

Can Private Public Partnership Pullout Lebanon Out of Its Worst Economic Crisis?

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Abstract. *Lebanon is grappling with the worst economic crisis in decades. One cannot escape the reality that Lebanon is broke and is set to face an even more agonizing economic downturn. While Lebanon has lost many past opportunities to develop its infrastructure including its energy, waste management, water, and transport, it is high time that authorities roll up their sleeves and give development a fillip in the country through Public Private Partnership (PPP). Financing a project through a public-private partnership can allow a project to be completed sooner or make it a possibility in the first place. Public-private partnerships allow large-scale government projects to be completed with private funding. The success of PPP project is defined on the basis of repayment of loans without recourse to public sector guarantees or tax revenues and the provision of public services without inflicting a direct or indirect burden on the population, that is already encumbered with huge debt as in the case of Lebanon. On one hand, establishing a railway network in Lebanon via PPP will not only enable mass public transportation but will add significantly to economic growth in the country. Electricity, as well, in the heart of the economic crisis, the government should consider partnering with green power producers via PPP to resolve this issue. Furthermore, Lebanon had two oil refineries, renovating those refineries will allow Lebanon to secure its needs of oil and then eventually to export its surplus. Likewise, Special Economic Zones play a key role in rapid economic development of a country. Hence, upgrading the infrastructure of Tripoli and its port has numerous benefits especially with the intent of reconstructing Syria.*

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Introduction. Lebanon is grappling with the worst economic crisis in decades, driven by a currency collapse that decimated business and plunged families into destitution and extreme poverty. The country's pound has lost more than 94% of its value on the black market, threatening to suck the economy into a hyper-inflation. Moreover, with a rate higher than 150.43% debt to GDP ratio, interest payments consume almost half of government revenues. In its press release on the 3rd of August, 2022 the World Bank published its Lebanon Public Finance Report, titled: "Lebanon's Ponzi Finance Scheme Has Caused Unprecedented Social and Economic Pain to the Lebanese People". The report emphasized that excessive debt accumulation was used to give the illusion of stability and reinforce confidence in the macro-financial system for deposits to continue to flow in. Lebanon's depression – deliberate in the making over the past 30 years – has hollowed out the state of the provision of basic services to its citizens.

The world bank report perceived that the current crisis aggravated long prevailing and serious gaps in the financing of those basic public services: Water, Electricity, Transport, Health, Education and Social Protection. The crises revealed the fragility of Lebanon's service provision model, itself a product of elite

capture of State's resources for private gains. And hence, immediate and effective measures should be taken to address the urgent needs of the population.

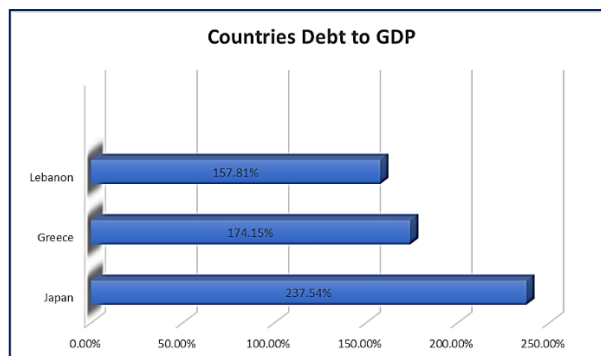


Figure 1. In 2019, Lebanon was the third most indebted nation.

Source: Statista 2020.

Unraveling the Lebanese economic crisis. The crisis also led to the unravelling of what has been described effectively as a state sponsored Ponzi scheme run by the Central bank, where it was borrowing from commercial banks at above-market interest rates to pay back its debts and maintain the Lebanese pound's fixed exchange rate with the US dollar.

Lebanon is one of the largest remittance-receiving countries worldwide, where remittances have exceeded one fifth of its nominal GDP and surpassed financial inflows from both exports of goods and services and foreign direct investments over the past decade. Nevertheless, they have a weak positive economic impact, a low correlation with domestic investment, and a high correlation with both inflation and imports. Consequently, this leads to a nonfunctional nonproductive economy importing most of its vital products due to the pseudo belief of a strong currency.

In March 2020, the state defaulted when it failed to make a payment of US\$1.2 billion on a hard-currency bond. The decision to stop paying the Eurobonds believed to be worth about US\$35 billion as debt becomes due that was supposed to mature in 2037. It was Lebanon's first-ever sovereign default.

How the central bank ran the Ponzi scheme? For years, the Lebanese government and the central bank Banque du Liban (BDL) played a game. The government spent more than it collected in taxes and financed its resulting deficits by paying sky-rocketing interest rates on the debt it issued. The central bank bought some of the debt and kept the official Lebanese pound-US dollar exchange rate pegged at 1,500. Banks offered relatively 'high' interest rates to depositors and were also part of the game.

For a surprisingly long period of time, the money poured in from domestic savers, the Lebanese diaspora, and other foreign investors. Thanks to the well-played Ponzi scheme, in 2018 deposits amounted to 179 \$ billion where two-thirds of these deposits were in US dollars – more than three times the country's GDP.

