Lebanon's State-Owned Enterprises and the Potential Impact of Privatization on the Current Financial crisis

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Lebanon witnessed some stabilization in 2022 marked by increased tourism, robust remittances, and improved terms of trade. However, ongoing challenges especially the recent development in the Middle East and the potential spillover of the war between Hamas and Israel to Lebanon are weighing on the ambiguous economic outlook and hinges on policy actions. That said, today more than ever, the need for implementing a robust recovery plan is essential to alleviate imbalances for Lebanon and boost confidence, and to foster a return to sustainable growth. Nevertheless, final agreement with IMF has not been reached yet and maintaining the status quo poses the greatest risk for Lebanon's stance. Limited investment in physical capital, constrained bank credit, and subdued real growth are more to see. The external position may be volatile with limited support from international partners. Public debt remains unsustainable without reforms, restricting government borrowing and services.

As the IMF's Executive Board recently has been engaged in discussions with Lebanese officials regarding economic developments and policies, talks about a proposed solution have been conveyed – though yet still unofficial and not publicly disclosed -- involving the creation of a public assets fund. This fund aims to facilitate the gradual return of bank deposits over the next two decades, according to unconfirmed reports. It's important to note that this information has not been officially announced by the IMF or the Lebanese government, and discussions surrounding this potential resolution are currently circulating through informal channels.

In light with this suggested resolution, we will emphasize the significance of public assets and delve into a comprehensive examination of the status of state-owned enterprises in Lebanon and the implications of privatization of public held assets amid the ongoing financial crisis.

Overview of the State-Owned Enterprises (SOEs) in Lebanon

In the past, calls for privatization in Lebanon were often accompanied by tension among the traditional political class. However, recent trends showed a decline in such tensions; however, the Lebanese public sector lacks clear delineation of State-Owned Enterprises (SOEs). Over 110 entities are labeled as "public institutions," exhibiting administrative and financial autonomy under specific ministers. To identify SOEs in this context, we've established the following criteria: autonomy, government control, and a focus on commercial activities. Notable SOEs in Lebanon include Ogero, Electricité du Liban, water authorities, Casino du Liban, the tobacco sector (Régie des Tabacs et Tombacs), Middle East Airlines, and various ports.

State-Owned Enterprises (SOEs) in Lebanon have autonomy in formulating their budgets, subject to approval by both their board of directors and Parliament. Legal obligations mandate the publication of an annual report and independent audits, but the Ministry of Finance, responsible for oversight, does not receive the annual accounts. Weak planning capacities exacerbate budgeting challenges, and the absence of a unified accounting system hinders standardization. Despite broader mandates, SOEs are perceived as inefficient, often influenced by clientelism and political pressure in board appointments. Non-compliance with OECD Corporate Governance Guidelines and the sectarian nature of Lebanese politics overshadow their service provision, resulting in inefficiency, low productivity, and a lack of innovation. This operational underperformance significantly contributes to Lebanon's poor global rankings in the cost of doing business, corruption, and overall infrastructure. Additionally, regulatory authorities overseeing SOEs, such as the dysfunctional Telecom Regulatory Authority and yet-to-materialize Electricity Regulatory Authority, further hinder effective governance and competition.

SOE's Fiscal Position

Some state-owned enterprises (SOEs) in Lebanon contribute positively to government revenues, with the telecom sector leading the way. In contrast, others, including large SOEs, pose a financial burden on the state, contributing to a substantial percentage of government debt. The proposal to establish a multi-billion Public Assets Management Fund, incorporating SOEs' assets, aims to alleviate public debt and stimulate economic growth, besides deposit recovery, as outlined in the Government's Financial Recovery Plan. However, challenges persist, such as unreported spending, off-budget operations, and the lack of an integrated fiscal information system, contributing to fiscal risks and hindering effective public finance management.

