Lebanese Forces Economic Brief

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OP-ED

The Lebanese Government Tries to Solve a Problem of its Own Creation

Under the stated goal of "organizing" the—technically illegal—sector of private electric generators and "protecting the consumer" the Ministry of Economy started enforcing on October 1 the requirement that generator owners install a meter for each of their customers because, it is said, customers would save money by paying for only the electricity they use instead of a flat fee. Many consumers applauded the measure. But generator owners complained that this new regulation would make their businesses unprofitable, and some threatened to exit the sector completely. In response, the interior ministry threatened to confiscate their generators if they do so. The economy ministry also set the rate that the generator owners are allowed to charge, but this led to a separate spat between the official bodies themselves as an economic expert appointed by the judge of urgent matters in Aley decided to set a different rate. The economy minister responded that setting the rate is his prerogative alone.

This kerfuffle is the latest example of the economic damage and unnecessary conflicts that the Lebanese government continuously keeps creating under the promise of "organizing," "helping," or "protecting," while in reality delivering nothing but strife, chaos, and misery; not to mention, in the current example, the Kafkaesque scene of an official body threatening to punish an illegal sector for stopping its illegal activities.

It is important for the Lebanese public to realize that this "problem," which the government is claiming to be trying to solve, was created by the government in the first place. And so the logical way to solve this problem would be to simply reverse the regulations that created it, not by pilling on new regulations that will have unintended consequences of their own, followed by more regulations to deal with those consequences, and so on. In short, the first step to get out of a hole is to stop digging.

Let us be clear: the age-old electricity shortage in Lebanon is the natural result of government regulations hindering the private supply of electricity.

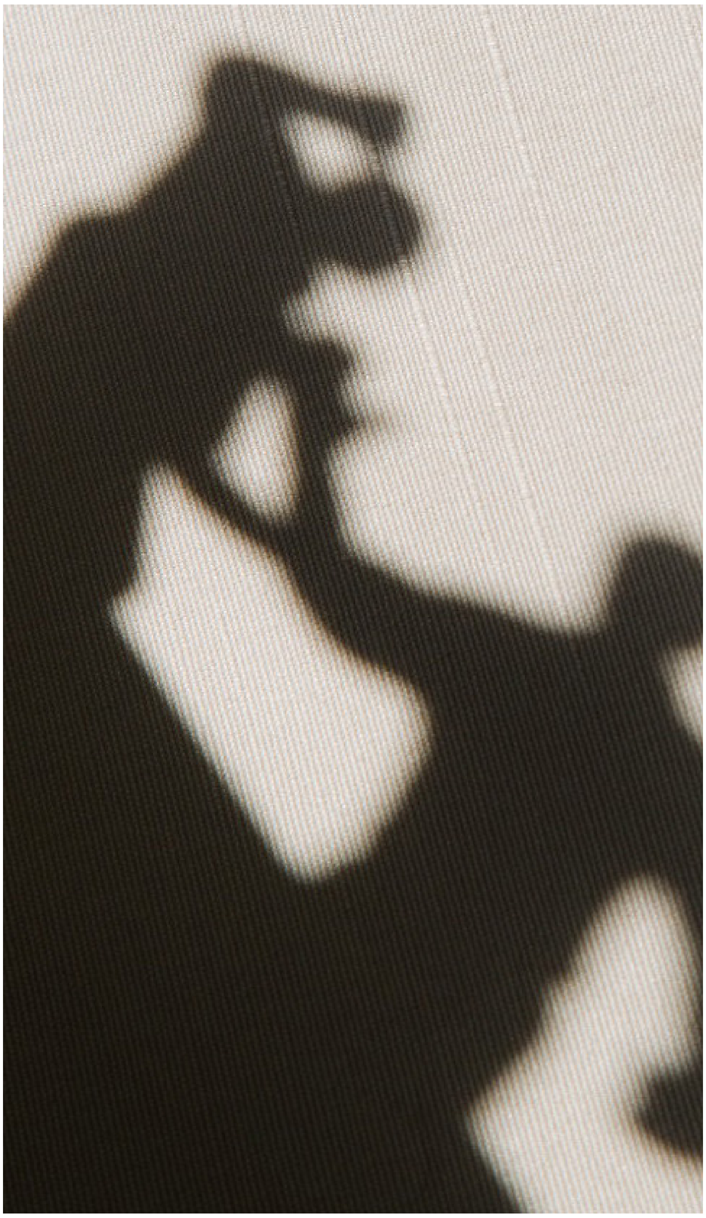
Since restricting supply does not restrict demand, a shortage naturally emerges. And this shortage created an illegal electricity sector to fill the gap.

But the private sector's illegal status impedes its ability to make significant long-term investments in order to compete on price and quality, resulting in a service that is expensive and of poor quality. But if the sector was liberalized then it would become better and cheaper through competition and other market processes, as is the case for other legal businesses. However the government's "solution" to tighten rather than loosen the regulations on the sector would make things worse because adding regulations inevitably leads to decreased supply, and thus either greater shortages or increased prices, which is the opposite of the government's stated goal.

Let us suppose that the interior ministry followed through on its threat and confiscated the private generators. Would it be able to manage them better than their current owners? Can it effectively manage those thousands of generators, spread out all over Lebanon, of different makes and models, requiring different maintenance procedures according to different schedules and using different spare parts, and without the profit motive acting as an incentive to keep them running? Of course not, as it cannot even manage the handful of power stations it runs now. This so-called "solution" would result in Lebanon plunging into darkness. And we haven't even begun considering the dangerous economic ramifications of a minister singlehandedly deciding to expropriate private property.

