Weekly Insights 26 Nov 2020: UAE needs to attract FDI into viable, sustainable economic diversification sectors & projects

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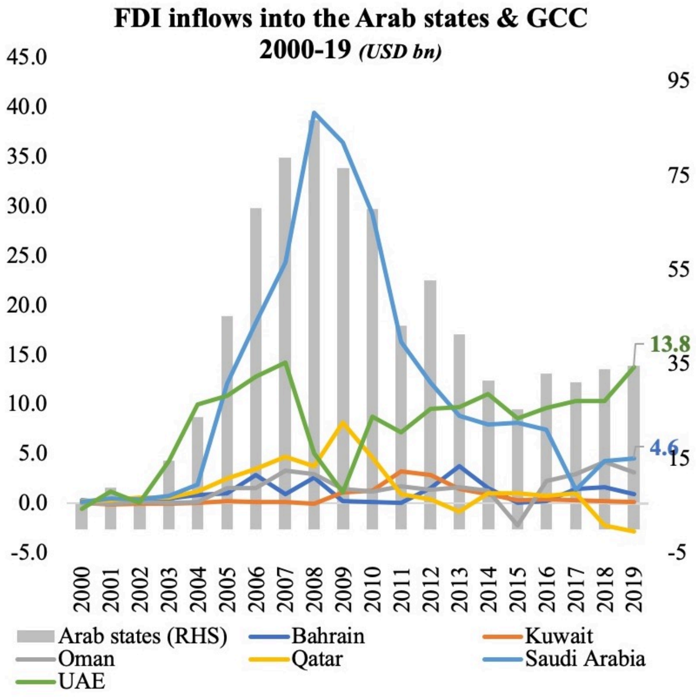
UAE needs to attract FDI into viable, sustainable economic diversification sectors & projects

The liberalization of foreign ownership laws in the UAE (announced this week) breaks down major barriers to the rights of establishment and will be a game-changer for the country. This reform will help to reduce costs of doing business, lead to a recapitalization of existing jointly owned companies and encourage entrepreneurs to invest in new businesses and new ventures, supporting innovation and the introduction of new technologies while also promoting inflows of foreign direct investment. Foreign companies within UAE’s free zones would also be allowed to link up with the domestic economy, supporting local businesses and thereby boosting overall growth. The barriers between free zones and the domestic economy would become blurred, if not absent leading to greater competition and improved competitiveness.

The latest announcement follows a spate of reforms undertaken this year – including labour (long-term residency via a 10-year visa, Dubai’s virtual/remote working visa and retirement visa, Abu Dhabi’s freelancer permit/ license) and social (removing laws which criminalized alcohol consumption, cohabitation) – aimed to revive the economy attempts from the negative impact of low oil prices, Covid19 and the Global Lockdown. Importantly, these reforms will encourage the retention of savings in the UAE, reduce remittances and capital outflows, thereby structurally improving the balance of payments. Overall, the result will be an improvement in the Doing Business ranking of the UAE.

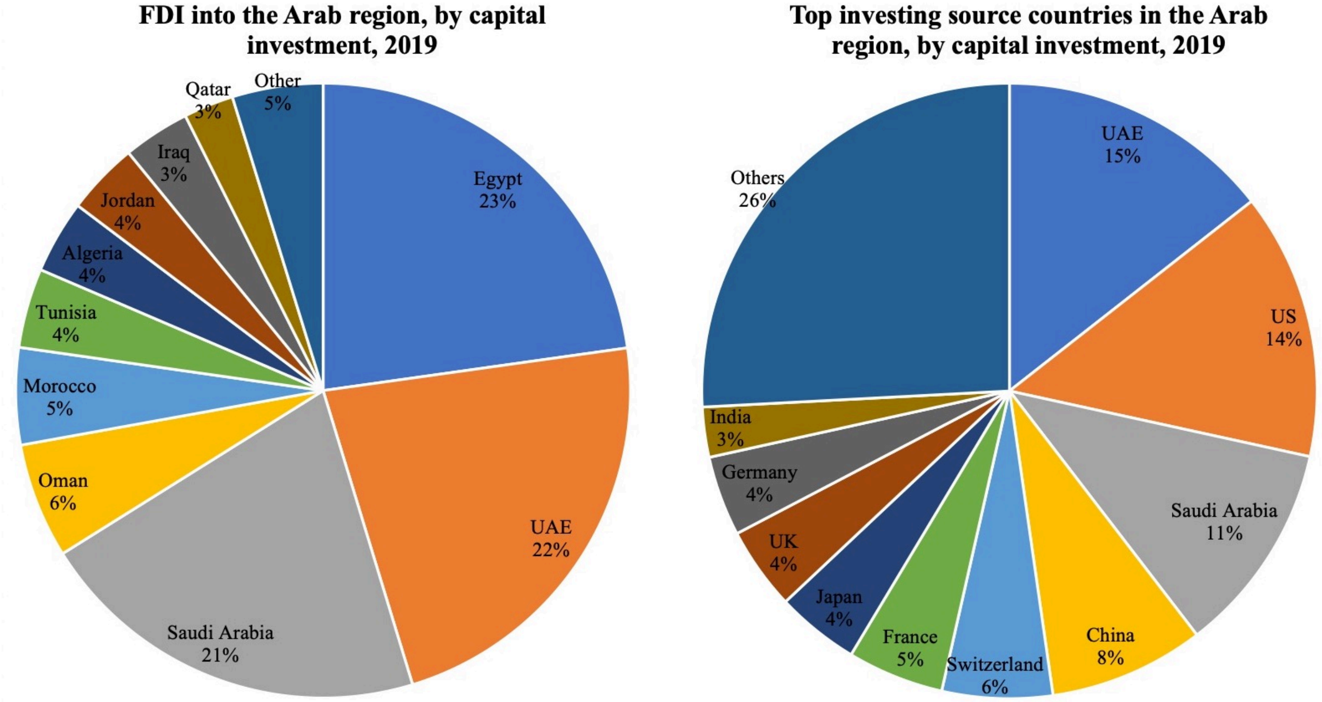


Source: UNCTAD, Nasser Saidi & Associates.

We focus on FDI in this Weekly Insight piece. FDI inflows are essential to the UAE's diversification efforts, as it would not only create jobs, raise productivity and growth, but could also lead to transfer of technology/ technical know-how and promote competition in the market. According to the IMF, closing FDI gaps in the GCC could raise real non-oil GDP per capita growth by as much as 1 percentage point.