Estimate of SOEs' Fiscal Size and Cost on the State

The introductory section highlighted the absence of a clear legal definition for State-Owned Enterprises (SOEs), coupled with scattered and inconsistent fiscal data. This note aims to estimate the size and fiscal impact of SOEs on the government by identifying 24 SOEs among Lebanon's 110 public institutions, utilizing specific criteria. However, for some, like Middle East Airlines and various Port Authorities, budgetary data was unavailable. The majority of these SOEs are presented as a single budgetary line, revealing only their net balance publicly. To estimate the fiscal cost, unaudited spending data from the Ministry of Finance for the period 2017-2019 was collected, classified, and analyzed, recognizing the absence of officially audited data pending approval by the Court of Accounts and Parliament. Despite potential limitations, this methodology provides indicative figures for the size and fiscal impact of SOEs in public finances.

Aggregate Breakdown (2019):

Fiscal cost by SOEs

Description	2019 (in millions of LBP)
Electricté du Liban	2,269,196.25
ELYSSAR	2,700.73
Lebanon Television Station	17,962.00
National Archives Institute	1,350.00
Ogero	-
Public Authority for Consumer Markets for Lebanon	878.00
Public Corporation for Housing	200,000.00
Public Hospitals	15,900.00
Rachid Karami International Fair	400.00
Railway and Public Transportation Authority	16,108.95
Sports City Agency	1,310.00
Water establishments	-
Aggregated Total	**2,525,805.93**

Net revenue generated by SOEs

Description	2019 (millions of LBP)
Banque du Liban	60,358.00
Casino Du Liban	116,122.00
National Lottery	66,226.00
Lebanese Petroleum Administration (Revenues from Oil & Gas)	-
Port of Beirut	219,555.00
Public institutions - Revenues from government shares	171.00
Public institutions - Tax on interests	10,266.00
Public investment agency at the Beirut airport	251,237.00
Régie des Tabacs et Tombacs	200,256.00
Telecom Surplus	1,427,966.00
Aggregated Total	2,352,157.00

Source: Briefing Note SOEs in Lebanon, March 2021 by The Institut des Finances Basil Fuleihan

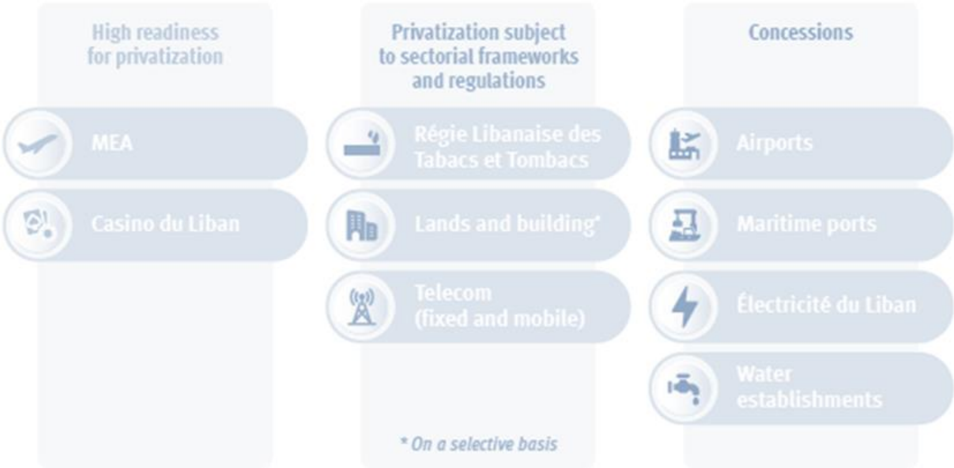
Results are the followings:

Over the past three years, State-Owned Enterprises (SOEs) have constituted an average of 10% of budget expenditures. The primary contributor to this fiscal impact is the allocation of funds to Electricité du Liban, accounting for 89% to 96% of SOE expenses. Anticipated reforms in energy and fuel subsidies, along with changes in EDL, are expected to significantly alter the scale and structure of the fiscal burden from SOEs. These enterprises, on average, have generated 14% of total revenue, with the Telecom surplus contributing 60% to 70% of this income. Nevertheless, the sustainability of this revenue source is now jeopardized by the devaluation of the national currency, affecting maintenance costs and international telecommunication subscriptions invoiced in USD.

The privatization of Lebanon's public held assets carries significant implications for the country's future. Success in this initiative requires a comprehensive, long-term assessment beyond the current focus on loss recovery. Factors like the impact on public service provision, citizen accessibility, and the broader economic effects of privatization are crucial considerations. Additionally, effective privatization efforts should include a strategy to evaluate asset potential and outline how funds gained will benefit the population.

