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Statement by the Hon. **GEORGES CORM**,
Governor of the Bank for **LEBANON**,
at the Joint Annual Discussion

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Mr. Chairman,
Dear Colleagues,

It is my pleasure to address this distinguished audience in my capacity as a member of the new Government of the Republic of Lebanon which has come to office in December 1998 with a pledge to undertake a full reform of its public finance. This reform is targeting two main goals: establishing transparency and efficient governance in public spending and in the taxation system on the one hand, and addressing effectively the issue of ever-increasing public deficit that has plagued the Lebanese economy and led to an unbearable level of real interest rate, on the other.

As you may know, Lebanon through regular constitutional process has elected a new President in October 1998. Our Government that took office in December, within the framework established by President Emile Lahoud, is dedicated and committed to implement all the basic elements of good governance and accountability. More specifically, we have pledged to abide by the rule of law, to reinforce the role of institutions, to introduce transparency in public accounts, and to ensure full disclosure of data and statistics. We are also addressing the issue of distributing fairly the tax burden among citizens and we will attempt to stop the continuing damage to the environment.

It is our feeling that the issues of good governance and accountability that are receiving more international support and focus, are key issues for the next century. We have to thank the IMF, the World Bank and other UN institutions for promoting these issues and bringing them into the limelight, but more efforts have still to be done. The development of free market economies, the dismantlement of cumbersome regulations and the opening of markets to international trade and to financial flows have all created a new frontier for development but also with potential negative side effects. What has happened in certain parts of the world in terms of economic instability, financial disruption, and abuse of public assets, show that the global markets are indeed needing better governance and accountability to become more beneficial.

In fact, the transition to free market economies and the globalization of the international economy and of financial markets constitutes a difficult turning point. Not all countries, nor all social groups inside each country are taking advantage of global markets and more productive economic freedom. Social inequalities are on the increase in many parts of the world. Too often, globalization is associated with undue and unproductive windfall profits. State institutions are encountering many difficulties in adapting to the new role of impartial regulator of liberalized domestic markets. Low paid

and inadequately trained civil servants are not always able to resist being influenced by large private companies.

On the other hand, corporate governance rules which are enforced in some countries are not being introduced or implemented in many other countries. Due to this situation, privatization does not always yield the expected benefits for the consumer and the economy in general. This is why we believe that both the IMF and the World Bank, in their remarkable efforts to induce member states to fight corruption more efficiently, should put the same emphasis on corporate governance in the private sector as is being put on State and public sector governance, transparency, and accountability rules. In many emerging markets, private sector companies are resisting the introduction of corporate governance and business ethics' rules. Legal rules and the judicial system are not being adequately modernized and made more efficient to secure the minimum level of corporate governance to the benefit of the economy as a whole.

We, in Lebanon consider that putting economic growth on sound and sustainable basis requires clear priorities to be addressed. This is why our Government has devoted its first months to produce a five-year fiscal consolidation plan to address the need to re-introduce financial discipline in public finance. After fifteen years of war and eight years of high annual deficits and a huge pile-up of domestic debt, we have developed a package of financial reforms to curb public deficits, reduce the very high and unsustainable level of domestic debt, and allow real interest rates to fall down from their very high level. This first priority is designed to allow for a come back of private investment as the main engine of growth. During the reconstruction years, private investment has been oriented towards real estate and contracting which has come to a stop after a few years. Oversupply in the real estate sector and the piling up of state arrears to contractors, have affected negatively the private sector, in addition to the crowding out effect of the private sector on the credit market due to the increasing need of public sector financing. An additional result of this situation has been the high costs of running the economy and the lack of competitiveness of domestic products and, thus an ever-increasing gap in our external current account balance.

This is why our package of financial reform is designed to cure the unhealthy situation prevailing both in the public and private sector. We need to slim down the inflated role of the public sector in the economy and to bring back domestic private investment in the various sectors of the economy at the forefront of economic development. Investments will have to be oriented towards increasing the competitiveness of the economy and diversifying its productive capacity.