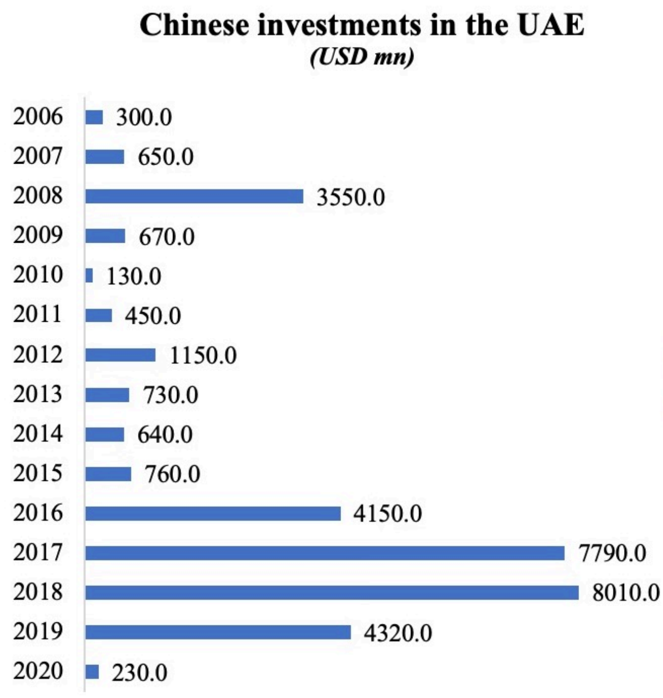
While FDI inflows into the Arab region have been slowing in the past decade, the UAE still remains one of the top FDI destinations in the region. Inflows dipped during the time of the financial crisis (to USD 1.1bn un 2009 from an all-time peak of USD 14.2bn in 2007), but rebounded to USD 13.8bn last year, before the Covid crisis. Reforms to improve the investment climate (including allowing 100% ownership at free zones and protecting minority investors), its ease in doing business, good infrastructure as well as macroeconomic and political stability are factors that have aided the increase in FDI.

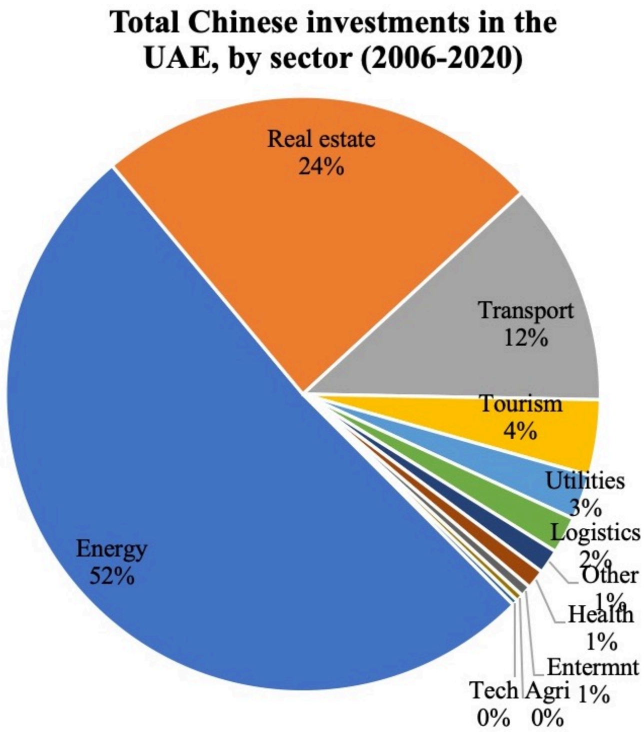
In 2019, UAE was the second largest destination for FDI inflow into the Arab region (USD 13.6bn or 3.4% of GDP, accounting for 21% of total), behind Egypt (USD 13.7bn or 2.8% of GDP, 23% of total) while it dominated FDI by number of projects (445). Interestingly, UAE is also a major capital exporter, having invested a total USD 8.7bn into the Arab nations last year (topping the list and accounting for 14.4% of total FDI inflows into the region). In part, this reflects the UAE’s hosting of multi-national enterprises investing across the region.



Source: fDI Markets, Arab Investment & Export Credit Guarantee Corporation, Nasser Saidi & Associates.

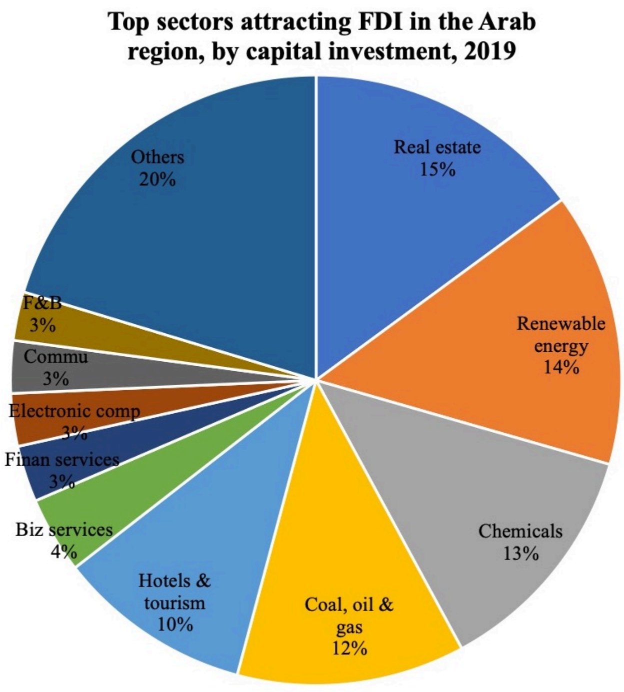
In spite of the Covid19 outbreak negatively affecting FDI inflows[1], Saudi Arabia defied the trend by posting a 12% yoy increase in inflows to USD 2.6bn in H1 2020[2] – in part linked to its mega-projects related to achieving Vision 2030. In Q1 this year, the UAE, along with Saudi Arabia and Egypt accounted for a share of 65.4% of total investment cost of projects in the region, valued at USD 11.2bn. Outflows from the UAE still accounted for 38.2% of GCC’s share of foreign investments in Q1 this year[3].





Source: China Global Investment Tracker, AEI, Nasser Saidi & Associates

China's investments in the UAE have been rising, with UAE the top destination country (among Arab nations) accounting for more than one-third of Chinese projects tracked during Jan 2003-Mar 2020 (with the number of projects in double-digits in 2018 and 2019). According to AEI's China Global Investment Tracker, the value of Chinese investments touched a high of USD 8bn in 2018, thanks to a handful of large projects (including with ACWA Power and Abu Dhabi Oil). Sector-wise, investments were concentrated in energy (both oil and gas as well as renewables), real estate and transport – together accounting for 87.8% of total investments during 2016-2020. This is largely in line with FDI inflows into the Arab region as well, with the top 5 sectors (real estate, renewables, chemicals, oil & gas and travel & tourism) accounting for close to two-



Source: fDI Markets, Arab Investment & Export Credit Guarantee Corporation, Nasser Saidi & Associates.

thirds of total inflows in 2019.

