# "The Trouble with the Creeping Expropriation of Depositors", by A Citizens' Initiative for Lebanon, 24 Jan 2020

*The article titled "The Trouble with the Creeping Expropriation of Depositors", written by A Citizens' Initiative for Lebanon was published on 24th January, 2020 and is posted below. Click here to access the original article.*
*This note is the second in a series of analysis by an independent group of citizens who met in their personal capacity in December 2019 to discuss the broad contours of Lebanon's financial crisis and ways forward.*

While appearing to do nothing, policymakers are in fact tacitly responding to the crisis. They are doing so by allowing a maxi-devaluation of the LBP, while simultaneously weakening the rights of depositors without imposing pain on bank shareholders, as is legally required. In line with our recently released Ten Point Plan to Avoid a Lost Decade, we call for an immediate stop to these policies, which we argue are socially inequitable and economically inefficient.

## A Toxic Policy-Mix

The first element of this mix is the steep depreciation of the LBP. The LBP market rate is in free fall, now heading to nearly twice the official rate. While depreciation is necessary to reduce the current account deficit, it has been made much larger than necessary by inaction on the fiscal front. Deteriorating tax collection (down by 40 percent

percent already) is generating an additional deficit in the primary balance of about $4 billion. With no other choices available, this will be increasingly financed by the Banque du Liban (BdL) injecting LBP liquidity, thus accelerating inflation and depreciation in the future.

While runaway inflation and devaluation constitute in effect a tax on people's real incomes, the creeping expropriation of deposits extends this effect further to their hard earned savings, even when they had sought protection by saving in dollar accounts, which represent close to 75 percent of deposits.

This started when the BdL left banks to self-manage a soft system of capital controls, which allowed them to sequester small depositors, while some large depositors were able to escape. The BdL also allowed banks to pay for deposit withdrawals from dollar accounts *at official LBP rates*. The BdL later capped interest on deposits, but not on banks' loans. It also required banks to pay half of the interest on dollar deposits in LBP, again at the official exchange rate.

Given these precedents one would expect "Lirasation" at a discounted exchange rate to continue to expand in the future, first to all the interest, and later to the principal. Indeed, in a recent publicly televised broadcast the Governor of the BdL declared that banks are only obligated to pay depositors in LBP at the official rate, a statement that is not supported by the Code of Commerce or case law.

## Why this Policy?

A rampant "Lirasation" of deposits offers a magic solution to the public debt and banking sector problems. While the value of dollar deposits in banks would be reduced by as much as the LBP, bank assets would be much less affected, because they are largely denominated in dollars (loans to private firms, Eurobonds, and deposits at the BdL). If all deposits are

“Lirasised” and the LBP stabilizes at its current rate of 2000LBP/$, we calculate that banks would gain about $50 billion, a massive wealth transfer from depositors to banks’ owners.

Devaluation would also wipe out LL denominated sovereign debt, but it would increase the cost of servicing the remaining public debt dominated in dollars (Eurobonds and BDL deposits). However, it will be possible to finance the costs of a necessary restructuring of the remaining debt, held mainly by banks, by using up only part of the massive gain of the banks. At the end, the main burden of debt reduction and banking sector restructuring will be borne by depositors.

## Costs of this Policy

The current approach to the debt problem comes at unacceptably high costs:

- It is unfair and discriminatory. Lebanon’s lower and middle classes will be decimated not only by lower real wages and pensions, but also by a liquidation of the wealth and lifetime savings accumulated by generations of expatriate and resident Lebanese. It is completely unprecedented to put the burden of loss on the depositors while shielding banks’ shareholders from such pain.
- It is inefficient. It will lead to a sharper contraction of the economy than necessary and a reduction in its growth prospects, for four reasons. Wealth destruction will push down demand. Many private firms will go bankrupt because their borrowings are mainly in foreign currency while their income is in LBP. Confidence in banks will collapse leading to severe financial disintermediation. And inflation will accelerate further because of “too much” Liras in the system.

