Life Beirut – August 8th, 2017

Distinguished ladies and gentlemen,

I am very glad to address such a remarkable audience tonight, and I would like to thank Life for giving me the opportunity to do so.

We meet at a time when some of you are being asked to be part of advisory boards for various policymakers in Lebanon, while you may be wondering whether the existing structure of the Lebanese state allows good policies to be implemented. A time when our country faces big challenges on various fronts, including (1) exogenous factors such as the Syrian crisis, the international legislation, and various other external factors of instability, (2) serious governance issues, and (3) the well-known imbalances of the Lebanese system.

To be more specific, we are dealing with (1) a dangerous refugee load with many implications on the economy, the public finances, the infrastructure, the safety nets, and the security of our country, (2) new regulations worldwide such as tax transparency, and locally, such as the financial sanctions against Hezbollah, (3) the geopolitics of petroleum, as we have become part of it, (4) miscellaneous factors that have a direct impact on the Lebanese fundamentals, such as oil prices with their impact on financial inflows, US interest rates and their expected impact on public finance (my personal expectations are that we are going to see a hike in December), the regional wars, turmoil and instability and their impact on growth, remittances, trade, and security costs, and finally (5) the most important factor, which is the inability of the power structure and the political level to properly address those issues and define the adequate set of policies, let alone being able to implement them.

But you know all that, and I am not going to overburden you with figures related to Syrian refugees in Lebanon, or the details of the soaring public deficit, and the figures of the balance of payment. You know that the real economy is in a very difficult shape, and that the public finance deficit together with the external account deficit are very high, that debt dynamics are pretty bad (public and private debt), and that the balance of payment figures are back to negative. I will save those details for my meetings with Christine Lagarde, Jim Kim and their teams in October. With you, we have much more important things to discuss.

As top financiers, you have been scrutinizing and analyzing the recent unusual operations between the central bank of Lebanon and most of the local banks. And beyond the questions that you raise around those operations regarding their transparency, the existence of a moral hazard, the market distortions, the bailouts with free money, the overall cost of the operations, and on top of all, the worrying signals that they send and that many of you flagged, it is very important to all of us to try to make a proper diagnostic of what has been happening.

Since the end of the 1975-1990 war, Lebanon has entered an era of low productivity and worsening competitiveness with various policies that have largely contributed to the weakening of the productive sectors, and to an environment that is hostile to “independent” investment and labor, and to the demolition of the middle-income layer of the population. Our country has witnessed a brutal accumulation of public debt accompanied by a stranglehold on public assets that is regularly legalized ex-post. Since then, the only persistent logic underlying the various policies that were pursued was the permanent search for securing large financial inflows into the system.

The depreciation of the pound at the beginning of the nineties was the first big shock aiming at bringing in as much hard currencies as possible, as Lebanese assets suddenly became very cheap. Another measure was the issuing of Eurobonds that started in the mid-nineties and that is consistently increasing in volume since, even though one could have easily questioned the rationale behind it. Then our country had to cope with extremely high interest rates for nearly a decade, with the impact that you can imagine on corporates and productive sectors, again for the sake of attracting capital. In the meantime, many tax incentives went unnoticed on this same front, including breaks on real estate registration fees, the slashing of taxes on interest income, and others, all aiming at making the economy attractive to inflows, even though they were systematically penalizing production and labor and diverting resources from productive investments. Let us also not forget the donors' conferences of Paris II and Paris III, which main purposes were to compensate for the drop in financial inflows by forcing several billions of dollars into the system at times where there were concerns about its sustainability. There were other smaller similar capital injections, but all of them failed to force the system into the reforms that were – and still are – badly needed. In my view, the main failure of those donors' interventions was the absence of conditionalities that could have put Lebanon on the right track. But to continue to illustrate the permanent quest for massive capital inflows, I would also like to mention the exoneration of investment banks from the mandatory reserves by the central bank at a certain period of time, and also the Junior/Senior product at the end of the nineties whereby institutions would end up paying between 12 and 15% on the dollar instead of market rates that were half those figures.

By the way, many of you have probably been very fund of those tricks given the opportunities they created for your business, and that is fair because you were not the ones who should have worried about the economy. Three days ago, a 30 year-old friend of mine whom you all know very well was telling me that he is unable to understand the underlying economy of our country. The fact is there is very few left to understand.

Therefore, the conclusion of my first point is that the underlying purpose of the financial operations presently known as financial engineering is far from being a novelty. What our markets witnessed are yet another tool to secure as much financial inflows as possible, with important side effects such as bailing out institutions or generating artificial means to embellish ratios. So instead of discussing the said operations with their pros and cons, now that they have become a given fact, my purpose is to investigate why our system needs so badly to sacrifice so much in this never-ending quest for more and more inflows. And this brings me to my second part, in which I would like to challenge some simplistic explanations related to what is wrong in the system.