For the oil producing & exporting countries of the GCC and the wider MENA, the broader trade and investment landscape was further disrupted (in addition to Covid19) as a result of the profound changes in the structure and dynamics of the energy sector and market. The deep recession and Covid19 lockdown and induced collapse in transport and travel led to a sharp fall in the demand for oil and cratering of oil prices. Fossil fuel prices are unlikely to recover even in the medium term due to the increasing competitiveness of renewable energy (solar, wind and geothermal), persisting competition from shale oil & gas and new fossil fuel discoveries, while climate change mitigation policies and greater energy efficiency are leading to a downward shift in the demand curve for fossil fuels.

Accordingly, returns on investment in oil and gas (O&G) will decline. The implication is that FDI into the traditional O&G in the UAE and the GCC will be on a downward trend. The challenge will be to attract FDI into viable, sustainable economic diversification sectors and projects.

The new post-Covid19 FDI landscape for the UAE will likely be boosted if the recently announced deep structural reforms are executed well, alongside a review of existing economic strategies. The next obvious step is greater regional integration – a GCC common market (to start with), allowing for free movement of both labour and capital – as well as formalizing trade and investment treaties with major partners including China.

[1] *UNCTAD expects global FDI flows are expected to contract between 30 to 40% during 2020-21.*

[2] *Source: UNCTAD*

[3] *Source: Arab Investment & Export Credit Guarantee Corporation*

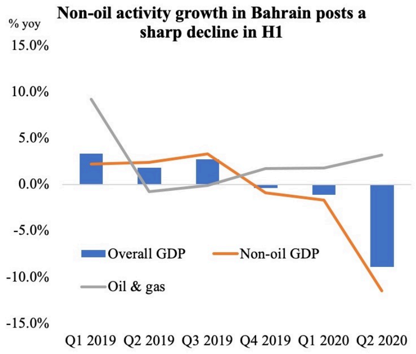
Weekly Insights 6 Oct 2020: Economic activity in Bahrain & Saudi Arabia

Charts of the Week: Last week, both Bahrain and Saudi Arabia released Q2 GDP numbers: as expected, overall growth contracted, with private sector activity significantly affected. The initial sections offers a forward-looking perspective on the two nations based on more recent data and proxy indicators. Saudi Arabia also disclosed a medium-term fiscal strategy, which forms the last section of this Insights' edition.

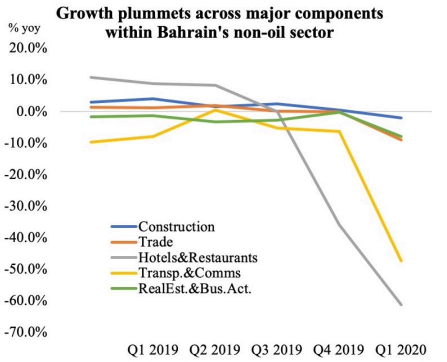
1. **Bahrain GDP & economic activity**

GDP in Bahrain declined by 8.9% yoy in Q2 2020, following a 1.1% drop the previous quarter. This was primarily due to the non-oil sector which plummeted by 11.5%. As expected, the largest dips in GDP came from the hotels and restaurants (-61.3%) and transport & communication (-47.4%) – both directly affected by the Covid19 outbreak. Spillover effects were also visible across the board: the financial sector, which accounts for the largest share of non-oil GDP (16.8% in Q2), posted a 5.8% drop while the sub-sectors real estate and business activities and construction slipped by 7.9% and 2.1% respectively.

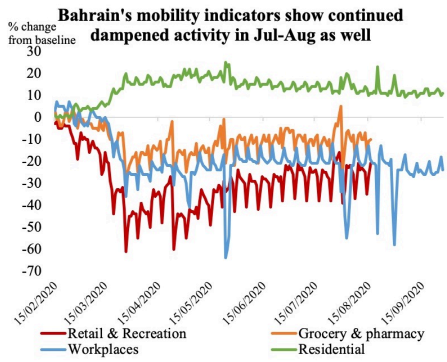
With Covid19-related restrictions slowly being phased out in Bahrain, can we expect a resumption of economic activity? The data for Jul-Aug show the pace of recovery has been slow, with readings for retail and recreation still at an average 26% below the baseline data (pre-Covid19). Recent announcements of extended government support – be it the exemption of tourism levies for 3 more months or extended support to KG & nursery teachers, taxi drivers or Bahraini citizens’ payment of utility bills and about 50% of salaries in the private sector (only those affected) – will provide direct support and likely nudge recovery. hotel occupancy rates in four- and five-star hotels increased by 13.3% mom and 17.6% in Jul and Aug respectively. Opening borders with Saudi Arabia will not only increase the number of trucks crossing the King Fahd Causeway (improving transport/ trade) but will also attract visitors from Saudi Arabia (supporting hospitality and retail).



Source: Bahrain Information & eGovernment Authority, Nasser Saidi & Associates



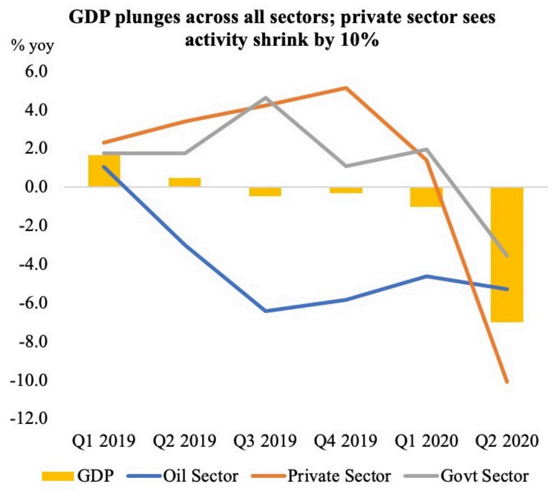
Source: Bahrain Information & eGovernment Authority, Nasser Saidi & Associates

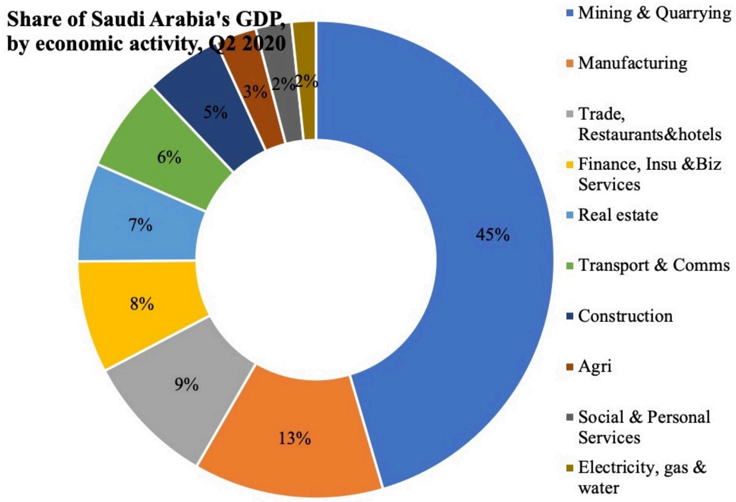


Source: Google Covid19 Community Mobility Report, Nasser Saidi & Associates. Note: Google have temporarily suspended updates in some categories to improve how they are calculated.

