# Lebanon: Staff Concluding Statement of the 2023 Article IV Mission

**March 23, 2023**

A Concluding Statement describes the preliminary findings of IMF staff at the end of an official staff visit (or 'mission'), in most cases to a member country. Missions are undertaken as part of regular (usually annual) consultations under Article IV of the IMF's Articles of Agreement, in the context of a request to use IMF resources (borrow from the IMF), as part of discussions of staff monitored programs, or as part of other staff monitoring of economic developments.
The authorities have consented to the publication of this statement. The views expressed in this statement are those of the IMF staff and do not necessarily represent the views of the IMF's Executive Board. Based on the preliminary findings of this mission, staff will prepare a report that, subject to management approval, will be presented to the IMF Executive Board for discussion and decision.

**Washington, DC:** *An International Monetary Fund (IMF) mission visited Beirut from March 15 to 23 to conduct the 2023 Article IV consultation, assess the economic situation, and discuss policy priorities.*
*Lebanon is at a particularly difficult juncture. For over three years, it has been facing an unprecedented crisis, with severe economic dislocation, a dramatic depreciation of the Lebanese lira and triple-digit inflation that have had a staggering impact on people's lives and livelihoods. Unemployment and emigration have increased sharply,* and *poverty is at historically high levels. The provision of basic services like electricity, public health, and public education has been severely disrupted, and essential social support programs and public investment have collapsed. More broadly, capacity in public administration has been critically weakened. Banks are unable to extend credit to the economy and bank deposits are mostly inaccessible to customers. The presence of a large number of refugees exacerbates Lebanon's challenges.*
*Despite the severity of the situation, which calls for immediate and decisive action, there has been limited progress in implementing the comprehensive package of economic reforms, set out in the Staff Level Agreement, notwithstanding some efforts by the government. This inaction disproportionately harms the low-to-middle-income population and undermines Lebanon's long-term economic potential. The Government, Parliament, and the Central Bank (BdL) must act together, rapidly and decisively to tackle longstanding institutional and structural weaknesses to stabilize the economy and pave the way for a strong and sustainable recovery.*

**The economy remains deeply depressed**. After contracting precipitously by about 40 percent since the start of the crisis, economic activity appears to have stabilized somewhat in 2022, driven by some recovery in tourism, further deleveraging of the corporate sector, and continued strong remittances inflows, which have supported consumption. However, many economic trends remain negative:
· Inflation is in triple digits, driven by a dramatic depreciation of the Lebanese lira, reflecting a lack of confidence in the Lebanese financial system, large increases in money supply, and the complex interplay of BdL circulars that gives rise to multiple exchange rates and speculative arbitrage.
· The collapse in budget revenue has forced a drastic and disorderly cut of public spending to minimal levels. Still, the government relies on central bank financing, accumulation of arrears

and some donor assistance to support a budget deficit of over 5 percent of GDP. The deficit could be even higher, if the ongoing quasi-fiscal operations by the central bank—such as provision of FX at subsidized rates—are included.
· The banking sector is under enormous strain with an eroding capital position and substantial unrealized losses looming ahead.
· After sharply improving in 2020-21, the current account deficit is estimated to have widened significantly to over 25 percent of GDP in 2022, mainly due to high oil and food prices and accelerating imports ahead of an expected exchange rate adjustment for tax purposes. The weak external position and ad hoc monetary policy decisions have led to a steady decline in foreign reserves to about US$ 10 billion as of December 2022 (excluding gold), compared to US$36 billion prior the crisis.

**Lebanon is at a dangerous crossroads, and without rapid reforms will be mired in a never - ending crisis.** Poverty and unemployment will remain high, and economic potential will continue to decline. A continuation of the status quo would further undermine trust in the country's institutions and additional delays in implementing reforms will keep the economy depressed, with irreversible consequences for the whole country, but especially low-to-middle income households. High uncertainty will further weaken the external position and the BdL will continue to lose scarce international reserves. Exchange rate depreciation and spiraling inflation will remain unabated, accelerating the already high cash dollarization of the economy. The informality of the economy will further increase, reducing the scope for taxation and further depressing budgetary spending, while increasing the risk of illicit activities becoming entrenched in the economy. Without acknowledging and credibly addressing the large financial gap in the banking sector, the banks will not be able to provide meaningful credit to support the economy, and small depositors will continue to incur large losses on their FX withdrawals, while medium-to-large deposits will remain indefinitely locked. Emigration, particularly of skilled workers, would accelerate, undermining future growth prospects even further.