In the second half of 2001, Argentina went through a similar experience. A sudden stop of inflows led to a bank run. Soon after, deposit withdrawals were sharply curtailed (the “corralito”) and the ARS1/1$ currency peg was abandoned. A law was passed to convert all dollar deposits (which were predominant, as in Lebanon) into pesos at ARS1.4 for $1. The market rate collapsed however to ARS3.9 for $1, reducing the value of dollar deposits by 64 percent. A deep recession followed, with GDP collapsing by 12 percent. But there were two major differences with Lebanon: the banks held little public debt, and the exports improved rapidly. The resulting recession in Lebanon can be expected to be far more destructive, especially that Lebanon’s exports are unlikely to rebound as fast as in Argentina.

Creeping Lirasation is also illegal. The Money & Credit Code of 1963 and its various amendments which is the legal framework for money and payments, does not provide a mandate or authority for the Central Bank to force the payment of interest in a different currency than in the deposit contract, let alone to force deposit conversion into LBP at below market rates. Such actions would require the passage of a ‘nationalisation law’ by Parliament and possibly, an amendment of the constitution.

To stop Lirasation, we recommend adopting the market rate as the legal reference for foreign currency deposit repayments. This calls for a mechanism to establish a market rate at all times, similar to the flexible exchange rate regime which characterized Lebanon’s experience from 1949 till 1996 and which allowed it to weather domestic and external shocks.

The 10-point comprehensive plan that we have proposed calls for a quick adjustment in the fiscal accounts to reduce inflationary pressures, especially by curbing corrupt practices. It also calls for an immediate moratorium of debt repayment, and for an orderly reduction of public debt. This would be place the burden on bank equity, and by limiting haircuts to the 0.1 percent of depositors who account for more than 35 percent of all deposits. A well-devised policy package along the lines we recommend will be not only be socially fairer, but it will also lead to a faster recovery.

### *Signatories*

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# "Road Map to an Orderly Restructuring of Lebanese Public Sector Debt", Article in An-Nahar, 21 Jan 2020

*The article titled "Road Map to an Orderly Restructuring of Lebanese Public Sector Debt", written by A Citizens' Initiative for Lebanon appeared in An-Nahar's online edition on 21st January, 2020 and is posted below. Click here to access the original article.*

We believe Lebanon's public sector debt is unsustainable. In line with our recently released Ten Point Plan to Avoid a Lost Decade, we strongly recommend that the Lebanese government commences with a comprehensive restructuring effort – one that brings down the debt burden to a level the country can afford. Using scarce international reserves to make future Eurobond payments will be a mistake. Equally, the bond-by-bond rescheduling approach being discussed postpones the inevitable and is costly and inefficient. Sovereign debt restructurings are not un-precedented and best practices do exist. But for the effort be successful, it should be part of a broader stabilization and reform package.

**How large is Lebanon's debt?**

Repeated government deficits have led to an extraordinary accumulation of public sector indebtedness. From $25 billion in 2000, gross debt had mushroomed to $90 billion by the end of 2019—the equivalent of 150 percent of GDP. Lebanon today is the third most indebted emerging economy worldwide.

However, this is not the whole story. This debt is likely to continue rising as a result of two additional factors:

- The larger the FX depreciation, the higher the debt/GDP ratio. On the positive side, a large portion of the debt is in Lebanese Lira (LBP). A Foreign Exchange (FX) depreciation will therefore reduce the "real" value of debt. As an indication, if the FX settles at LBP2260/$ (i.e., a 50 percent depreciation), gross debt, when measured in USD, will drop from $90 billion to $71 billion. However, and by the same token, an FX depreciation will reduce the country's USD-measured GDP. Again, for illustrative purposes, a 50 percent FX depreciation, when combined with a 20 percent inflation and an 8 percent recession, will reduce GDP from $60 billion in 2019 to $44 billion in 2020.*1* Consequently, despite the FX-led dilution of LBP debt, debt to GDP will actually rise from 150 percent in 2019 to 161 percent of GDP in 2020.
- Deepening recession and public sector deficits will need to be funded through increased debt. First, the 2020 (and beyond) recession will result in a public sector deficit that will have to be funded through debt. Second, the official (IMF, World Bank, Cedre, etc.) funding support that the country needs will be debt creating. Finally, important quasi fiscal "holes" including, most prominently, BDL's necessary