2. Saudi Arabia GDP & economic activity

Saudi Arabia’s overall GDP plunged by 7% yoy in Q2 2020, with falls in both the oil and non-oil sectors. The oil sector’s 4.9% drop in H1 is a result of the reduction in oil production in line with the OPEC+ agreement. Within the non-oil sector, all sub-sectors posted declines in Q2 ranging from trade and hospitality (-18.3%) to finance, insurance and real estate (-0.7%). The share of GDP by economic activity shows that the oil sector continues to dominate (45% of overall GDP), closely followed by manufacturing (13%) and trade and hospitality (9%).



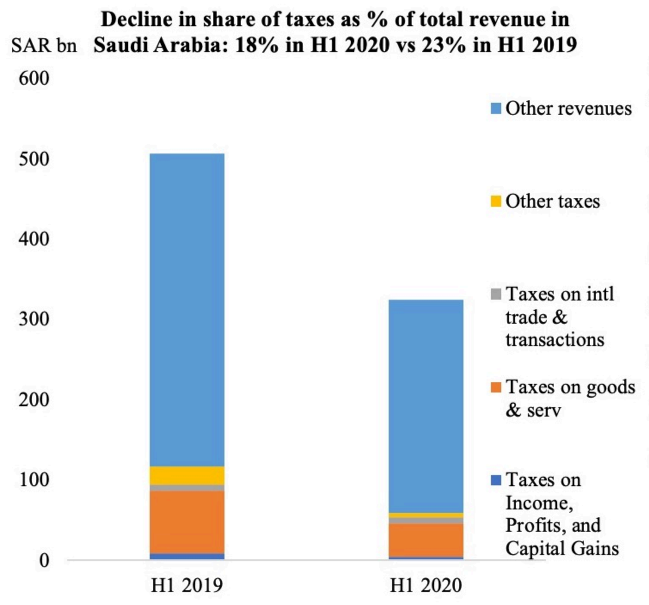


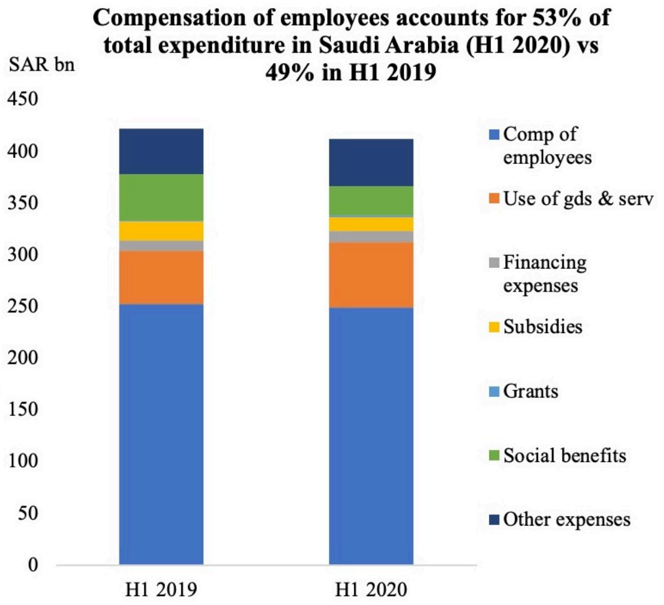
Source: Saudi Arabia GaStat, Nasser Saidi & Associates

To gauge any underlying change in activity during Q3, we refer to the central bank’s data on consumer spending and point-of-sale (PoS) transactions by category. There is a spike before the VAT hike came into place in Jul, as expected, but the Aug data seems to indicate a slight recovery for hotels (+2.6% yoy, following 6 months of double-digit declines) while items like jewelry and clothing continue to register negative growth. The construction and real estate sector look well-placed to improve in H2 this year: not only has letters of credit opened for building materials imports increased by 64% yoy in Aug (following 5 months of double-digit declines), cement sales has also been picking up during Jun-Aug; a temporary boost for the sector will also come from the recent announcement that real estate would be exempt from the 15% VAT (to be replaced instead by a 5% tax on transactions, of which the government would bear the costs for up to SAR 1mn for the purchase of first homes).

3. Saudi Arabia’s fiscal space

With oil prices around the USD 40-mark, extended government support in Saudi Arabia during the Covid19 outbreak will put a strain on finances. From the H1 2020 estimates disclosed by the Ministry of Finance, it is noticeable that the share of taxes as % of overall revenue has declined to 18% (H1 2019: 23%). Compensation of employees remain the biggest strain on the expenditure side, with the single component accounting for 53% share, though it is commendable that subsidies have declined by 27.8% yoy to SAR 13bn.





Source: Saudi Arabia Ministry of Finance, Nasser Saidi & Associates

Medium-term fiscal projections (in SAR bn)

	2019	2020e	2021f	2022f	2023f
Total revenues	927.0	770.0	846.0	864.0	928.0
Total expenditures	1059.0	1068.0	990.0	955.0	941.0
Budget deficit	-133.0	-298.0	-145.0	-91.0	-13.0
as % of GDP	*-4.5%*	*-12.0%*	*-5.1%*	*-3.0%*	*-0.4%*
Debt	678.0	854.0	941.0	1016.0	1029.0
as % of GDP	*22.8%*	*34.4%*	*32.9%*	*33.4%*	*31.8%*

Source: Saudi Arabia Ministry of Finance; Note: e refers to estimates & f to forecasts

If Saudi Arabia’s fiscal consolidation plans are to be met, reforms are required on both revenue and expenditure side. The Kingdom has already increased VAT to 15% from Jul: however, with subdued demand and consumer spending, it seems unlikely that this move will add substantial revenue this year. We have highlighted in previous editions that Saudi Arabia can benefit from the introduction of other more revenue-generating taxes – e.g. carbon taxes, which will also contribute towards a cleaner environment. Additional measures could include energy price reforms (thereby reducing subsidies) as well as a consolidation or removal/ reduction of various small fees and taxes after undertaking an impact exercise (i.e. do these fees raise significant revenues or do they hinder development of the related sector?). The other major route to take is lowering "compensation of employees": this can be done either by reducing the public sector workforce (and increasing productivity through increased digitalization) or by decreasing wages (and synchronizing public holidays) to be on-par with the private sector – these moves could also support creation of jobs in the private sector, lead to higher productivity levels and growth.

