

Kulluna Irada's Comments on the Government's Draft Reform Paper

April 16, 2020

The official recognition of the magnitude of losses is the first step to exit the crisis

Lebanon's economic revival rests on the conditions of establishing a new social contract and freeing the economic/political system from patronage politics

Taxpayers should not bear the burden of compensating financial losses: no to selling state assets

The government's draft reform paper¹ is an official recognition of the losses facing Lebanon's financial system, and a first step in managing the crisis. The diagnosis revealed in the paper should be followed by clear accountability; it has become obvious that there can be no emerging from the crisis without a political transition that leads to structural changes to the failed system which led to this collapse.

The first step is an acknowledgement of the magnitude of losses and an honest communication with citizens.

The magnitude of losses facing Lebanon is one of unparalleled historical proportions by international standards. The paper has officially confirmed what Kulluna Irada and numerous experts have been warning about for the past years. The reality will prove to be harsh and bitter. Lebanese citizens have a right to know the scale of losses in full transparency and objectivity. It is now time to end the denial surrounding our financial situation, a denial which prevented appropriate decision-making and exacerbated the level of losses. Every day that passes without action exacerbates the crisis and increases our losses.

¹Draft for discussion (v41), <http://kulluna-irada.org/article71->

These losses are due to multiple crises in Lebanon's financial and economic systems, which resulted from years of mismanagement of public funds and accumulation of losses, in addition to an unparalleled hole in BDL's balance sheet that was masked for years. BDL's losses account for over 40 billion dollars - a figure that exceeds the size of Lebanon's GDP - without any oversight attempts to question monetary decisions and hold BDL to account by successive Ministers of Finance, cabinets and parliaments.

Emerging from the crisis will require restoring confidence in the system by defining responsibilities, notably through an independent audit of BDL and other public accounts, as well as reforming the Lebanese power structure and current way of doing politics.

The draft paper has come as a shock to Lebanese citizens, many of whom are still coming to terms with the loss of income and wealth and lifestyle deterioration. Confidence is lost, and anger is only held back by the vital need to respect confinement measures in the face of the coronavirus outbreak. There is a need to rebuild confidence and transition towards accepting the sacrifices that will be required, for the sake of state building. To do so, we must build a new social contract for Lebanon based on durable and just pillars.

The diagnosis outlined in the leaked paper, which classifies the crisis facing the country as one not caused by foreign factors but rather as a homegrown one, cannot be followed by a reform plan without clearly defining the beneficiaries of the current financial, economic, and political systems, who saw societal wealth transferred to their benefit, leading us to the current crisis. This process must be followed by placing responsibilities and subsequently ensuring accountability measures; this process must be launched by an audit of BDL's accounts and those of all public institutions.

Three months after its formation, the Cabinet must take bold and decisive measures that demonstrate its ability to enact real and effective structural change to free Lebanon's political, financial, and economic system from the old way of doing politics, thus restoring confidence in the State and its institutions.

We call on the government to use the draft paper as a framework to develop a comprehensive rescue plan, with the end-goal of establishing the foundations of a strong and just civil state.

Kulluna Irada calls on the government to rapidly begin work on and adopt a multi-pillared rescue plan in line with the diagnosis and general directions of the draft paper. While we have many technical comments which we will publish at a later stage, we believe it is important to first outline the basic principles on which this plan should be built:

- 1) The plan must have a comprehensive and strategic vision to ensure the advancement of Lebanese society and the building of strong state institutions that work in the service of all citizens, within the framework of a new social contract based on social justice and mutual rights and duties between the state and its citizens.** This requires a strong political decision to successfully implement this vision and support it with the needed reforms. This in turn, requires moving away from the sectarian system based on patronage, clientelism, and quotas, and building a civil state based on the rule of law. This starts with the application of Article 95 of the Constitution, which calls for adopting competence-based criteria for public sector positions and not allocating specific jobs to certain sects, as well as rapidly passing a judicial independence and transparency law.
- 2) The plan must ensure the protection of citizens' basic rights as a priority,** especially economic and social rights guaranteed in the constitution and in international treaties, which include the right of all citizens to social security, the right to health and education, and the right to an adequate standard of living. This requires a reform of state institutions to restore their ability to provide basic services and needs for citizens.
- 3) A full bailout of the banking sector, especially by selling state assets to compensate large depositors, is neither acceptable nor feasible given the size of losses. It is also crucial that any rescue package protect the rights of small depositors, and the social savings of liberal professions, and those of the National Social Security Fund.** As mentioned in the draft, no government can take the responsibility of placing the burden of past losses on future generations. Therefore, we reject calls to sell state assets to cover the losses, which would place the burden of

saving the banking sector on the entirety of Lebanese citizens and taxpayers, knowing that more than half of the Lebanese people do not have any bank account and the vast majority of the second half are small depositors, while bank accounts that exceed 1 million USD are no more than 25,000.

4) Domestic resources had become insufficient before March 2020, which confirms the need for external funding to ensure the success of any rescue plan. However, external support, as indicated in the draft, will not be available to compensate for the losses of our homegrown financial meltdown, which resulted from years of mismanagement. Indeed, since the 2008 financial crisis, various countries around the world have abandoned the idea of supporting failed financial systems with taxpayer money.

5) Growth cannot pick up without a healthy banking sector. The size of the losses necessitates a restructuring of the banking sector from which there is no escape. This begins with a comprehensive audit of the Central Bank and the identification of measures needed to manage the gaps in foreign currency accumulated in its accounts. Subsequently, there will be a need to address the negative situation of banks² through mergers and recapitalizations in a manner that reduces the size of the sector and restores confidence, solvency and sustainability, based on a model that serves the needs of a productive economy. This in turn requires a reform of the legal framework related to the regulation and supervision of the financial sector (BDL and regulatory agencies). It also requires a comprehensive banking sector restructuring strategy, and amending the legal framework related to banks' cessation of payment, in a way that takes into account the size of the restructuring and some of its technical aspects.

6) In order to reform public finances, it is necessary to respect constitutional procedures, lift total banking secrecy, reform public administration and the taxation system, and rationalize public spending, within the framework of a strategic vision to reform the public sector and achieve social justice³.

²See our paper on BDL circular 148: <http://kulluna-irada.org/article70->

³See our paper on restructuring the banking sector: <http://kulluna-irada.org/article63->