recapitalization as well as the arrears recently accumulated by the fiscal authorities, will have to be recognized and will inevitably lead to significantly higher debt.

**Is Lebanon's debt sustainable?**

No. The easiest way to see this is by examining what it would take to service the existing stock of debt. Given the $71 billion debt figure cited above (which is the debt calculated after the FX depreciation dilutes the LBP debt but before any new debt is accumulated as described above), a conservatively assumed 7 percent interest rate would lead to $5 billion (annually) in interest payments. Moreover, if one assumes a seven-year maturity on the debt, there will be an additional $5 billion in annual principal repayments. Combined, this $10 billion represents almost a quarter of 2020's GDP. Seen in even starker terms, this amount is actually larger than the projected government revenues for 2020.

Lebanon's debt service burden is not a new phenomenon: it has been large and growing for years now. The government has sustained it thus far by borrowing the debt service and adding the amount to existing debt. However, a future repeat of this approach is extremely unlikely. First, the amount of new debt required to service the existing debt ($10 billion annually) is, in the foreseeable future, almost certainly impossible to raise in capital markets. Second, even if "borrowable", this will add to an already extraordinarily high level of debt. *2*

**What's the "right" level of debt for a country like Lebanon?**

The academic literature on debt "tolerance" indicates that emerging economies cannot sustain high indebtedness and that, when they do accumulate it, defaults often ensue.*3* The literature's conclusion is that, to avoid defaults, an emerging country should hold a relatively "low" debt load. So, what defines "low"? "Investment grade" countries, that is countries seen as having strong and healthy economies, offer a good benchmark. Historically, those countries have defaulted only 3% of the time. On average, those countries' debt load amounted to 60 percent of GDP. To expand the universe a bit wider, countries that are rated three notches below "investment grade" and have defaulted 10 percent of the time, have held a debt load of 80 percent of GDP.

As such, we believe the above range (60-to-80 percent of GDP) is a maximum medium target for Lebanon's sovereign debt. We would be even more aggressive. Lebanon's institutional and political fragilities severely challenge the public sector's ability to generate the budget surpluses needed to service debt over time. We would therefore argue that the lower part of that range is more advisable. Given that Lebanon's debt today is (at least) 160 percent of GDP, achieving the medium-term target of 60 percent of GDP will require a dramatic debt restructuring effort.

**Does a restructuring necessarily mean a "hair cut"?**

Not really. Even though the previous section defined sustainable debt in "percent of GDP" terms, the reality is not all debt is created equal. An extreme example illustrates the point: a 100-year bond with zero coupon entails a dramatically smaller debt burden than, say, a 10-year bond with a seven percent coupon.

A more sophisticated way of thinking of the debt load then is to think of it in terms of net present value (NPV). In effect, this means thinking of debt along three different axes: i) the debt's notional amount; ii) the debt's interest rate; and iii) the debt's maturity.

**How should the restructuring effort look like?**

Following international sovereign restructuring experiences, we would recommend a "menu approach". Some investors will prefer a principal reduction so long as the interest and maturities remain unchanged. Others will prefer to keep the principal unchanged but could accept lower interest rates

and/or extended maturities. The governing principal should be that all creditors are
asked to give the same NPV concession.