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Weekly Insights 10 Aug 2020: Lebanon's way forward, PMIs & Mobility, Saudi monetary statistics, Arab FDI

The Beirut blast and its recovery/ reconstruction dominate news in the Middle East*. Our take on the path for Lebanon's economic recovery is part of this Weekly Insight edition. Given the scheduled global PMI releases last week, we take a close look at the region's PMIs and Mobility indicators in parallel. Also covered are the latest* ***monetary indicators from Saudi Arabia*** *and* ***FDI flows in the Arab region*** *(Q1 2020).*

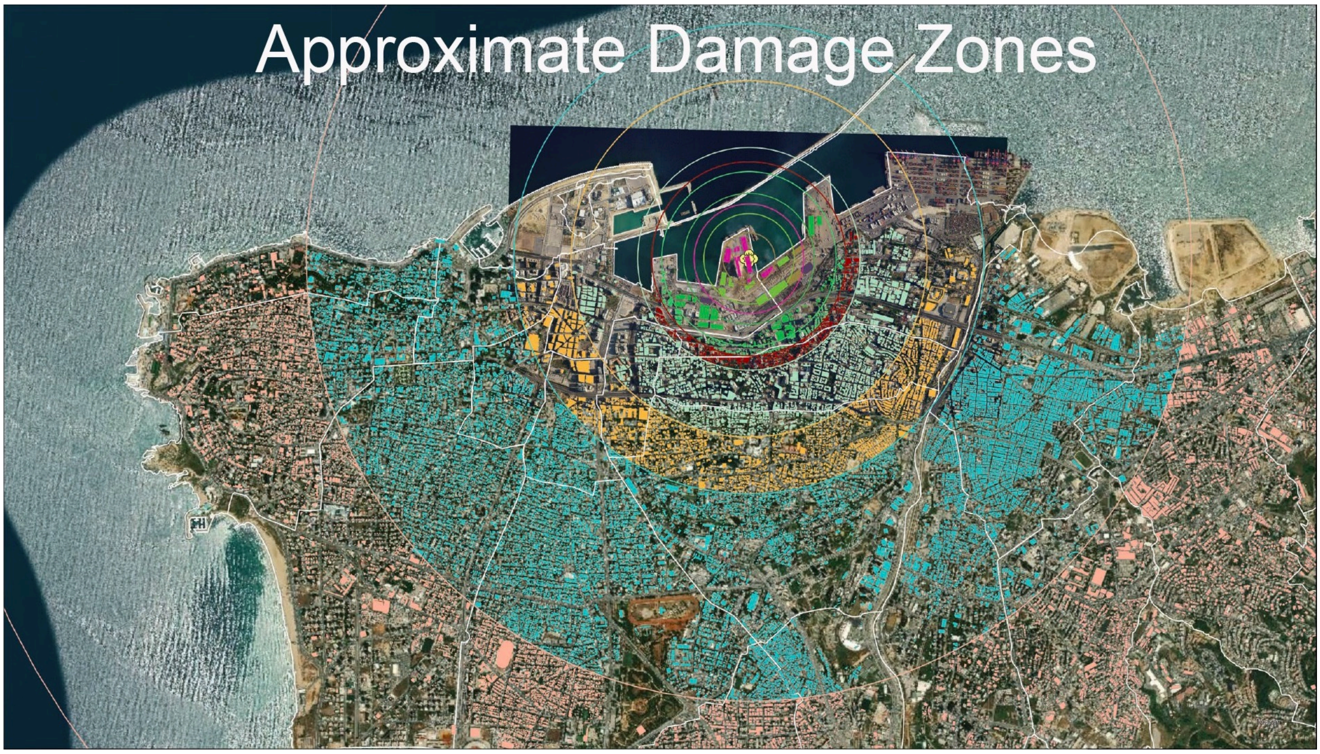
1. **Beirut blasts and Lebanon's way forward**

The Beirut port explosion on Aug 4th – which left at least 158

people dead, 6000 injured and 300k homeless – was possibly the last straw for the people already immiserated by an economic, banking & financial meltdown (since Oct 2019) alongside dealing with the Covid19 outbreak. The explosion led to calls for resignation of the government (three ministers have resigned, including after the blast, citing failure to reform), with demonstrations gaining traction over the weekend. In addition to the loss of human lives and destruction of buildings (homes and businesses), it is critical to understand the **importance of the ports**: 80% of the country's food imports come through the port, in addition to medical supplies as well as oil and gas. The silos have been demolished (which hold 2-3 months supplies of grain), leading to shortages of food (& higher prices – food inflation had surged by 108.9% in H1 2020 and by 250% in Jun 2020); expedited imports of food and fuel will also be constrained by damaged logistics (transport and warehouses). Additional cuts in electricity (given the impact on fuel supplies) will negatively affect hospitals (that are fighting the Covid19 outbreak in additional to normal operations) and businesses.
Damage to infrastructure (port, transport, logistics and related facilities), housing and businesses is extensive. A detailed survey will be required to assess the total costs of reconstruction but it is clear that Lebanon does not have the fiscal space and will require international support. The destruction will further depress economic activity through a negative impact on consumption, investment and export activity. We forecast an overall reduction in real GDP by some 30% (Great Depression levels) along with continuing and potentially accelerating inflation. Beirut's governor stated (without presenting evidence or survey estimates) that the repair bill for the capital alone will cost up to USD 5bn while overall cost of damages is estimated at around USD 15bn. The Cabinet's approval of an exceptional allocation of LBP 100bn *[or USD 26.3mn at the central bank's set rate of LBP 3,800 to the USD at money transfer firms]* to deal with the crisis will fall way short of requirements. **International**

donors pledged EUR 252.7mn for humanitarian aid at the Paris conference yesterday held to raise emergency relief for Lebanon. President Macron during his visit to the location stated that he would "propose a new political pact" to all political forces in Lebanon, also assuring that aid would "not go to corrupt hands".

The **way forward is to undertake a comprehensive series of macroeconomic reforms, including at various sectoral levels** – ranging from reforms of the power sector to the banking sector, to exchange rate reform alongside an active intent to increase transparency and stamp out corruption. So far, there has been a refusal by the authorities to bite the bullet and undertake reforms. The donor conference yesterday (as well the CEDRE pledges in 2018) are promising: but the aid should only be released within the umbrella of a broader IMF programme – with clear conditionalities of reform (and potentially bringing in independent 'technocrats' to form a new government)**. The country is in urgent need of an equivalent of a Marshall Pan (size of USD 25-30bn and growing), given cumulative losses owing to lack of reforms so far**.



