



LEBANON'S 2020 BUDGET

AN ATTEMPT TO CONTINUE BUSINESS AS USUAL IN THE EYE OF THE CRISIS

January 2020

Lebanon's 2020 budget

An Attempt to Continue Business as Usual in the eye of the Crisis

OUR POSITION IN A NUTSHELL

Members of Parliament are invited to convene in two sessions to discuss the 2020 budget on the 27th and 28th of January 2020. The budget relies on a significant and artificial reduction of the cost of servicing the local debt, without dealing with the stock of debt. We are worried that such temporary solutions would only postpone the inevitable while increasing the cost on society through inflation and the devaluation of the Lira.

Kulluna Irada warns against the adoption of a law that fails to address the major crisis Lebanon is facing. The utmost emergency today is to put in place an immediate and comprehensive solution to the crisis, on the monetary, financial and social levels. Time should no longer be wasted in further attempts to kick the can down the road, while Lebanese citizens are losing their jobs by the day and falling into extreme poverty.

We therefore call upon Parliament to refrain from voting on this draft budget law.

And we call upon the new Government to swiftly present its ministerial statement for the vote of confidence and proceed to dealing with the urgent financial crisis at hand. We also urge the Government to withdraw the draft budget law and commit to presenting a new one which should fall within the framework of a fair and comprehensive rescue plan which responds to the aspirations and demands of the Lebanese people and includes the restructuring of the debt and the financial sector. This should be achieved within one month at the latest, given that an important debt maturity awaits us in March of 2020.

Table 1: Budget figures

in LBP Bn	2020 As Adjusted by Budget Commission	2020 as Prepared by MOF	2019*	2019 Budget
Budget Revenues	13,396	19,009	15,066	18,783
Budget Expenditures	19,732	24,100	22,338	25,605
Current Spending	17,878	22,697		24,150
of which Debt Servicing*	4,719	9,219	7,419	8,312
of which Transfers to EDL	1,500	1,500	2,363	2,499
Capital Spending	1,003	1,402		1,456
Budget Balance	(6,336)	(5,091)	(7,273)	(6,823)
Treasury Deficit	N/A	N/A	(1,111)	N/A
Fiscal Deficit	N/A	N/A	(8,384)	N/A

*Given that fiscal accounts of November and December 2019 have not yet been released, revenues for those two months were assumed to be 30% less than those of 2018. However, a linear distribution was assumed for telecom revenues along with fiscal expenditures.

GENERAL COMMENTS ON THE PROPOSED BUDGET

The Lebanese authorities have yet again exceeded the Constitutional deadline set by Article 32 for passing the public budget, which is the roadmap to a government's activities within a given year. With a focus on adopting the budget law before the extended deadline of end-January set by Article 86 of the Constitution, the latest draft fails yet again to meet the emergency of Lebanon's triple crisis (balance of payments, sovereign default, and banking crisis).

The 2020 budget was expected to be a main pillar of the multifaceted crisis management plan that citizens have taken to the streets to demand. Not only does the proposed budget fail to meet the urgency of Lebanon's situation, but it also fails to mention the financial crisis throughout the text of the law.

A key pillar of the budget is a gentleman's agreement involving the Ministry of Finance, Association des banques du Liban, and the Central Bank to drop the government's debt servicing cost without setting it within a clearly stated medium term debt strategy within a crisis management plan. This agreement entails a 50% drop in the government's debt servicing cost with no indication of the type of operation underlying it or the implications of such operations on the lira and on inflation.

If approved as is, the proposed budget is expected to aggravate the crisis and lead to an inevitably larger correction further down the line since it does not rely on a credible source of financing. Counting on the Central Bank yet again to finance an unsustainable deficit puts the country at risk of hyperinflation, which is the worst scenario for Lebanon.

SPECIFIC COMMENTS ON THE PROPOSED BUDGET

AN UNSUSTAINABLE DEFICIT WITH NO CLEAR FINANCING SCHEME EXCEPT RELIANCE ON BDL

The Government's planned deficit is targeted at LBP 6,336Bn or 8.73%¹ of GDP. This reduction in the deficit is due to the fact that GDP contraction is forecasted at 15% notwithstanding that cuts in spending are not credible, nor sustainable.