Once the negotiations with creditors are completed, the Lebanese government would announce an “exchange offer“ where it retires the existing debt and issues a new set of securities. Some of the new bonds will have lower principal (“discount bonds”) while others will have similar principal (to the existing bonds) but lower interest and longer maturities (“par bonds”). There is also an argument for including “sweeteners” into the exchange (including “warrants” that only pay if the Lebanon grows in the future). International experience suggests that creditors value these warrants thus improving chances of a successful operation.

**Is a sovereign debt restructuring a “big deal”?**

Yes it is. However, sovereign restructurings are not rare either. Since 1980, there has been 111 cases of sovereign debt restructurings—roughly three a year. This does not mean that debt
restructuring is cost-less or “normal”. There is ample empirical evidence that a stigma, measured by the country’s market risk premium, persists. Nonetheless, restructurings have occurred across the globe and they do not spell Lebanon’s ability to finance itself in international markets in the future.

**Are debt restructurings disruptive?**

They don’t *have* to be. If handled properly, they can be cooperative and relatively smooth. Best practices do exist. First, retaining good legal and financial counsel is crucial as the negotiations
will be complicated. Second, it is best not to wait too close to the next maturity before announcing the intention to restructure. The more advance notice creditors are given, the better. Third, Communication matters. In announcing the intention to restructure, the sovereign should make it clear that this is not meant as a “hard default”. By the same token, strong-armed/cramdown

tactics should be avoided if the objective is to reach an orderly and cooperative workout. Finally, fairness and contextualizing the restructuring as part of a broader macro package are
crucial requirements for an orderly effort.

**Will creditors be open to a restructuring effort?**

Creditors are more likely to be open to restructuring efforts if they are part of a comprehensive macro package that includes official foreign support. It is worth keeping in mind that Lebanese
debt is currently trading at a large discount and investors have already priced in a restructuring. They will therefore be open to offering concessions so long as the value of the new bonds is at or above the market value of the bonds they currently own. In other words, the bar for a deal is not too high and the timing is ripe for entering restructuring discussions with creditors.

We also believe that a credible and well-designed debt workout can actually be advantageous to creditors. If the restructuring is undertaken as part of a strong reform package, a Lebanon without a debt overhang will emerge as much more “creditworthy”. This will translate into a lower “risk premium” which, in turn, could take the value of the new (i.e., post NPV-hit) debt above current valuations. This is not a theoretical possibility: most successful sovereign restructurings have resulted in a country’s bonds, even after a large NPV hit, trading well above the pre-restructured bond levels. For this to be the case, though, the importance of a proactive, orderly, equitable and well-run restructuring process cannot be overstated.

**Should the Government be selective in what debt it restructures and what debt it spares?**

At the broadest level, comprehensiveness and equality of treatment should be the guiding principle. The size of the debt itself, as well as the challenging fiscal/growth backdrop over the
next few years, mean that the restructuring effort should

touch all public sector debt and not just the Eurobonds.

That said, the arguments for selectivity are complicated and not straightforward. First, shortdated LBP debt will be hit hard by the FX depreciation so is probably best spared. Second, while debt issued under Lebanese law (treasury bonds and BDL claims) is legally and politically easier to restructure, it's also debt the government will have easiest access to in the future. As such, there is an argument to treat it preferentially. Third, penalizing non-resident creditors is appealing politically and even morally (since most foreign creditors are institutional investors who weren't coerced to own the bonds and knew the risk they assumed). However, foreign creditors won't be as cooperative as locals during negotiations and may complicate the process including through lawsuits. In that regard, actions that complicate the Republic's future return to the capital markets should be avoided if possible.

The bottom line is that there is no straightforward answer to the question of selectivity. The broad principal is that successful restructurings are ones where investors perceive the effort as "fair" and reasonable.