Source: Khatib & Alami.

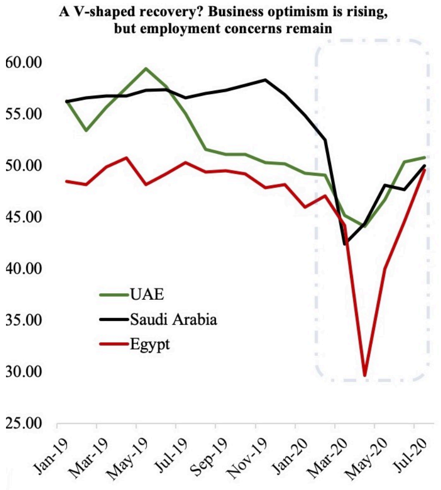
2. **PMI Activity recovers across the globe, including in the Middle East**

	US	Germany	EU	UK	Japan	China	India	UAE	Saudi Arabia	Egypt	Lebanon
Jan-19	54.9	49.7	50.6	52.8	50.3	48.3	53.9	56.3	56.2	48.5	46.5
Feb-19	53.0	47.6	49.5	52.1	48.9	49.9	54.3	53.4	56.6	48.2	46.9
Mar-19	52.4	44.1	48.3	55.1	49.2	50.8	52.6	55.7	56.8	49.9	46.3
Apr-19	52.6	44.4	48.4	53.1	50.2	50.2	51.8	57.6	56.8	50.8	46.7
May-19	50.5	44.3	47.9	49.4	49.8	50.2	52.7	59.4	57.3	48.2	46.3
Jun-19	50.6	45.0	47.6	48.0	49.3	49.4	52.1	57.7	57.4	49.2	46.3
Jul-19	50.4	43.2	46.6	48.0	49.4	49.9	52.5	55.1	56.6	50.3	47.7
Aug-19	50.3	43.5	47.1	47.4	49.3	50.4	51.4	51.6	57.0	49.4	47.8
Sep-19	51.1	41.7	46.0	48.3	48.9	51.4	51.4	51.1	57.3	49.5	46.4
Oct-19	51.3	42.1	46.2	49.6	48.4	51.7	50.6	51.1	57.8	49.2	48.3
Nov-19	52.6	44.1	47.0	48.9	48.9	51.8	51.2	50.3	58.3	47.9	37.0
Dec-19	52.4	43.7	46.4	47.5	48.4	51.5	52.7	50.2	56.9	48.2	45.1
Jan-20	51.9	45.3	48.1	50.0	48.8	51.1	55.3	49.3	54.9	46.0	44.9
Feb-20	50.7	48.0	49.1	51.7	47.8	40.3	54.5	49.1	52.5	47.1	45.4
Mar-20	48.5	45.4	44.3	47.8	44.8	50.1	51.8	45.2	42.4	44.2	35.0
Apr-20	36.1	34.5	33.4	32.6	41.9	49.4	27.4	44.1	44.4	29.7	30.9
May-20	39.8	36.6	39.5	40.7	38.4	50.7	30.8	46.7	48.1	40.0	37.2
Jun-20	49.8	45.2	47.4	50.1	40.1	51.2	47.2	50.4	47.7	44.6	43.2
Jul-20	50.9	51.0	51.7	53.3	45.2	52.8	46.0	50.8	50.0	49.6	NA

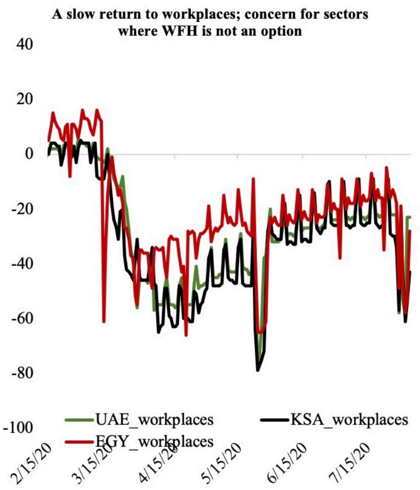
Source: Refinitiv Datastream, Nasser Saidi & Associates

Global manufacturing PMIs mostly ticked up, given rebounds in both output and new orders. India was one of the nations reporting a lower PMI in Jul: unsurprising given the fast pace of Covid19 confirmed cases – it took only 9 days for India to go from 1.5mn to 2mn – and restricted lockdowns in parts of the country. In spite of the V-shaped recovery in PMI, all is not smooth: restrictions have not been eased fully, demand is largely domestic-driven, and supply chains issues remain – average vendor delivery times lengthened for the 12th consecutive month for global manufacturing PMI. A resurgence in cases/ 2nd and 3rd waves will only add to the burden.

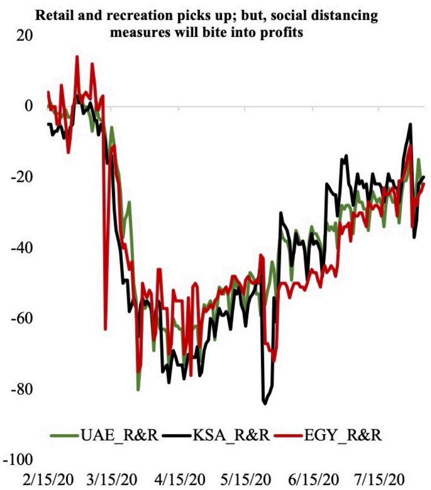
3. **What can we learn from the latest PMI & Mobility indicators?**