The moment when the government defaulted on its debt on March 2020, grinding came to a halt and the whole Ponzi scheme collapsed and eventually all debt in Eurobonds became due. The default triggered a sharp depreciation of the pound in the black market, a surge in inflation, and caused a socioeconomic havoc. Banks imposed unofficial capital controls, dollar deposit withdrawals were prohibited with limited exceptions and as result remittances almost completely evaporated. The Central Bank's situation is even more dire because its loans to commercial banks are mostly denominated in US dollars.

The game of smoke and mirrors. The intervention of the central bank resulted in a contractionary monetary policy that has been utilized for 27 years. The long term technique resulted in a quasi-complete demolition to the production sector in the economy as money fled towards the luring interest yields offered by local banks.

The central bank today, although claims contrary, is insolvent on a net basis once bad assets are written down against capital. Accordingly, the commercial banks are also insolvent despite claims of having assets

at the central bank. Thus, this is all a game of smoke and mirrors. No one can pay anyone, except in increasingly worthless local Lebanese currency.

Is there a silver lining to the doom and gloom? One cannot escape the reality that Lebanon is broke and is set to face an even more agonizing economic downturn. The rate of those living under the poverty line is also expected to increase dramatically. Furthermore, Lebanon is at risk of descending into complete chaos, hyperinflation, and social disorder.

The single solution available to the deteriorating currency and inflation is forming a currency board. In other words, the central bank can only print new banknotes if Lebanon has enough foreign currency to cover new banknotes. If this works out, the economy can aim on a loan from the IMF. Yet, it must take into consideration that a maximum of US\$14 billion may be available from the IMF and CEDRE (a Paris-based rescue club).

Furthermore, it also should be kept in mind that money will not be forthcoming without implementing forensic auditing, extreme austerity measures, monetary and fiscal reforms, and a complete restructuring of the banking system.

Restructuring the banking sector and haircuts on deposits. Most probably a haircut will be forced on large deposits, or most probably depositors will be offered to convert part of their deposits into shares with their banks. This is what is commonly referred to as a “bail-in”.

As debt is restructured, Eurobonds will be issued with longer maturity dates, lower interest, and often reduced principals. However, irrespective of the extent of the haircut, banks capital will not be enough, and the central bank will initiate a number of mergers to rationalize the number of banks operating in the sector.

Overcoming the Shortages of Funds Through PPP. While Lebanon has lost many past opportunities to develop its infrastructure including its energy, waste management, water, and transport, it is high time that authorities roll up their sleeves and give development a fillip in the country through Public Private Partnership (PPP).

Financing a project through a public-private partnership can allow a project to be completed sooner or make it a possibility in the first place. Public-private partnerships allow large-scale government projects to be completed with private funding. The latter would create an improved economic cycle as a portion of the proceeds would remain in the economy rather than being repatriated as profits by foreign entities.

How Can PPP Work for Lebanon? Lebanon has a public debt equivalent to 151% of GDP and a debt service of around 10% of GDP and thus adding a debt to its balance sheet is not deemed as the best approach. Not to mention that receiving a loan after Lebanon’s default on the 9th March 2020 has made this option fairly remote.

The success of PPP project is defined based on repayment of loans without recourse to public sector guarantees or tax revenues and the provision of public services without inflicting a direct or indirect burden on the population, that is already encumbered with huge debt as in the case of Lebanon.

Railway Transport. Establishing a railway network in Lebanon will not only enable mass public transportation, de-clog congestion from Lebanon’s main arteries, decrease pollution levels and significantly aid economic growth in the country. Apart from becoming the backbone of a public mass transport system it will also transport freight.

Currently, in economic terms, the annual cost of traffic congestion is above US\$2 billion representing a large impediment to growth and regional connectivity. What further exacerbates the current situation is lumbering the country with a high petrol import bill reaching US\$3.77 billion per annum.

Under Build – Own – Operate – Transfer (BOOT) the government grants to a private sector party the right to finance, design, construct, own and operate a project for a specified number of years. Constructing a modern non emission a hydrogen fuel cell rail via BOOT will also boost the opportunity for Lebanon to join the Chinese ‘One Belt One Road’ initiative that will reconnect the Levant with Europe. Such connection and trade openness will create an opportunity for further investment in the country’s infrastructure. The benefits are, thus, manifold.

Power Plants. At the heart of the economic crisis is the electricity sector. The failure to ensure reliable electricity supply is a symbol of the Lebanese state’s long-standing crisis, accountable for more than

US\$39.5 billion, equivalent to 43% of the public debt. Lebanon continues to rely on aging expensive power plants with heavily polluting imported fuel and diesel oil despite the plans that have been presented to overhaul the power sector.

Cutting expenses requires a series of actions, including switching the power plants, fuel source from heavy fuel oil and diesel oil to natural gas, significantly decreasing technical and nontechnical losses and improving cost effective power generation. The option to purchase power and inflict high electricity prices on end users is already excluded with the already broke government.