According to Mr. Albert Kostanian's study on "Privatization of Lebanon's public assets," Public Held Assets (PHAs) show varying levels of feasibility and appeal for privatization, depending on meeting necessary conditions. Three distinct categories emerge: 1) assets ready for privatization with prerequisites; 2) assets with high privatization potential requiring a national strategy and frameworks; and 3) assets that could be developed under concession, or lease contracts.

Case for privatization of different PHAs:



Source: Privatization of Lebanon's public assets, no miracle solution to the crisis by Albert Kostanian

Assets with a high readiness for privatization, like Middle East Airlines and Casino du Liban, can be fully or partially divested in the short term, posing minimal risks from a national standpoint. However, prerequisites outlined in this paper must be in place. State-owned enterprises currently causing conflicts of interest may fall into this category.

Assets, such as RLTT, Telecom, and Real Estate, subject to sectorial frameworks, require time and effort for partial and progressive privatization. Real Estate faces complexity in assessing public versus private domains, considering national interest, and addressing market uncertainties amid the financial crisis.

Assets suitable for development through concessions (lease contracts), like water and wastewater management, electricity, and transportation, can offer long-term benefits. However, success hinges on fair contractual terms, procurement processes, and adherence to sectorial frameworks. The strategic importance of keeping these assets public, coupled with potential gains from private sector participation, underscores their inclusion in this category.

Privatizing of Public Held Assets (PHAs) is not a panacea for addressing Lebanon's current financial sector losses. The near-term revenues from these assets fall significantly short when measured against the country's overall losses. An inclusive valuation of PHAs, excluding concession-related assets, estimates a total value ranging from approximately $12 billion (conservative) to around $22 billion (optimistic), with an average of $17 billion.

Valuation of Different PHA s (excluding potential concessions):

	Conservative valuation (million USD)	Optimistic valuation (million USD)
MEA	600	740
CDL	320	420
RLTT	1,440	1,700
Airport	-	-
Ports	-	-
Real estate	7,120	14,380
Telecom (fixed and mobile)	2,180	4,280
EDL	-	-
Water Agencies	-	-
TOTAL	11,660	21,520

The valuations and resulting figures in this table correspond to high-level estimations based only on publicly available data that we were able to identify. Valuation of these assets in the case of any future privatization effort will be highly dependent on the economic context and outlook at the time of potential privatization, as well as on the availability of data. All figures are based on a USD/LBP rate of 1507.5 and should be largely viewed as being in local banks dollars.

Source: Privatization of Lebanon's public assets, no miracle solution to the crisis by Albert Kostanian

The study "Privatization of Lebanon's public assets " indicates that real estate, contributing USD 14.38 billion in the optimistic scenario, is the predominant factor in the assessed total value of Public Held Assets (PHAs). Telecom, encompassing fixed and mobile services, follows with a contribution of USD 4.28 billion in the optimistic scenario. Taking this into account, the potential gross revenue for the Lebanese State from privatizations could vary from around USD 6 billion in a realistic program to approximately USD 13 billion in an optimistic scenario. It's worth noting that these estimates exclude concessions, leases, or leasing contracts that might generate increasing revenues or savings over time, emphasizing the importance of a fair and transparent granting process.

Estimation of gross revenues for the State from Privatizations:

Realistic privatization program		Bullish privatization program	
Assets	Value (million USD)	Assets	Value (million USD)
MEA	670	MEA	670
CDL	370	CDL	370
Telecom (50% of assets)	1,615	Telecom (100% of assets)	3,230
Real estate (30% of assets)	3,225	Real estate (70% of assets)	7,525
		RLTT	1,570
TOTAL	5,880	TOTAL	13,365

Average between conservative and optimistic valuations

Source: Privatization of Lebanon's public assets, no miracle solution to the crisis by Albert Kostanian

Challenges of the SOEs

Before the crisis, inadequate control over State-Owned Enterprises (SOEs) and significant financial losses heightened fiscal and economic imbalances. The governance framework was weak, with low professional standards for hires, managers, and board members. Ownership, oversight, and policy functions were unclear, and boards lacked essential operational tools. Transparency and reporting requirements were poorly defined and enforced, resulting in minimal information on SOEs' financial performance. The lack of audited financial statements for several years weakened the Ministry of Finance's oversight and risk assessment capacity.

