LIFE believes that the current subsidy system in Lebanon is regressive, distortionary and unsustainable. It constitutes a major drain on the budget and the Central Bank’s foreign exchange reserves, both of which are in a highly perilous state. Additionally, it is a major driver of widespread corruption and cross-border trafficking.

We believe this system should be drastically reformed through: 1) a substantial reduction of energy related subsidies, including EdL’s, and 2) an enhancement of the social safety net, to be facilitated by concessionary loans from international institutions and a gradual shift towards a targeted, transparent and more affordable direct cash transfer model under the supervision of the World Bank.
Lebanon’s subsidy system is expensive and unsustainable

As estimated by the Lebanese Ministry of Economy and Trade, the subsidy system costs over $3.4 billion (more than 10% of GDP).

It is a major contributor to the steady depletion of the Central Bank’s available FX reserves, which are already at critically low levels.

Lebanon is headed towards a disorderly adjustment of the exchange rate, hyperinflation, an uncontrolled collapse of the economy and more severe debt and financial sector restructuring (e.g. bail-in and forced conversion of USD deposits to Lebanese Lira). The social impact of such a scenario is catastrophic.

A REGRESSIVE SYSTEM

The system is regressive, especially for fuel subsidies, which represent 65% of the subsidies cost. For instance, a large share of subsidised energy benefits higher income groups, 80% of whom own motor vehicles, as opposed to less than 25% of the poorest segment of the population. As such, it encourages over-consumption of fuel and has room for optimisation and a reduction of its negative environmental impact. The World Bank estimates that the richest 20% of the population receive around 55% of the energy-related subsidies, highlighting the need for reform.
The current system also reduces the desperately needed incentives to reform the electricity sector, which has been Lebanon’s fiscal black hole for the past three decades. It also stealthily redirects limited fiscal resources away from other areas, cannibalising sectors that are needed for Lebanon’s economic transformation and adaptation (see below).

Finally, the current system hinders import substitution, which is key to reducing Lebanon’s external funding needs over time, and encourages rampant cross-border smuggling, representing a further drain on Lebanon’s fiscal and monetary resources without any benefit to the country.

**LIFE’S VIEWS**

**Energy related subsidies need to be significantly curtailed**

Cash transfers need to be used to mitigate the impact of higher energy prices, particularly relating to products used for heating and transport in the case of lower income groups. Subsidies relating to medical products and food products, representing less than one third of the total cost of subsidies can also be recalibrated and refined. However, removing or phasing out basic food and medical subsidies should not be a current priority.

The World Bank (‘Lebanon Subsidy Reform Note’) recommends the implementation of a broad-based cash transfer programme prior to subsidy removals, in order to offset the sharp inflation that would follow the withdrawal of subsidies. Cash transfers should not be restricted in their use, thereby giving households greater autonomy to purchase what they require and not what the government decides should be subsidised. **While LIFE is in favour of a broad cash transfer system, it is also of the view that this system needs to be realistic in its scope and hence targeted towards the poorer segment of the population, estimated at 45–55% of the population.** Replacing subsidies with cash transfer system of the same (or roughly similar) size would not reduce fiscal and monetary pressures and wouldn’t address the large-scale inefficiencies of the current
system. As such, as the population adjusts to new market prices for currently subsidised items and as the economy recovers, the coverage of this targeted compensation programme can be adjusted to ensure a smooth phasing out.

In light of Lebanon’s weak institutional framework and lack of transparency, it is imperative that any cash transfer programme is designed and implemented with the help and supervision of the World Bank, as well as credible international agencies and local NGOs. LIFE, which has been at the forefront of humanitarian aid delivery in Lebanon, welcomes the chance to share its on-the-ground experience.

Eventually, subsidy reforms should be complemented by select tax exemptions to encourage Lebanon’s economic transformation towards a more sustainable model, including encouraging food safety, helping selected manufacturing sectors and promoting economic spheres where Lebanon possesses – or could possess – a competitive edge, including its educational and medical sectors.

Reforming the subsidy system is not a substitute for the long list of desperately needed economic reforms. Engaging in piecemeal economic reforms is far from ideal and LIFE recognises the phasing out of subsidies will further squeeze a Lebanese middle class, which is already unjustly struggling. As such, subsidies reform should be part of a holistic IMF-led economic and financial programme. However, on balance, it is imperative to address the subsidy issue immediately, thereby shifting the burden away from the remaining Central Bank’s reserves which are crucial in rebuilding confidence in Lebanon’s financial sector.

Absent which, Lebanon’s hard currency reserves, which are already at perilously low levels, will be depleted. Such a scenario will irreversibly reduce the ability of the government to protect the residual value of bank deposits. It will also create a cataclysmic social situation in which Lebanon’s medical and food security will be in jeopardy.
LIFE is a global membership organisation for Lebanese professionals working together towards a brighter future. Headquartered in the UK, LIFE is not-for-profit, apolitical and areligious. LIFE operates through its four pillars: connect Lebanese professionals together; nurture the future generation of Lebanon; promote the development of the Lebanese economy; and advocate for economic and social reform.

Advocate is LIFE’s advocacy and influence pillar. Advocate channels the expertise, resources and goodwill of LIFE members to: 1. support the development of sound and rigorous economic, financial and social policies; 2. steer the economic narrative on Lebanon around the world in line with LIFE’s impartial views; and 3. engage with students and grassroots organisations in order to raise awareness on civic duties and good governance.

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