**Is restructuring sufficient to reduce the debt burden?**

No. The stock of debt is too large to be brought down solely through a debt restructuring. There are other ways to reduce the burden. As we argued in our 10-point plan, there is scope for the judicious usage of state assets including privatizations and securitizing future cash flows. Moreover, and as part of any future (large) depositors' bail in, there is room for swapping some deposits into concessional debt. Finally, the public sector should also assume some of the future burden by running primary surpluses that can be used to gradually lower debt over time.

**Is debt reduction alone the answer to Lebanon's problems?**

Absolutely not. It is but one part of the solution. The main argument of our 10-point plan was that a comprehensive

stabilization and reform program is a must. Debt restructuring has to be
part of a larger macro package—one that deals with the banking sector, with BDL's balance sheet, and with private debt. More importantly, a successful debt workout is one that, in parallel,
convinces creditors that the "flow" issues that created the problem in the first place have been dealt with. This, in practice, means addressing Lebanon's endemic fiscal issues, its large external imbalances, as well as the other parts of the macro policy toolbox such as FX and monetary policy.

Creditors will give the sovereign significantly better terms if they perceive the macro framework as credible and sustainable. There are plenty of examples where restructuring proposals that
were advantageous to creditors ex ante were rejected because the creditors didn't think the sovereign can follow through with its macro promises.

**Will legal complications render restructurings impossible?**

We don't believe so. But they are not straightforward. As noted above, retaining good legal counsel will be crucial to the effort. A broad point is that a cooperative approach will increase the
chances of achieving the thresholds needed for a smooth and orderly restructuring.

Lebanese Eurobonds are issued under New York Law and have broadly standard terms including cross default clauses and a 7 days grace period for principal repayments and 30 days for coupon payments. A quarter of the principal holders are needed for acceleration of the Eurobond's repayment.

The area that may well complicate the restructuring effort relates to the collective action clauses required for modifying the terms of the Eurobond. The contracts foresee creditors' meetings that can modify bond terms so long as 75 percent of bond-holders consent. This includes changing amounts payable, reducing/cancelling principal, and modifying currency of payment. Any such resolution passed in this manner would be binding on all holders regardless of whether they voted in favor or not. However, there is no collective action clause across series. As a result, outstanding Eurobonds would have to be restructured series by series. Ownership structure of each Eurobond could thus be an important factor when negotiating with creditors. Our recommendation is that the Government approaches all bondholders across the different series with a single restructuring proposal but we wouldn't rule out the eventual possibility of differential treatment based on ownership structure.

**Summary**

In summary, we call on the Lebanese Government to immediately initiate a plan to proactively address the unsustainable debt burden. An organized, fair and credible debt effort that is part
and parcel of a broader reform and stabilization program is imperative for Lebanon's eventual recovery and its longer-term economic stability and growth.

**Signatories in their personal capacities**

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# "Lebanon's Economic Crisis: A Ten Point Action Plan for Avoiding a Lost Decade", by A Citizens' Initiative for

# Lebanon, 6 Jan 2020

*The article titled "Lebanon's Economic Crisis: A Ten Point Action Plan for Avoiding a Lost Decade", written by A Citizens' Initiative for Lebanon was published on 6th January, 2020 and is posted below. Click here to access the original article.*

*An independent group of development specialists, economists and finance experts met in Beirut late-December to discuss the ongoing economic crisis and the path forward. This note summarizes the deliberations and puts forth a ten-point action plan meant to arrest the crisis and place the country on a path of sustained recovery.*

## How did we get here?

The economic crisis is, at its core, a governance crisis emanating from a dysfunctional sectarian system that hindered rational policymaking and permitted a culture of corruption and waste. The country, led by the public sector, lived beyond its means. Decades of pursuing this model left the economy with high debt and a bloated banking sector.

Inevitably, the dramatic debt increase resulted in an-expanding debt-*servicing* burden. The large yearly funding needs rendered the country vulnerable to external and regional shocks. As external financial flows into Lebanon slowed, the central bank resorted to desperate and extremely expensive efforts to attract them. Ultimately, this proved unsustainable. Since October, we've had a virtual cessation of capital inflows and a sharp acceleration of outflows.