To address these issues, IMF addressed comprehensive reforms for SOEs that are crucial to enhance governance, operational viability, and mitigate fiscal risks. Priorities include professionalizing management, strengthening boards, improving transparency, accountability, and financial oversight by the Ministry of Finance. Reducing political interference and considering capacity constraints and corruption vulnerabilities are essential. The initial step involves creating a detailed SOE inventory and publishing annual financial statements. Conducting financial audits by reputable international firms for large SOEs is critical for an accurate assessment of their financial situation. Cabinet approval of an SOE ownership strategy aligned with IMF recommendations is vital, outlining objectives, oversight, and management principles. This strategy enables the government to conduct an SOE triage, deciding which enterprises to keep, privatize, or liquidate. To support these reforms, a new SOE law, based on the ownership strategy and international standards, should be adopted.

However, the staff endorsed the authorities' electricity sector reform strategy implemented in 2022 to ensure the sector's sustainability but emphasized the need for its prompt execution. The immediate priorities include enhancing the operational performance and financial viability of EDL, improving transparency in financial reporting and cash management through audited financial statements, and establishing an independent Electricity Regulatory Authority (ERA) to provide crucial technical and economic oversight for the generation and distribution sectors. These reforms play a pivotal role in attracting donor financing to increase electricity supply and achieve cost recovery by 2026. Although the electricity tariff hike in November 2022 was a significant initial move, its impact on EDL's financial sustainability remains uncertain, contingent on EDL's ability to enforce collection, reduce non-technical losses, and enhance supply. EDL could also explore the option of introducing monthly tariff reviews using a pricing formula mechanism to reflect fluctuations in global oil prices.

Conclusion

The 2020 Fiscal Transparency Report conducted by "the Institut des Finances Basil Fleihan" underscored challenges in fiscal transparency, particularly regarding the absence of reliable, comprehensive budget data for State-Owned Enterprises (SOEs) and their government-guaranteed debt. Emphasizing the need for improved transparency and participation, the report urged the disclosure of detailed budget information for SOEs. Despite proposals in the 2020 budget to address this through liquidation, sale, or privatization of SOEs, concrete measures were hindered by the country's default on debt, leading to a severe economic and financial crisis marked by currency devaluation, hyperinflation, FX reserve shortages.

Moreover, in the current political environment, privatizing assets in Lebanon poses a significant threat to the public, lacking the necessary transparency and fairness. The absence of prerequisites for a just privatization process raises concerns, as historically seen in countries with weak governance and transparency. There's a risk that Lebanon's state assets may be sold non-transparently to politically connected elites, perpetuating the socioeconomic challenges the country faces. Genuine political and socioeconomic reforms are crucial for ensuring social justice in privatizing Lebanon's assets. Despite international organizations advocating privatization, evidence worldwide suggests potential harm without proper evaluation, especially for vulnerable populations. Distributional effects, such as price impact, access, income distribution, and employment levels, must be considered in any privatization strategy for Lebanon, requiring a thorough evaluation of potential impacts and appropriate sector-specific models.

While privatizing certain Public held Assets (PHAs) might generate significant revenue for Lebanon, it shouldn't be considered as a sole solution to the country's financial crisis. Focusing solely on mitigating losses may threaten Lebanon's prospects for sustainable growth and the well-being of its citizens. For privatization to truly benefit Lebanon, it requires a thorough assessment based on a comprehensive strategy. This strategy should encompass long-term structural and regulatory reforms, revitalization of productive sectors, and a philosophy of wealth distribution. Additionally, ensuring government accountability in privatization efforts necessitates transparency through the public availability of relevant information for an open and assessable evaluation of the process and the value of PHAs.

Lastly, an alternative to privatization is to establish an independent public asset company that manages these assets on efficiency and profitability grounds, following the sound governance practices alluded to above. The higher returns from these better-managed assets can then be used to support the budget, fund social services, and feed the deposit recovery fund. And it is high time to turn SOEs from being the 'Achilles heel' of the Lebanese economy to a viable pillar of recovery and growth!

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