- The Treasury has been fully reliant on Banque du Liban (BDL) to cover for its deficit since Q3 2018. This use of monetary policy to cover for fiscal spending, and transfer the government's deficit to BDL, has led the country to its current financial position and has depleted BDL's foreign exchange (FX) reserves down to alarmingly low levels. It should be noted that BDL has an estimated USD 30Bn negative net FX position.
- 2020 will see a continuation of that trend and its public deficit will be financed through freshly printed LBP, with near zero interest rates, from the BDL. This would lead to a steep rise in inflation: with money demand collapsing, and bank liquidity unavailable, the Central Bank might not be able to sterilize this new injection of liquidity as it has been doing before.
- It should be noted that a similar funding deal was underlying in 2019's budget draft but was dropped after warnings from the IMF and credit rating agencies. However, the deal was brought back to light in Q4 2019 and BDL has lent the government LBP 4,500Bn at a cost of 1%.
- Given the fact that the Lebanese financial system is facing a prolonged liquidity shortage and that yields on the government's external debt are well passed near-default levels, the budget cannot be passed in the absence of a well-defined debt restructuring plan.

TAX REVENUE PROJECTIONS ACKNOWLEDGE A DOUBLE-DIGIT RECESSION

- The budget revenue projections, of LBP 13,396, are particularly striking. Bringing in a 29% drop when compared to 2019 budget and 11%* with respect to its actual expenditures. The government's projection factors in a double-digit economic contraction that negatively affect Lebanon's social fabric that should be addressed by the authorities. Nothing in the budget hints acknowledgement of the magnitude of the crisis by the authorities, let alone entailing policies to address it.
- Recording a contraction of revenues is not enough, especially on a gross level as listed in the draft 2020 budget. It is the role of the government to state clearly what revenues are expected to drop and address the reasons of a collapse by this extent.
- Even if projections seem to take a realistic account of the economic contraction, one cannot exclude that the current rise in civil disobedience - mostly tax payment boycotts - would limit the Ministry of Finance's ability to collect these taxes.

¹ Assuming the currency peg is maintained

- The purpose of this note is not to comment on each of the specific revenue measures that are included in the draft, such as a new 2% exceptional tax on banks and financial institution activity. However, one cannot but be concerned about the absence of rationale that should be underlying them. The lack of clarity is combined with the absence of any quantitative projection or impact analysis, for each of the proposed revenue measures.

A DROP IN EXPENDITURES THAT SIGNALS MORE POWER OUTAGE AND QUASI DEBT RESTRUCTURING

- With LBP 18,232n on the expenditures side, the budget plans a 29% drop in budget expenditures when compared to 2019's budget and 18%* with respect to its actual figures.

- A key driver of the drop in expenditures is an agreement between the government, ABL, and BDL to bring down debt servicing costs by LBP 4,500Bn. There is no clear indication of what this deal is taking into account. However, taking into account that the servicing cost of the government's existing market debt is around LBP 9,500Bn, the "agreement" involves an uncommunicated 80% haircut on the coupons of local currency debt.

- Another driver of the reduction in expenditures is a 40% drop in transfers to EDL when compared to 2018. The credit line is reduced to LBP 1,500 Bn compared to 2,500Bn in 2019's budget. Given the rising oil price outlook and no official change in its pricing model, this entails clearly to more power cuts. This drift in public service provision should be communicated clearly and not through a budget line, especially while false hopes of an overhaul to the sector are being communicated by senior government officials.

- It should be noted that current spending was dropped across the board without taking into account the effects of these spending cuts on the operations of their corresponding state-owned entities.

- A better distribution of government expenditures is still needed, and in times of harsh recession, resources should be allocated for a social security program to provide basic public services and cater to the rapid and substantial rise in poverty rates due to the ongoing crisis.

