IMF calls for strong domestic policies to face external challenges February 18, 2013 By Mohamad El Amin
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The International Monetary Fund (IMF) headquarters building is seen in Washington, DC in this May 15, 2011 file photo. The International Monetary Fund said January 18, 2012 it would seek up to $500 billion in new financial firepower as the European debt crisis threatens the global economy. (AFP PHOTO/YURI GRIPAS)

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Editor's note: *The following is the full text of an interview with Najla Nakle, the IMF's representative in Lebanon.*

Q: The IMF has, on many occasions, highlighted the dire impact of the Syrian crisis on the Lebanese economy. How do you see the economy performing in the short, medium and long terms? Any updated GDP-growth forecasts?

A: The crisis in Syria has already been costly to Lebanon, primarily by disrupting tourism and increasing the costs of bilateral and transit trade, while Lebanese banks have had to reduce their exposure to Syria.

In the near term, Lebanon's economic performance is expected to remain sluggish. Growth is estimated to have been 2 percent in 2012, and is projected at 2.5 percent for 2013, significantly below the 8 percent per year recorded during 2007-10. Risks are substantial, mainly on account of potential spillovers from the crisis in Syria.

Inflation has moderated, but could rekindle with wage increases under discussion. Preliminary information points to a primary fiscal deficit in 2012 and a resultant slight increase in the debt-to-GDP ratio (to about 140 percent of estimated GDP at end-2012). Pressures on the external current account are expected to persist over the near term, reflecting weak tourism and other services inflows.

The medium- and long-term growth outlook is moderate with Lebanon's growth potential estimated at 4 percent. Faster, sustained, and more inclusive growth over the medium term would require investment and reforms in infrastructure as well as improvements in the business climate and the labor market.

Fiscal policy should be anchored in a sizeable reduction in the debt-to-GDP ratio – which is one of the highest in the world.

Q: Finance Minister Mohammad Safadi was in Washington last week where he met IMF officials. Ministry sources have told The Daily Star that the IMF offered the Lebanese government to assist in dealing with the economic impact of the influx of hundreds of thousands of Syrian refugees. Please explain how the IMF would help Lebanon tackle this problem.

A: Minister Safadi and IMF officials focused in their discussions on recent developments and the near- to medium-term macroeconomic outlook. In this context, it was noted that the conflict in Syria is taking a toll on Lebanon's economy, including by having to absorb a large influx of Syrian refugees.

The international community has expressed support for Lebanon's efforts to alleviate the hardship of the refugees, as also demonstrated during the recent donor conference in Kuwait. While not a donor agency, the IMF will continue supporting Lebanon through macroeconomic policy advice and technical assistance.

Q: During Safadi's visit, the IMF asked Lebanon to realize urgently needed bold fiscal and financial reforms. Can you elaborate more on these reforms?

A: The challenging external environment calls for strong domestic policies that instill confidence and preserve policy buffers. These policies would include prudent fiscal policies, embedded in a medium-term agenda and focused on reducing the government debt-to-GDP ratio.

Fiscal policy should target primary surpluses to keep Lebanon's debt-to-GDP ratio on a downward path. Tackling infrastructure bottlenecks through investment and reforms, improving the business climate and the labor market, and strengthening the social safety net are key to generating faster, sustained, and more inclusive growth.

Q: In what other ways is the IMF planning to help Lebanon amid current economic challenges?

A: The IMF is committed to supporting the region with financing, technical assistance, and policy advice. It stands ready to help Lebanon in any way that serves the interests of its people.

The IMF continues to be in close contact with the Lebanese authorities and provides policy advice tailored to Lebanon's circumstances in the form of regular consultations. The IMF is also very active in Lebanon through technical assistance and training to promote economic development and capacity building.

Technical assistance is provided by IMF headquarters and the Middle East Regional Technical Assistance Center, which is located in Beirut. Recent technical assistance to Lebanon, including through METAC, has focused on public financial management, revenue administration, financial supervision and statistics.

Q: Are there any new loan agreements being mulled by the IMF and the Lebanese government?

A: Lebanon has not requested financial assistance from the Fund.

Q: Lebanon's leading private sector group, the Economic Committees, has often quoted the IMF and the World Bank in statements slamming the salary increases being proposed for public employees. What is the Fund's position on the issue?

A: Prudent fiscal policies targeting a primary surplus are important to assure markets that macroeconomic stability will be maintained. Thus, any increase in public sector salaries will need to be carefully managed and accompanied by mitigating measures.

If the salary increase is not accompanied by a commensurate increase in revenue or savings elsewhere, it could raise financing pressures on the budget and interest rates and, in the long run, have an impact on fiscal sustainability and ultimately reduce growth.

The wage increases as well as tax measures could also affect Lebanon's competitiveness. In this context and as noted earlier, structural reforms to improve the business climate and labor market while upgrading infrastructure are all the more urgent.

Lebanon should thus aim at developing a medium-term fiscal strategy anchored in reducing the debt-to-GDP ratio, freeing up space for public investments, and implementing structural reforms to raise productivity.

Q: The government has spoken about the need to increase taxation to fund the new salary scale and other expenditures. Do you believe this would be a sound policy amid a slowing economy?

A: Without mitigating measures, the large-scale salary increase under discussion could raise concerns about competitiveness and fiscal sustainability – in particular given the permanent nature of current spending. This is particularly important given that, in 2012, the budget posted a primary deficit and the debt-to-GDP ratio increased for the first time since 2006.

If not accompanied by permanent savings elsewhere or a commensurate increase in revenue, a wage increase would increase government financing needs and thus put upward pressure on interest rates. Any wage increase not supported by revenue measures should be done in the context of a comprehensive policy package, including civil service reform.

Tax measures on top of wage increases could further affect Lebanon's competitiveness. They should focus on broadening tax bases and be accompanied by enhancing tax administration. And they should be accompanied by structural reforms so that Lebanon can maintain its competitiveness.

There is also a need for higher social spending, including to mitigate the adverse social impact of potential tax measures and make the tax system more equitable.

Q: The IMF recommended previously that Lebanon should increase interest on treasury bills. Do you still believe this is needed to lure local banks into buying more treasury bills?

A: The recommendation referred to was in the context of the 2011 Article IV consultation. The authorities increased interest rates in March 2012. Further increases in T-bill rates may be needed to reduce the government's reliance on Banque du Liban financing; These will be discussed with the authorities during the next consultation.

Q: The IMF Article IV Consultation for 2012 has not been released yet. Why has been the report delayed?

A: The last Article IV consultation discussions were held in November 2011 and the report was published in February 2012. Staff visits took place in October and November last year and the 2013 Article IV consultation – to be followed by a report – is expected to take place later this year.