From those who fail to see the fundamentals as they are or those who simply don't want to, tens of invalid or insufficient explanations are given. Here are some samples. Is our problem about being able to mobilize more revenue through better collection? This simplistic view reduces the problem to a financial imbalance issue and neglects the fact that collection rates have been volatile with periods of significant improvements. It also fails to understand that balancing the budget doesn't necessarily means that the economy is going to improve, as a balanced budget could hide increasing inequalities if revenue sources are not well fairly distributed, which in turn would have a long-term negative impact on sustainable growth and poverty reduction.

Thus the answer is: No, it is definitely not only about increasing revenue and collection. And since we are talking about bringing the deficit under control, it would be useful to note that government spending consists of a long list assigned to satisfy everybody at all time, and important expenditure do not necessarily come first. The value of time is wasted and the debt is soaring. Related current expenditure come before capital expenditure, and are borne before the related projects take place. Accommodating everybody means that no clear work program is defined, and no performance assessment is possible. We start many projects at a time and we finish none, so we spend plenty of money with no valuable return on public investment. My team developed a medium-term expenditure and budget framework which provides a clear prioritized agenda, and we are now able to theoretically optimize public investment.

Is the problem about fiscal issues such as EDL's deficit? It was very convenient to many politicians who were in charge of financial management to blame it on EDL. But EDL's deficit has nothing to do with the company and is imposed by the government. The latter imposes the tariffs, buys the fuel, manages the hiring and the compensations, and decides on the capital investment for the energy sector and EDL. Therefore, EDL has no say with regards to its revenue and expenditure, and is structurally in deficit because of government's subsidies policies. This issue illustrates the inability to take proper action, the weight of vested interest in the system, and the unwillingness to properly share the burden, and sorting it out will certainly do a lot of good to the country's public finance, but again, it is far from being the only required solution, as the pricing of the service will remain very high and will keep large segments of the users outside the formal sphere, while remaining a burden for the productive sectors and the real economy, not to mention that the system will find a substitute as a new black box, just like what happened with other public entities that I will not name tonight.

By the way, for those who are calling for a higher tax burden in Lebanon, which is understandable if we look at the official ratios, it is important to note that the cost of inefficient public services, from education to utilities and others, is very high, and that those services require additional expenditure to compensate for their inefficiencies, which leads to a very significant burden that leaves little room for further tax mobilization across the board.

How about administrative reform then? Isn't the public administration inefficient and corrupt, and isn't it the source of obstacles ahead of investments? Again, I have to say that this is totally false. First because the system is striving to annihilate the administration, which has become quasi totally dominated by the political level, and therefore, reforming the administration without ensuring that the political level abides to the law is totally useless, especially that civil servants who break the law are backed by their political godfathers. If corruption is widespread within the public administration, the big corruption is at a higher level, and it is the one that is changing the face of the country into something ugly. We often hear that the administration is the main obstacle ahead of investment, but I would argue that although part of the civil service is corrupt, the main obstacle to professional investors are those at the higher level who want to have a share of all businesses and who impose their conditions on investors simply because they can. This is the real high cost in the system, and very often, the administration is under fire because it dares remind those players of the existing laws.

And since I have mentioned the public administration, let me say a couple of words with regards to the salary scheme of the public sector. As you may know, the number of civil servants today is below eleven thousand persons, which is very low, but the hiring in the public education and the military forces continues at a fast pace, with nearly 54000 teachers in the public sector and more than 110000 people in the armed forces. Lots of teachers in a country where the government subsidizes private school students. Lots of new recruits in the armed forces in a country that is hardly able to upgrade its equipment and weaponry. And finally, Lebanon has very few civil servants and a very large number of contract employees, advisors, and sometimes irregular workers, who are hired to assert the power of politicians and to absorb unemployment given the inability of the private sphere to create jobs.

On the other hand, all attempts to eliminate the tax levy to the benefit of private interests such as funds and private orders have failed, despite the big debate on taxpayers' resilience that is accompanying the new tax measures.

Coming back to what is the main source of our problems, is it security? Wars, occupation, weapons outside the theoretical monopoly of the State? Of course, some of this may explain why foreign investment is very reluctant to come our way. But the Lebanese and their money is largely here. Plenty of liquidity is in the system for a very long time, doing practically nothing. It is not running away because of insecurity, and did not run away when we had a Syrian gauleiter, and is not flying away because our neighboring countries are burning. Even the newly announced sanctions are not likely to have an impact on the existing available level of liquidity. The system simply keeps it away from capital investment and productive sectors.

Is it because of the public sector? Remember how many times some of you thought that there would be new privatization business in this country, and how many people believed that this was the solution. It was amazing to hear those in charge of the Lebanese public sector explain themselves that the said Lebanese public sector will always be unable to properly manage anything. These achievers were promoting privatization as a magic solution. Being myself a believer in the virtues of privatization, on a case-by-case basis, with strict specifications and without any ideological burden, I have to say that unfortunately, privatization will do no good as long as the State doesn't fulfill its role of lawmaker, law enforcer, and fair provider of regulation, infrastructure and safety nets.