The Lebanese public is advised to not rush and applaud every government measure that promises to improve on how a private service is being provided because economic laws, such as the law of supply and demand, will keep operating regardless of what the government does. The public should also study how the market works because as long as the public keeps preferring government solutions to market solutions the people will continue to receive lofty government promises while their living standard spirals downward.

Disclaimer: The views and opinions expressed in this article are those of the author and do not necessarily reflect the official policy or position of the Lebanese Forces



General Overview

Further Delay in Government Formation Complicates Efforts for Next Cabinet

The delay in forming a government, as well as the resurgence of political wrangling among political parties, brings back memories of a protracted political conflict with considerable economic cost. While no strange to Lebanon's political history, a protracted conflict could this time have serious implications, given the country's precarious economic conditions. The delay in forming a government has already started to undermine the momentum generated by the CEDRE conference, compelling the World Bank to revise its projection for Lebanon's real GDP growth to 1% in 2018 from an earlier forecast of 2%, and to warn that Lebanon's medium-term economic prospects will remain sluggish and that its risk profile is rapidly rising because of local and global conditions, including tighter monetary policies.The longer the delay in forming a government, the harder it becomes for the next cabinet to address a range of pressing issues, including structural and fiscal reforms as mandated by CEDRE conference. Simply put, the next cabinet call ill afford deferring the implementation of needed legislations, as Lebanon's risk is rapidly increasing, and unfavorable global developments might very well add to the pressure. Lebanon's public finances, for instance, require swift reform measures to address what seem to be an uncontrollable rise in deficit – the fiscal deficit more than doubled; after the government passed the public sector salary scale in 2017, reaching $1.9bn in the first four months of 2018, wich constitutes an increase of 126.5% from the $844m deficit posted in 2017. The IMF, in the meantime, called on the government to implement a credible fiscal consolidation plan to reduce the burden shouldered by Banque du Liban and the heavy reliance on deposit inflows to cover Lebanon's financing needs – Lebanon awaits paying $1.5bn of bond maturities in the rest of 2018, and some $5bn in 2019. Although the opening of the Jaber-Naseeb between Syria and Jordan might help increase Lebanese export activity, unfavorable global developments, especially in the US, are expected to create further pressure. In particular, the Fed is set to increase its tightening policy until the key rate reaches 3.4% by 2020, after having raised its benchmark rates in September. Higher cost of borrowing, of course, means a-higher financing cost and less growth and development for Lebanon. In parallel, the recent US sanctions against Hezbollah are finding their way at an important time in Lebanon, In fact the country is suffering from a government vacuum and political parties are still unaware of the exact magnitude and impact that these sanctions could-create.

Goldman Sachs: Policymakers Have Clear Focus on Priorities

Global Investment Bank Goldman Sachs said the formation of a new government in Lebanon is expected to have a positive effect over the short term; and that policymakers seem to have a clear focus on a range of priorities that they plan to address, which would result in better prospects for Lebanon.
These priorities include fiscal consolidation to narrow the deficit; implementing designated projects under CEDRE to unlock the funds pledged by the international community; and reforming the electricity to reduce the burden of treasury transfers to EDL. Electricity reform, it is assumed, would yield fiscal saving of about $2bn per year. Yet, the downside is in the lack of addressing other structural problems, such as freezing recruitment in the public sector. Goldman Sachs also said that the $5.5 billion debt swap that the Ministry of Finance conducted with Bank du Liban in May 2018 can finance maturing Eurobonds up until April 2019, which would limit the refinancing risk, and that there are no intention on conducting further debt swap; as this would undermine confidence in the debt markets and distort pricing.

Word Bank: GDP Growth Revised Down to 1%

The Word Bank reduced its projection for Lebanon's real GDP growth to 1% in 2018 from an earlier forecast of 2%.
It underlined a slowdown in economic activity across all sectors expect for external trade, and anticipated net exports in 2018 to constitute the main driver of growth for the second consecutive year, instead of private consumption. It said that the suspension of subsidies on mortgages has removed one of the drivers of economic activity and that inflationary pressure

continues amid a rise in commodity prices. The Word Bank considered that macro-financial risks have increased, after they receded in the aftermath of the CEDRE conference in April 2018, due to the slowdown of the economic activity and the delay in forming a government.
It forecast real GDP growth at 1.3% in 2019, and 1.5% in 2020, noting that its baseline scenario does not take into consideration the fiscal reforms that Lebanon pledged at CEDRE. It expected the fiscal deficit to widen from 6.6% of GDP to 8.8% in 2018, due to higher current spending following the increase in the public sector wages and salaries.

Parliament Approves $66.3m in Interest Subsidies for Housing

Parliament in September approved LL100bn ($66m) in interest subsidies for low-income borrowers, and the Banque du Liban announced plans to resume its own housing stimulus package in 2019. These measures fill a gap already left by a yearly estimate of 5,000 candidates whose many applications were left pending after Banque du Liban's 2018 funds for housing loans had been depleted in the first few months of 2018 due to the unprecedented demand coming from public sector's employees. It remains to be seen, however, how these measures would translate into concrete steps, as negotiations between the Associations of Banks in Lebanon and the Public Corporation for Housing are still underway to determine the conditions under which housing loans would be offered, including the interest charged. In the meantime, Banque du Liban and or Ministry of Finance plan to announce the size of its own stimulus for housing in 2019, despite that it won't cover the local demand for housing in Lebanon.
The Ministry of Finance, in its part, remains intent on pushing for a comprehensive housing policy that puts an end the housing crisis and usher in new and sustainable solutions for low-income citizens.

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