt>
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# OXFAM

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