Source: Refinitiv Datastream, Nasser Saidi & Associates



Source: Google Mobility Indices, Nasser Saidi & Associates



Source: Google Mobility Indices, Nasser Saidi & Associates

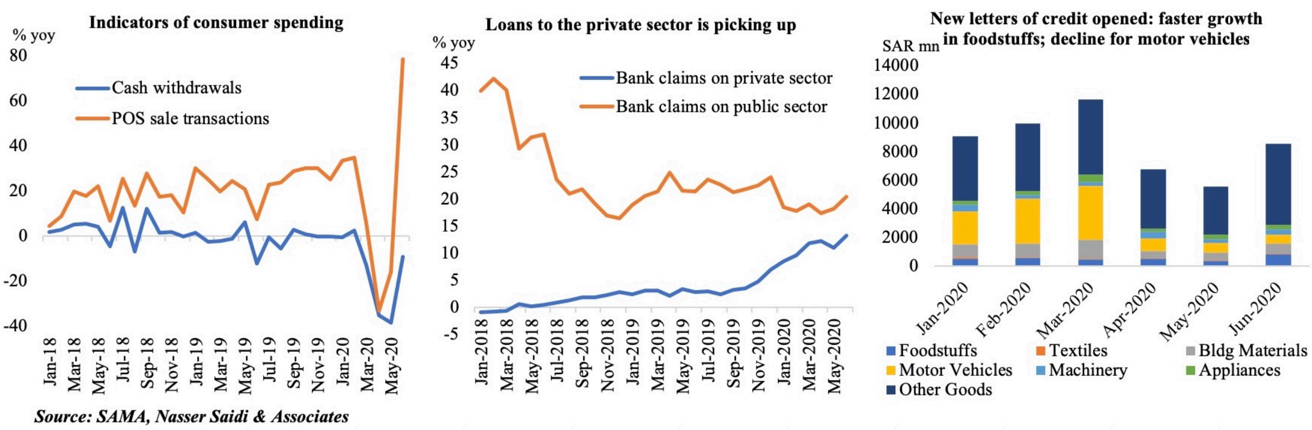
PMIs in the region indicate a sharp V-shaped recovery following the lockdown period, but is it too much optimism from those surveyed? Order books have improved, though export orders remain weak, indicating domestic demand driving the rise.

This is reflected in the **retail and recreation segment** of the Google Mobility indicators: with less stringent restrictions in place, movements were higher in the days running up to the Eid Al Adha holidays (across the three nations) while in Saudi Arabia, a similar trend was also visible towards the last week of June, ahead of Jul’s hike in VAT. For firms in the retail and recreation sector, social distancing measures are likely to eat into the firms’ profits (if any) and the road to recovery is likely to be slow. In spite of marketing efforts, it will be affected by spending capacities, salary reductions/ cuts in allowances/ job losses & return of expat labour to their home countries (e.g.~500k Indians have registered for repatriation flights from the UAE).

Workplace mobility is still around 20% below the baseline numbers (excluding Eid holidays): widespread availability of telework technology and the feasibility of performing work remotely has kept firms operational. However, those sectors where work from home is not the ideal option (think retail, tourism, hospitality), the learning curve has been steep – e.g. retail firms’ rolling out previously unavailable online options.

Bloomberg reported that while working from home, workdays were longer by 48.5 minutes, with 1.4 more emails sent to colleagues per day and an 8% increase in emails sent after hours (questioning the work-life balance and happiness quotient) though offering more flexible work hours (and potentially higher productivity levels). The UAE government's announcement of **flexible working hours** for its staff is a good move to raise productivity, reduce peak hour traffic and can act as a precursor for the private sector to emulate. The obvious next step is providing **the option for employees to work from home**, when possible – think of either shorter work hours (in the office) daily or working from home a full workday during the week.

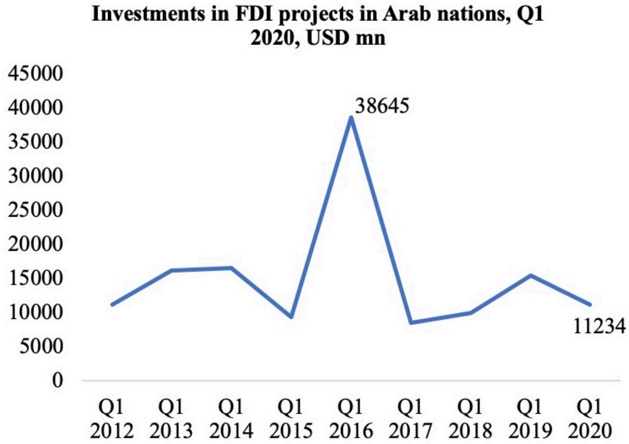
4. **Saudi Arabia: monetary indicators**

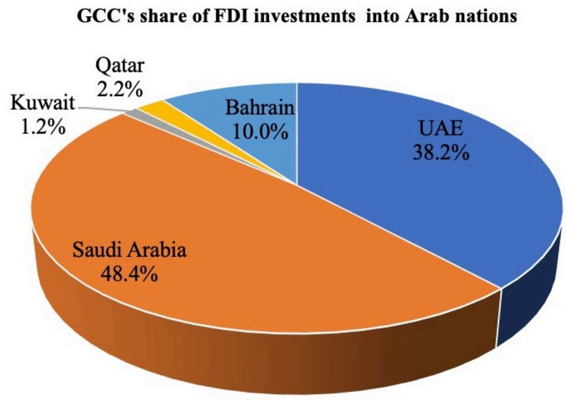


Monetary statistics for Jun 2020 in Saudi Arabia reinforce the trends from the Mobility indicators in the previous panel. Both **indicators of consumer spending** – cash withdrawals and point-of-sale (POS) transactions have ticked up in Jun, ahead of the hike in VAT from July 1st. **Loans to the private sector is picking up**, thanks to the various measures in place to support the economy as it tackles the Covid19 outbreak. Initiatives like the provision of concessional financing for SMEs and loan guarantee programme likely supported the faster pace of growth. The Corporate Sustainability Programme launched by the Ministry of Finance mid-Jul to support the private sector will also provide support going forward. The final chart tracks **new letters of credit opened**, by sector – an insight into trade finance. A letter of credit is a financial instrument, usually issued by a bank, which guarantees the seller will receive payment for goods sold to a foreign customer. The Covid19 outbreak put the brakes on activity from Apr-May. Recovery is visible in June’s data, but the difference is stark: LoCs opened for foodstuffs has been rising faster than say motor vehicles (accounted for 25.6% of total in Jan 2020 vs 7.2% in Jun). It is time to **switch trade finance to blockchain technology** – which will make trade faster, safer, and simpler (elimination of paperwork and associated costs, increased transparency and prevention of fraud)!

5. **FDI flows in the Arab region**

In Q1 2020, the number of new FDI projects in the Arab region contracted by 30% yoy to 185 projects in Q1 2020, with investments down by 27.3% to USD 11.2bn while job creation slipped by 23% to 21.3k, according to the Arab Investment & Export Credit Guarantee Corporation (Dhaman). GCC’s share of investments in the Arab region show that Saudi Arabia and UAE together account for 86.6% of the total in Q1 this year. **FDI flows are likely to slow in the region this year**, mirroring global trends: UNCTAD estimates global FDI inflows to decline by USD 1.1trn this year. The slowdown of implementation of ongoing projects will hurt prospects in the region as well as potential shelving of projects in the near- to medium-term – underscoring the **need to diversify sectors into which FDI flows** (oil and gas & real estate).
Egypt, UAE and Saudi Arabia together accounted for two-thirds of the FDI inflows into the Arab region during the period 2015-2019 though in terms of number of projects, UAE topped the list (41.4% of the total). The top two sectors attracting investments – coal, oil and gas and real estate – together account for almost half of the total investments (from just 7% of total number of projects). The largest number of FDI projects recorded during 2015-19 were in business services (13%) and financial services (11%) – but its share of investments was only 2% each.





