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Preface

"This time is different because the shock does not have a limited time span." Six years after publishing this paper on May 31st 2013, Lebanon is facing its most severe financial and economic crisis. Meanwhile, the government remains crippled especially burdened with unsustainable macro-parameters, further highlighting the urgency for serious structural reforms.

This is the title of a book by leading economists Carmen Reinhart and Kenneth Rogoff whereby they reject the usual rhetoric of experts "this time is different" following financial and economic crises. Each time experts claim that the old rules of valuation no longer apply and that the new situation bears little similarity to past disasters. Throughout the book, the authors try to prove them wrong and argue that "financial combustions are universal rites of passage for emerging and established market nations".

Unlike the authors of the book, we argue that in Lebanon, this time the slowdown in economic growth is different as it could last much longer than previous declines and will constitute another test to the resiliency of the Lebanese economy. Reasons behind the slowdown are many starting from the spillovers of the war in neighboring Syria, passing by the decision of GCC countries to warn their citizens against coming to Lebanon, and ending with the fiscal problems and structural issues that are strangling the economy.

This time is different because the shock does not have a limited time span. The repercussions of the war in Syria are continuous and the war in itself does not seem to have a known end date. Hence the policies that should be adopted to face such a large factor of uncertainty have to be different. When the war erupted in Syria, Lebanon did not have the right infrastructure to attract Syrian investors. Wealthy Syrians owning factories and businesses in Syria were obliged to flee their country and preferred to invest in the UAE and Turkey rather than in Lebanon. The latter was not equipped to welcome such investments. Only banks attracted a limited amount of deposits and the real estate sector attracted some buyers.

This time is different because the tourism sector has been hardly hit by the decision of GCC countries to warn their citizens not to visit Lebanon; and no timeframe for this decision is known. It is worth mentioning that direct and indirect contributions of the tourism sector to GDP hover 30 percent. Since Arab visitors are the main spenders among the whole spectrum of tourists, the retail sector, in addition to the hotel and restaurants businesses, is feeling the impact of the decline in Arab tourists.

This time is different because our public debt and fiscal deficit levels do not provide any leeway for further deterioration. Public debt is at 138% of GDP and fiscal deficit reached 9.3% of GDP at end 2012. Therefore the government does not have the luxury to adopt an expansionary fiscal policy to boost economic growth. In this context, the government is not even able to increase its capital expenditures to improve the faltering infrastructure following many years of restricted capital spending.

This time is different because international interest rates are not going to stay this low forever. Once the Federal Reserve starts increasing its interest rates, Lebanon will have to follow and the impact on the debt service won’t be negligible. The public debt rise will accelerate and debt to GDP ratio will increase. If the government does not tackle its fiscal deficit problem until then, the fiscal situation will deteriorate and will impact the entire economy.

On another front, the weakening infrastructure is limiting the potential growth of real GDP. Following several years of high GDP growth, the Lebanese economy has shifted, during the past two years, from high to low gear economic growth. Real GDP growth recorded 2% in 2011 and 1.2% in 2012 and this year will be no exception. This was partly due to the lack of investment in infrastructure during years of high growth. Lebanon needs to upgrade its infrastructure in all sectors including Energy and water, roads and transportation, and IT and telecommunications. Since the government does not have the means to do all the necessary investments, several schemes should be considered such as the public private partnership, the Build Operate Transfer, and privatization, only to name few .

This time is different because Lebanon’s balance of payments (BOP) registered the consecutive deficits of $1.9B in 2011 and $1.5B in 2012 which reveals the chronic, substantial amount of capital fleeing the country with no reversals in sight. By March 2013, the BOP recorded a deficit of $62.2M. Therefore, this time the magnitude of the BOP outflow remains open-ended, jeopardizing the economic and financial stability of the Lebanese economy in the years to come, absent active efforts to implement drastic reforms.

Finally, the government may benefit from this low growth trend to embark on an aggressive structural reform program. Enhancing the business environment is a priority. Of course it is well known that a perfect setting will not be able to attract investments if security and political conditions are not stable. However needed reforms regarding laws and regulations have to be upgraded – such as the cost and time it takes to open and close a business – in order to be ready when the situation in the Levant region gets better. The outdated commerce law should be revamped to accompany new developments. The judicial system has to be modernized to shorten the time needed for decisions to be taken regarding mainly business related cases. Revamping the tax system, putting in place regulations and laws to encourage transparency and reduce corruption is necessary as Lebanon is positioned near the bottom of the world ranking regarding transparency and corruption.

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