Our financial reform package is based on two main components. The first is a comprehensive plan to review and modernize our outdated tax system that is yielding only 14% of GDP as tax receipts, while our level of spending is above 35%. Our plan is to increase tax receipts to the level of 19% of GDP in five years while, at the same time, trimming down expenses to 25% of GDP. The main components of our tax reform program are the following:

- The introduction of a value added tax (VAT) to replace most excise duties and to reduce the very high dependence of tax receipts on custom duties that will have to be trimmed down in the future.
- The introduction of a global income tax system to replace the old system of schedular income taxes that assess separately and at different rates the various sources of revenues of the tax payer.
- The modernization of the stamp duty.
- A package of tax incentives that will induce companies to invest and to upgrade their productive capacities, to open their share capital to foreign participation, and to register their capital stock on the local stock exchange.
- Raising the ceiling of income tax rates from the present low level of 10% for the higher tranches of revenues to 20%.

The changes of income tax rates have already been adopted by the Lebanese Parliament in the 1999 Budget law. A draft law on VAT will be presented to Parliament before the end of the year.

The second main component of our financial reform package is privatization. Although Lebanon has never had a large number of public enterprises, there is a need to modernize Public services and to secure better-priced and more efficient services to the consumer, mainly in the area of water, electricity and telecommunication. However, in our privatization program we want to avoid the mistakes that have been done elsewhere. It is extremely important for our Government that we do not just transfer a public monopoly into the hands of a private monopoly consisting of a few large shareholders from the private sector. The aim of our privatization efforts will be to enhance competition to the benefit of the consumers, thus reducing prices and, also, optimizing the flow of resources accruing to the State Treasury. In addition, we would like to see the largest distribution of shares among the Lebanese public so as to activate the domestic financial market and avoid any monopoly position.

To abide by transparency rules and fair competition principles, we have prepared a draft law that is now being discussed in Parliament. The law states clear procedures to be implemented and requires that adequate regulatory authorities be created to supervise privatized sectors.

Our financial reform package has already produced very beneficial results on the domestic financial markets. The previous negative trends have been reverted and interest rates on domestic T-bills have declined by almost two percent. Budget deficit is being held below 40% against an average of more than 50% in previous years and the balance

of payment has returned to a positive trend after last year huge deficit of more than 400 million dollars.

In addition, our Government has also recognized State and Public Sector unbudgeted arrears piled up by the former Government to the Private Sector. The Parliament has approved the Government's request to pay these arrears and allowed the Ministry of Finance to issue three-year T-bills to be delivered to the beneficiaries of the arrears as payment.

But we still have a long way to go to establish proper governance and transparency. Our next steps will be the following:

- 1) Determining the exact amount of arrears inside the Public Sector and clearing them to suppress financial distortions and unfair situations between Public entities, or between the State and Public entities.
- 2) Establishing a fair and acceptable tax framework. In this context the Ministry of Finance intends:
 - to settle old unaudited tax payers' file in an acceptable and fair way,
 - to induce people unknown to the tax authorities to register themselves with the concerned tax department,
 - to review and simplify all tax procedures and suppress sources of corruption.
- 3) Setting-up an efficient, fair and transparent system for the management of public domain in Lebanon. As in many other Arab countries, this is a big issue in Lebanon. Too often public domain is being leased at very low rates when it is not being illegally occupied.
- 4) Improving public procurement procedures to secure proper competition.
- 5) Improving expenditure control procedures by:
 - Shifting the emphasis from ex-ante control to ex-post control so as to establish a real accountability in spending procedures instead of diluting responsibilities.
 - Creating effective cost control criteria.
 - Setting a transparent management system for non-privatizable Public enterprises.

- Establishing an adequate social network to tackle enlarging social pain and help the poor to adapt to economic and financial structural adjustment.

In our endeavor, we are very grateful for all the assistance we are receiving from the IMF, the World Bank and the IFC. We are developing a very fruitful dialogue with all three institutions and are trying to make the best use of their experience and advice. We are very glad that the World Bank is opening an office in Beirut and are looking forward for more cooperation with the Bretton Woods Institutions.

We do hope that all the efforts that are being developed to reinforce the architecture of the international, financial and monetary system as well as efforts for poverty alleviation will be successful in the near future. We need to enter into the next millennium with a more stable and more transparent world and a much fairer and equitable system of distribution of chances within the new context of global markets.

Thank you.