- A sharp drop in capital spending will put even more pressure on Lebanon's ailing infrastructure. Reducing expenditures adopted in a multi-year program and just delaying them to 2021 cannot be considered a serious policy. This approach reveals the inability of the authorities to set priorities and public spending policies.

LEGAL PERSPECTIVE

Parliament is heading towards an urgent discussion of the budget law before the extended deadline (end of January) set by Article 86 of the Constitution expires. However, this leaves two main constitutional issues unaddressed.

First, this is yet another budget law that violates Article 87 of the Constitution related to approving the Statement of Accounts of the previous year before adopting the new budget.

Second, the budgetary voting session fails to address the contradictory provisions of Articles 69 and 32 of the Constitution, which we believe should be read in accordance with the spirit and functions of the institutions, and in light of two key contextual factors: the timing (the voting session comes after the formation of a new government and at the beginning of a new budget year cycle) and the urgent financial crisis. A healthy constitutional process would require Parliament not to pass a budget law before the new Government receives a vote of confidence and swiftly presents a new draft budget that responds to the situation at hand and falls within a fair and comprehensive rescue plan, to be voted in the shortest deadlines.

The former government's resignation came on 29 October 2019, right after the beginning of the ordinary session reserved for the discussion of the budget, i.e. at a key moment of the constitutional cycle. This timing - coupled with the context of the financial crisis and the popular uprising calling for a rescue government with special powers to develop and implement an emergency crisis management plan that requires a new budgetary approach - is key in the interpretation of the relevant constitutional provisions.

A government being sworn in at the beginning of a new budget cycle and in the middle of a historic financial crisis, cannot conduct its mission successfully on the basis of a budget passed just a few days before its vote of confidence. And it should be noted that based on the principle of unity of the budget, the Government can only make minor amendments to the budget once it is passed. These amendments are submitted to Parliamentary vote as per Article 86 of the Constitution related to exceptional budget lines. The Government is hence bound by the budget law that will be passed in Parliament, in its general rationale, its approach and most of its items, which will keep it from adopting any structural reforms or new budgetary approach that responds to the crisis at hand.

- Article 69 parag. 3 of the Lebanese Constitution provides that when the Council of Ministers resigns, the Chamber of Deputies shall automatically be considered convened in extraordinary session until a new Council has been formed and has gained the Chamber's confidence.
- And while Article 32 provides that, from mid-October until the end of the year, Parliament convenes in an ordinary session reserved only for the budget, a "good faith" approach that preserves the spirit of democratic institutions would have consisted in forming a crisis Government that would submit a new budget which responds to the current crisis all before the end of 2019.

- Today, and after the constitutional deadline of Article 32 has already been missed, the new government cannot be held accountable, especially at the beginning of a new budget year, on the basis of a budget presented months in advance by the caretaker government.
- It should also be noted that Article 33 allowing for the President of the Republic in agreement with the Prime Minister to “summon the Chamber to extraordinary sessions by a decree that specifies the dates of the opening and closing of the extraordinary sessions as well as the agenda” cannot be taken as an excuse for the political powers to abuse of their constitutional rights and disrespect the institutional mechanisms and deadlines set by the constitution. Constitutional provisions should be interpreted and implemented in good faith and with the objective of preserving the spirit of the institutions.



Kulluna Irada is a civic organization for political reform, engaged in setting the foundations for a modern, secure, efficient, sustainable and just state. It is funded exclusively by Lebanese citizens in Lebanon and abroad. Kulluna Irada believes transparency, accountability and citizen participation as major constituents of good governance. The organization's goal is to raise awareness on public issues and engage constituencies of the Lebanese society: citizens, NGOs, experts, municipalities, and members of Parliament and Government in order to find and implement sustainable solutions. Kulluna Irada's internal governance is based on collegial decision making and strict rules on conflict of interest: board members have vowed not to run for elections or participate in any public auction.

Kulluna Irada

Beirut Digital District
BDD 1281, Ground Floor
Syriac Patriarchate Street
Bachoura - Beirut, Lebanon
+961 1 640 020
info@kulluna-irada.org