**There is an alternative path that would lead to stability and growth.** The mission emphasized the urgency of implementing the following package of comprehensive reforms:

- *A medium-term fiscal strategy* to restore debt sustainability and create space for increasing social and development spending. The first step should be to adopt a 2023 Budget that uses a unified market exchange rate for customs and tax purposes, adjusts specific taxes to inflation, and makes the first steps toward restoring public administration. The Budget should also provide the necessary funding for essential social spending and initiate important public sector reforms which over time would improve efficiency. In subsequent years, strengthening public finances would require revenue mobilization reforms focused on broadening the tax base, closing existing loopholes, and improving tax compliance across taxpayers through strengthened and modernized tax administration. The revenue mobilization effort is critical to support a gradual scale up of priority social and development spending to more appropriate levels. The overall fiscal strategy should be supported by reforms to eliminate SOE losses and phase out transfers from the budget, particularly to the energy sector, improve public administration, and advance sustainable pension system reforms. Gradual fiscal consolidation will be critical to complement the needed debt restructuring that should aim to reduce public debt to a sustainable level over the medium term.

- *Credible restructuring of the financial system* to restore its viability and support economic recovery. This requires acknowledging and addressing upfront the large losses incurred by the central bank and commercial banks, respecting the hierarchy of claims, protecting small depositors, and limiting the recourse to the public sector given its current unsustainable debt position. Viable banks should be restructured and recapitalized under a timebound plan, and unviable banks should exit the market. The effective implementation of the strategy requires amending the Banking Secrecy Law to address outstanding critical weaknesses, notwithstanding the important improvements from the recent reform. In particular, relevant agencies should have access to data on individuals' transactions and deposits at the client level. In addition, the legal and institutional framework of the central bank and other banking authorities should be modernized to strengthen governance and accountability so that trust in institutions is rebuilt. To increase transparency, the special audit of the central bank should be published.
- *Unification of exchange rates and tightening monetary policy* to rebuild credibility and improve the external position of the economy. Unification would remove harmful distortions, eliminate rent-seeking opportunities, reduce pressures on the central bank's FX reserves, and pave the way for a market-determined exchange rate. The process should be accompanied by temporary capital controls to help guard the limited FX resources in the financial system needed to ensure an equitable solution for depositors. To help reduce inflation following unification, tight monetary policy would need to make use of all the available tools, and central bank financing to the government should be strictly prohibited. Foreign exchange interventions will need to be very limited and only for the purpose of addressing disorderly market conditions.
- *Ambitious structural reforms* to supplement economic policies and create an enabling environment for stronger growth.

o *Strengthening the public finance management (PFM) framework* to ensure proper oversight of public finances, enhance fiscal discipline and improve transparency of budgetary process. The introduction of a modern PFM law would provide an overarching strategy for reforms that should include enhancing internal and external controls, formulating a medium-term fiscal framework, restricting the use of treasury advances and establishing a fully integrated treasury single account.

o *Reforming state-owned enterprises* to ensure good governance, transparency, financial and operational viability, better provision of services and to contain fiscal risks. Preparing a comprehensive inventory of SOEs and completing and publishing financial audits of the largest SOEs would be the first step, followed by development of an ownership strategy that would establish strategic purposes, and oversight and management principles of SOEs. Moreover, it will be critical to address long-standing issues in the electricity sector through swift implementation of sector reforms already approved by the cabinet in March 2022.

- *Enhancing governance, anti-corruption, and anti-money laundering/combating the financing of terrorism (AML/CFT) frameworks* to re-gain social trust of government policies and promote inclusive growth. The ongoing governance diagnostic will provide the roadmap to reform, including to enhance the independence and integrity of the judiciary system, and to improve accountability across the public sector. Moreover, the approved procurement law, which is in line with the best international standards, should be implemented promptly, starting with the full functionality of the Procurement Authority and the e-procurement platform.

**The IMF remains committed to supporting Lebanon,** and to continue its close engage with the authorities through policy advice and technical assistance. Collaboration and support from multilateral and bilateral partners are also critical for the successful implementation of the authorities' reform efforts. However, this support will also hinge on Lebanon's commitment and steadfast implementation of a comprehensive and ambitious reform program. In this regard, we welcome the authorities' commitment to work with the IMF and other international partners for the implementation of policies to address current challenges and place Lebanon's economy on a sustainable path, including under an IMF-supported program.

The mission would like to thank the Lebanese authorities and all other counterparts for the close collaboration, constructive policy dialogue, and their hospitality.

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