## Where are we now?

This situation leaves the country with three simultaneous crises.

***The first is a balance of payments and currency crisis***. For 2020, we estimate the gap between USD supply and USD demand at $8 billion. If this gap is not filled, the economy will experience difficulties including the servicing of external debt, imported goods' shortages, currency devaluation, and economic contraction.

***The second crisis is that of public finance.*** Beginning with a 10 percent of GDP deficit in 2019, government revenues are now collapsing under the weight of the recession and the banking crisis described below. Inflation-adjusted spending is also crumbling. We estimate a $3 billion primary budget deficit (excluding interest payments) for 2020. In the current situation, funding this deficit will prove challenging.

***The third crisis is that of the banking system***. With almost half of banks' assets invested in Lebanese sovereign risk including with the Banque du Liban (BDL) and another quarter representing risky private sector claims, banks are effectively insolvent and illiquid. Despite the loose and inefficient capital and banking controls recently put in place, the sector is experiencing a deposit run. In similar international experiences, the central bank usually steps in and provides the liquidity that banks need. However, the BdL is constrained by its limited USD reserves and by fears that an oversupply of LBP would lead to further currency weakening.

## Consequences of continuing on the current path

Persisting with the current ad hoc approach to policy making will lead Lebanon on a path of implosion and political disintegration. We foresee seven consequences:

1. ***The economy will experience a deep recession.*** USD shortages will force the economy to adjust to lower

imports. Bank and capital controls will hit a private sector that is dependent on liquidity and credit; business closures, salary reductions, and layoffs have already become common. The public sector will retrench given difficult financing conditions. Under this scenario, we forecast the economy will experience a double-digit contraction in 2020—i.e., a recession equivalent to what the US experienced during the Great Depression.

2. ***The Foreign Exchange (FX) will weaken sharply.*** The LBP will adjust downwards to bring the supply and demand of USD into balance. Left to its own devices, we estimate the FX could lose up to half its value leading to high inflation. In turn, this will have a massive negative impact on the cost of living, the availability of essential goods, food and healthcare, businesses and unemployment.
3. ***Capital and bank controls will intensify***. Banks will continue rationing deposit withdrawals and external transfers. The private sector's liquidity crunch will deepen and disorderly and un-managed debt defaults (including on Eurobonds) will prove inevitable. BdL will hemorrhage international reserves.
4. ***Debilitating social conditions will intensify.*** This kind of economic collapse will cause catastrophic wealth destruction. Poverty rates could rise to more than 40 percent of the Lebanese population with 1.6 million people unable to afford food and basic nonfood items. Unemployment will increase and much of the middle class could be eliminated.
5. ***A seismic political shift is likely to occur.*** The current political parties will not emerge unscathed. The security repercussions of social unrest will be significant and difficult to predict.
6. ***Without addressing the root causes, the crises will prove long lasting.*** To put it in stark terms, this would become a decade long economic crisis—one from which

chances of recovery are significantly dim. A “lost decade” will result from this scenario.
7. Finally, ***international financial support is likely to fall far short*** of what is needed to relieve the economy.

## Is there a better approach?

We think there is. Below we outline a three-year program that aims to arrest the crisis, deal with its root causes and set the country back on a path of recovery. The program seeks to ensure equitable burden sharing of the crisis’ fallout while protecting the most vulnerable especially during the period of transition. The ten concrete steps below should be implemented in parallel rather than piecemeal.