The government should consider partnering with Green Independent Power Producers (GIPPs) that generates electric power to utilities and end users. Green IPPs are environmentally friendly and use solar or wind energy. The advantages of entering with a partnership via BOOT with GIPPs are manifold as they are favorable for climatic conditions and cost effective especially with the shortage of capital for fuel purchasement after the project is transferred to the government with BOOT.

Oil Refineries. Lebanon had two oil refineries, which stopped functioning during the civil war, the first one was the Tripoli refinery which received oil from Iraq and the second was the Zahrani refinery that received oil from Saudi Arabia. The daily production of these two refineries varied from gasoline to diesel, to household gas, and even to car oil. These two refineries had a capacity of 30-60 thousand barrels per day, but the current need today exceeds 300 thousand barrels. When the barrel of oil was around US\$140, Lebanon could have imported for US\$20 crude and sell gasoline on the basis that the price of a barrel of oil is US\$140; imagine how much the treasury would have eventually profited from this endeavor? Renovating those refineries could be done via Build Operate and Transfer (BOT) model. As the Lebanese government is currently officially bankrupt, this will allow Lebanon to secure its needs of oil and then eventually to export its surplus.

Special Economic Zones. Free Trade Zones, also known as a free commercial zone, are a sub-category of special economic zones (SEZs). They are fenced-in, duty-free areas, offering warehousing, storage, and distribution facilities for trade, transshipment, and re-export operations, without the intervention of the customs authorities. SEZs play a key role in rapid economic development of a country.

The flow-down benefits for states hosting successful SEZs can be significant: a high-performing zone with strong foreign investment can create thousands of jobs while also building the capabilities of the local workforce as outside investors share expertise and know-hows.

Experts say that Lebanon has to prepare for Syria's reconstruction once the war there ends or else it will be a missed opportunity to improve the Lebanese economy. According to the World Bank, the restoration of Syria represents an industry estimated to be worth over \$200 billion. The figure has some businessmen and policymakers hoping that the anticipated boost in multinational trade will save the Lebanese economy.

Perhaps no city in Lebanon stands to gain more from Syria's repair than Tripoli, an impoverished city and a key supply route to the devastated Syrian Province of Homs. Syria's reconstruction will create a demand for 30 million tons of cargo annually. Tartous and Latkia ports, however, have only capacity for 15 million tons, and hence there is no readiness yet in Syria to host big shipment. Yet, the fulfillment of this project requires mobilizing funds for more than \$30 million to upgrade the infrastructure in either concessional loans, equity, or PPP. Obviously, the PPP seems the most feasible approach considering the credit rating of Lebanon.

If the country cannot meet expectations, Syrian reconstruction could become a missed opportunity for Lebanon. Additionally, there is talk now that Tripoli could even be a terminal in China's trillion-dollar new "Silk Road" project, carving a trade route from east Asia to Europe.

Conclusions

Public Private Partnerships (PPPs) are considered as alternatives to full privatization, in the sense that the government and private companies assume co-responsibility and co-ownership for the delivery of necessary services. Through these partnerships, the advantages of the private sector dynamism, access to finance, managerial efficiency and entrepreneurial spirit – are combined with the social responsibility, environmental awareness, and delivery of quality products for the public sector. The challenge, however, is for both partners to explore all salient factors and issues that could impact the viability of the proposed partnership and make sound choices accordingly. The development of a PPP type partnership has been proposed in this paper as an effective strategy to improve the present infrastructure and the long-term neglected public

services that the Lebanese population had been deprived of or underserved. PPP can allow large projects to be completed faster with private funding especially with the current financial condition of Lebanon and the current credit rating that made the option of receiving loan quite remote. Moreover, PPP allows proceeds to remain in the economy without recourse to the public sector or inflicting the population with additional tax burdens.

During the past years, Lebanon has lost many past opportunities to develop its infrastructure including its energy, waste management, water, and transport. This paper identifies four projects that can be effectively concluded via Private Public Partnership (PPP). The first is establishing a modern non-emission hydrogen fuel railway network via BOOT that will de-clog congestion, decrease pollution, and allow efficient transportation of freight. Furthermore, it should help elevate the country from its lumbering high petrol import bill. Secondly, is developing the electric sector that is at the heart of the economic crisis and accountable for a loss of around 40 billion USD. The government should consider entering into a partnership with Green Independent Power Producers (GIPPs) through BOOT that should bring with it multiple benefits from climate conditions to cost effectiveness, as the country is effectively insolvent and cannot afford to be encumbered with high prices of fuel. Thirdly, is renovating the two oil refineries in the country that has stopped during the war through Build Operate and Transfer (BOT). This would be deemed as an optimal solution, as Lebanon is currently broke and this initiative can secure its needs of oil and then eventually export its surplus. Finally, is mobilizing \$30 million through PPP to develop Special Economic Zones (SEZs) that would play a key role in economic development. The reconstruction of Syria is estimated at \$200 billion and Syria's ports have only the capacity to receive half of the expected cargo. Hence, mobilizing funds for SEZs, will enhance the country's national trade, boost foreign investment, and help transfer international expertise and know-hows for the local workforce.

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