By Mounir Rached

Stick to reality

The budget outlook for 2019

It took more than seven months to complete the 2019 budget law, despite the pressing need to have completed it by the maximum constitutional deadline of end January 2019. Had Lebanon managed to produce the 2019 budget within the mandated time frame, it would have gone a long way toward restoring confidence in the ability of the state to complete its financial functions, which, in turn, would have had positive effects on local financial markets, and on the countries and donors that pledged loans and grants to Lebanon on the condition of fiscal reforms at the April 2018 investment conference, known as CEDRE.

Based on figures released for the 2019 budget, the assumption of reducing the fiscal deficit to 7.6 percent from 11.5 percent the previous year is far-fetched; international financial institutions are in agreement on this. In terms of revenues, it is very difficult to achieve an increase of 8 percent to reach LL19.02 trillion ($12.7 billion) due to the passage of time, the continuing economic recession, and the fact that half the fiscal year had already passed before the 2019 budget was approved. Revenues alone are projected to reach a maximum of LL18.2 trillion ($12.1 billion), and estimates have been adjusted to reflect only the time factor—actual revenues for the first half of 2019 amounted to just LL8.67 billion ($5.8 billion).

The expenditures in the budget—estimated at LL25.8 trillion ($17.2 billion)—exclude several important budget items: the budget of the Council of Development and Reconstruction, estimated at LL500 billion ($333.3 million) annually, as well as the treasury account with a deficit of approximately LL700 billion ($466.7 million), in addition to the government obligations toward the National Social Security Fund (NSSF), that exceed LL360 billion ($240 million), and service of government arrears to the NSSF. Including these expenditure items within the budget is necessary to respect the principle of full inclusion in public accounting. With the addition of such items, total state expenditure is close to LL27.4 trillion ($18.3 billion)—perhaps even more—and the deficit increases to LL9.2 trillion ($6.1 billion) compared to LL9.1 trillion ($6.07 billion) in 2018.

But another important question to consider is Lebanon's GDP. The deficit ratio estimated in the official 2019 budget assumed that nominal output will rise by about 6.5 percent annually in both 2018 and 2019, to reach LL90.2 trillion ($60.1 billion) this year. The actual figure issued by the Central Administration of Statistics indicates an output of LL80.5 trillion ($53.7 billion) in 2017, and official estimates are not available after that year. It is difficult to achieve a nominal growth of 6.5 percent in 2019 in the recessionary environment we are in, and income (GDP), will not exceed 3.5 percent annually at the most. Output is not expected to exceed LL85 billion in 2019. Therefore, the deficit is very likely to be closer to 11 percent. A reasonable estimate would be to reduce the actual deficit by only 0.6 percent in 2019.

However, deficit reductions can be achieved through default and accrual of arrears shown in the financial statements, as they are calculated on a cash-only basis, but such an approach has serious negative implications on the economy.

One of the important proposed tax measures in the 2019 budget is to increase the interest income tax to 10 percent for a three-year period only. However, this tax may have a negative impact on financial markets and economic activity, as it will lead to higher nominal interest rates and discourage economic growth, especially in the real estate sector. It may also be a negative factor on financial flows to Lebanon due to the decrease in the effective interest on deposits after tax, not to mention the impact on low-income Lebanese, especially retirees. In addition, the cost of servicing the public debt may rise with the higher nominal interest rate.

Another important proposed tax measure is to increase import duties with some exceptions. Consideration should be given to its impact on trade agreements, and keeping in mind protection is not beneficial to economic growth; it may have a negative impact. Raising the tax on high salaries to 25 percent will have a limited impact as it is a narrow category. Instead, it would be more feasible to raise the corporate income tax rate to 20 percent, and apply two VAT rates: 10 percent on non-luxury goods, 15 percent on luxury goods.

In the case of expenditure, the most important item of waste has been deferred: the electricity sector. The rapid completion of the purchase of energy through a transparent power-purchase agreement (PPA) tender for the equivalent of 1000 MW, and raising the tariff rate to 15 cents per kilowatt hour; would save the treasury close to $2 billion and save the consumer $1 billion annually. It would take a few months to implement and result in annual savings of $3 billion. It must be given top priority.

Looking forward to the 2020 budget, it would be preferable that those budget figures be based on reality, rather than on an overly optimistic scenario.

Mounir Rached is a former IMF economist and currently the president of the Lebanese Economic Association. All numbers for 2019 cited within the above article are based on his own estimates.