1. ***Establish an empowered economic emergency steering committee*** to design, negotiate and implement the program. In parallel, create participatory mechanisms to discuss with civil society the policy package, and to empower citizens to monitor its implementation.
2. ***Replace the ad hoc and self-administered capital and banking controls.*** Controls are likely needed for an extended period even in the best of scenarios. They need to be run in a centralized and transparent fashion backed by proper legislation.
3. ***Decisively deal with public sector debt.*** Immediately announce a moratorium on debt payments (external and domestic), hire legal counsel, and convene a creditor’s committee. Our view is that Lebanon’s fundamentals justify a debt load ranging between 60 and 80 percent of GDP over the medium term. To reach this target, creditors should be offered a menu of concessions including lower principal, reduced interest rates, and extended maturities.
4. ***Embark on a credible fiscal reform.*** Public spending, currently inefficient, wasteful, and vulnerable to corruption, must be transformed. The electricity sector

is but one example. A wholesale governance and regulatory reform program is needed to curb the rent seeking culture. These reforms, along with savings accruing from lower debt servicing, should allow for increased spending on social sectors and infrastructure. Second, a broad revenue reform is needed that focuses less on raising tax rates and more on addressing weak collection and overt reliance on specific sectors. Third, we recommend the adoption of a binding and credible "fiscal rule" that caps the size of future budget deficits.

5. ***Deal with private sector debt***. The private sector is facing a severe crisis. Convene a creditor/debtor roundtable to agree on a standardized menu of financial relief actions aiming to safeguard viable firms while orderly liquidating those that aren't. The existing draft *Bankruptcy and Restructuring law* should be promptly passed.
6. ***Repair BdL's balance sheet***. BDL is a large lender to the government and has an estimated USD30 billion negative net FX position rendering it vulnerable to devaluations. Until this is dealt with, it is tough to see confidence in the LBP returning.
7. ***Bring the banking sector back to health*** as a prerequisite to reinvigorating the economy. Public debt restructuring and mounting Non-Performing Loans (NPLs) will render many banks insolvent. Complicating matters, banks are highly exposed to the BdL whose own balance sheet is impaired. Current bank equity is far from sufficient to cover these hits. Our estimates suggest $20-25 billion of fresh capital is urgently needed. Current shareholders need to assume the losses and be required to bring in fresh capital. This may also necessitate a reduction in the number of banks. In parallel, foreign loans and State assets could conceivably be used to recapitalize the sector (see below). As the above is not likely to be enough, there

is a near certain need for reducing portions of large deposits and swapping them into bank equity.

8. ***Preserve social peace through a focus on social justice.*** This involves a distribution of losses that is concentrated on the richest in society while sparing small bank depositors. Foreign funding should be used to blunt the pain of adjustment. A safety net must be put in place to fight poverty and support health and education. And workers should be helped to transition out of decaying sectors into those that benefit from the devaluation.
9. ***Re-think the FX/monetary policy mix.*** The fixed (and overvalued) exchange rate regime has contributed to large current account deficits, hurt export-oriented sectors, andforced BdL to maintain elevated interest rates. Looking forward, we recommend a more flexible exchange rate arrangement centered around a weaker LBP. However, until confidence in the LBP returns, it will be dangerous to allow the currency to freely float. Some form of currency management will have to be maintained for the medium term.
10. ***Secure a multi-year Stabilization and Structural Reform Facility.*** We estimate that a three-year $25 billion fund is needed. This facility should be used to shore up BDL's net reserves, help fund the immediate government budgetary needs, finance badly needed social spending, and contribute to bank recapitalization. The economic program recommended above can garner this kind of support, including from the World Bank, the EU, and the GCC. However, it will realistically require an IMF program as an umbrella. We also think there is scope to partly fund this facility with state assets and possibly hoped-for oil and gas revenues. We cannot overstate the importance of good governance, transparency and accountability in this regard.

## Conclusion

The consequences of the current path are catastrophic. Delays will only increase dislocation, exponentially magnify the needed adjustment, and place the burden on those least able to shoulder it. A better option is available. It won’t be easy, may at times prove painful and will certainly require a new social contract. But we sincerely believe this approach will pave the way to a better and prosperous future.

## Signatories (in their personal capacities)

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