Bottom line, this means that all efforts that consist for politicians of running away from their responsibilities by liquidating public assets will fail, and that privatization in particular can only succeed if the State bears its previously mentioned responsibilities. It is far from being our case. On the same line, the trend today is to promote PPPs as a magical solution to our infrastructure deficit. Again, it could be part of the toolkit if public authorities are able to fulfill their duties, and not as a substitute to a good governance in the public sphere. It is already very hard to contain corruption on a 3 to 5-year contract nowadays, so just imagine the impact on taxpayers' money if we embark on 30-year contracts, with no accumulated know-how to confront the heavily experienced counterparts. It can bring in some interesting potential only if the authorities do their job in the best possible way, and certainly not if they throw the hot potato and let the sharks play.

Ladies and gentlemen, if sorting those issues or using those tools that are raised all the time is not good enough, even if it is a combination of all that, then what do we do? Well this is what I would like to discuss with you in my last part.

To create jobs, secure long-term growth, balance the accounts, strengthen the balance of payment, create value-added, one thing only is needed: Productivity and competitiveness.

Easier said than done. This obviously requires significant rechanneling of wealth from a few pockets toward the productive economy, together with creating the proper environment at various levels. Among others, it requires tax and fiscal policies, together with efficient social safety nets, that would reverse the wealth concentration process, and that would reduce inequalities from the extremely high levels that we are witnessing. The said wealth concentration process is fueled by various factors including tax and budget laws, financial engineering operations, deteriorating safety nets, or corruption. Incidentally, re-creating a vibrant middle-class in Lebanon would certainly help reforms in the future, and one of the few good things about the salary and wage bill is that it favors the emergence of a middle-class. As I said, the wiping off of the middle class has had a very negative impact on our ability to introduce change and reforms. This is why my team and I keep working on a fair adjustment and keep proposing the trimming of unreasonable expenses that distort the fair redistribution of public money. This is also why I insist on targeting the loopholes in the tax system before relying on increasing the burden on taxpayers across the board. Having said so, we also want more rich people in Lebanon. Many, many, more. But we want wealth to derive from business, knowledge and smart choices, not from embezzlement, corruption, or abuse.

The road to productivity also requires to significantly squeeze corruption, as one main factor of wealth concentration and as a foil for investors. And since we are talking about governance, what is required here is not abstract: We need an effective reform of the judiciary power with a clear orientation toward fighting corruption and preserving national wealth, and we need to re-invent the decision-making process at the political level to secure the ability to define proper policies and implement them.

Productivity also requires a deep reform of the education system, which will be yet another contributor to inequalities reduction. Our education system has paid a very heavy price absorbing thousands of inadequate staff and tens of mushrooming universities, on top of a complete disconnection with market needs. Education has traditionally been a very big investment for Lebanese households. This means that it requires high returns, with no adequacy with the labor market needs and no sizeable demand for highly skilled labor. Conclusion: the skilled labor, like your goodselves, goes abroad and seeks higher returns. And with the Syrian displaced now, the system needs to be stabilized very quickly.

Finally, it is critical to fix productive investments and to widen our markets. By increasing productivity, we are making a choice of society. Indeed, this would mean fewer low-skilled foreign workers in our economy, and higher opportunities for our skilled workforce. This would also mean the establishment of big entities in Lebanon which would move massive resources toward productivity, which is something SMEs alone are unable to do. And to widen our tiny market, it is critical to become a regional player and to integrate our market with other neighboring ones. As you see, I am really talking about very concrete steps that would pull Lebanon out of its present unenviable position. And to succeed in those steps, we have to have the capacity of managing the change, including through protection measures and transition ones. This involves a very large reallocation of risks and assets, and it is important to anticipate how all this could happen. Would it happen naturally? Definitely not, simply because whomever is in charge of the present system is tied to it for two main reasons: Because they need to take up as much as they can from the system to cater for their troops' needs on one hand, and because they are perceived as the guarantors of the present system on the other hand. Would it happen after a crisis? We certainly shouldn't hope for that, as it could accelerate the meltdown, if not managed properly, and there are no adequate structures to do it. It could only happen through a political operation.

The existing system has permitted overconsumption for years, and has had pernicious and massive impact on brain drain, education, social instability, and inter-sectorial distribution. To sustain and entrench the windfall economy and the inflows, the Lebanese society itself has been transformed into an adjustment variable, and it is time to change this painful conclusion.

I am now ready to discuss details, or any other topic you wish to discuss, and I am happy to report that I was able to address financiers for such a long time in my director general of finance capacity without giving one single figure.

Thank you,

Alain Bifani