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Top 5 recipients of FDI in the Arab region during 2015-2019, by number of projects & investment

	Investment (USD mn)	% of total	Number of projects	% of total
Egypt	124,478	35.2	476	10.9
UAE	53,619	15.2	1814	41.4
Saudi Arabia	53,079	15.0	513	11.7
Oman	32,575	9.2	235	5.4
Morocco	22,160	6.3	432	9.9

Top 5 sectors attracting FDIin the Arab region during 2015-2019, by number of projects & investment

	Investment (USD mn)	% of total	Number of projects	% of total
Coal, oil and gas	86,965	25.0	116	3.0
Real estate	83,102	24.0	180	4.0
Chemicals	28,816	8.0	107	2.0
Renewable energy	26,355	7.0	127	3.0
Transportation & st	18,477	5.0	235	5.0

Source: Arab Investment & Export Credit Guarantee Corporation (Dhaman), Nasser Saidi & Associates

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Lebanon's Hidden Gold Mine, Article in Carnegie Middle East Centre, 16 Jul 2020

This article originally appeared in the Carnegie Middle East Centre on 16th Jul 2020. Click to download a PDF of the article.
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Lebanon’s Hidden Gold Mine

by Dag Detter & Nasser Saidi

Treating Lebanon's macro, fiscal & financial ailments alone will not resolve its multiple crises. Better management of the public sector, particularly the handling of public assets, is a critical prerequisite. Establishing a credible National Wealth Fund would help to alleviate the country's multiple crises.

"One of the tragic illusions that many countries . . . entertain is the notion that politicians and civil servants can successfully perform entrepreneurial functions. It is curious that, in the face of overwhelming evidence to the contrary, the belief persists." —Goh Keng Swee, former deputy prime minister of Singapore

Since October 2019, Lebanon has been in the throes of an economic and financial meltdown. Unsustainable monetary and fiscal policies and an overvalued fixed exchange rate have led to persistent fiscal and current account deficits. These twin deficits have led to a rapid buildup of debt to finance current spending, with limited public or private real investment.

Public debt is projected to reach 184 percent of GDP in 2020—the third-highest ratio in the world. And informal capital controls and payment restrictions to protect the dwindling reserves of Lebanon's central bank, the Banque du Liban (BDL), are generating a liquidity and credit squeeze and severely curtailing domestic and international trade. This situation has resulted in a loss of confidence in the banking system and the Lebanese pound, as well as a sharp, double-digit contraction in economic growth. Of course, the coronavirus pandemic has only exacerbated these problems.

Lebanon is simultaneously facing a public health crisis, a debt crisis, a banking crisis, and an exchange rate and balance of payments crisis. Together, these crises have created a vicious cycle. The deep recession has led to a steep reduction in government revenues and a rapid increase in the budget deficit financed by the BDL. In turn, the enduring and unsustainable monetization of deficits and debt by the central bank has accelerated inflation, depreciated the pound's value on the black market, and reduced real income—thereby further depressing consumption, investment, and growth. Layoffs, bankruptcies, and insolvencies, as well as unemployment and poverty rates, are spiking.

Given the economic and monetary dynamics, Lebanon's prospects are dismal unless a comprehensive reform package is implemented. It must comprise a macroeconomic, fiscal, financial, banking, and structural reform plan that includes restructuring the public debt and fundamentally reforming the public sector. The policy imperative should be credible and sustainable structural reforms with an immediate focus on combating the root causes of Lebanon's dire predicament—endemic corruption and bad governance.

The government of Prime Minister Hassan Diab has so far prepared a Financial Recovery Plan that comprises fiscal, banking, and growth-enhancing structural reforms. Passed on April 30, 2020, the plan has been presented to the International Monetary Fund (IMF), as part of negotiations for an IMF-funded reform program. But treating the country's macrofiscal and financial problems without addressing the structural components will not work. Public sector restructuring should be an integral part of the reform process. Fiscal and debt sustainability will not be possible in the absence of a fundamental, systemic overhaul of the government procurement process (a major facilitator of corruption), reform of the pension system and of salaries and benefits for civil and military personnel, and management of the ghost worker problem. The other pressing need is reforming the handling of public assets, an often overlooked part of the public sector balance sheet.

Policymakers and markets characteristically focus on public debt but largely ignore public assets. In most countries, public wealth is larger than public debt. Better management could help resolve debt problems while providing resources for future economic growth. This should be part of any solution for Lebanon.

The Economic Importance of Public Assets

How public wealth is managed is a crucial difference between well-run countries and failed states. Public wealth can be a curse when it tempts political overseers to engage in illicit activities and clientelism. This is exemplified in countries that are endowed with natural resources such as oil and gas but are financially vulnerable because of corruption and bad governance. Public assets in Lebanon are vast, as they are in virtually all countries. In fact, they are a hidden gold mine.

Public assets worldwide are larger than public debt and worth at least twice the global GDP. But unlike listed equity assets, public wealth is unaudited, unsupervised, and often unregulated. Even worse, it is almost entirely unaccounted for. When developing budgets, most governments largely ignore their assets and the value they could generate. Professionally managed public assets could, on average, add another 3 percent of GDP in additional revenues to a government's budget.

Public assets can be divided into two main types: operational and real estate. In most countries, the value of real estate is often several times that of all other assets combined, with government-owned commercial real estate assets accounting for a significant portion of land. But governments often know about only a fraction of these properties, most of which are not visible in their accounts. This wealth is hidden mainly because public sectors around the world have not adopted modern accounting standards similar to those used by private companies. These standards should be based on accrual accounting, as recommended by the International Public Sector Accounting Standards Board.

Typically, it requires a crisis to bring the issue of public assets to the surface. The political will to address this arises from a recognition that every dollar generated with an increase in yield from public commercial assets is a dollar less gained from budgetary cuts or taxation increases. That is the case today in Lebanon, where a public debate over the management and value of public assets is growing.

Operational assets—airports, ports, utilities, banks, and certain listed corporations—are sometimes called state-owned enterprises (SOEs) when owned by the national government. Although less valuable than real estate assets, these enterprises play a fundamental role in many economies by often operating in sectors on which the economy depends—electricity, water, transportation, and telecommunications. For these reasons, the importance of well-governed SOEs cannot be overstated.

The IMF finds that SOEs tend to underperform. They are on average less productive than private firms by one-third. In Lebanon, poorly performing operational assets are a major factor behind the country's dismal rankings in the cost of doing business (143 among 190 nations), corruption (137 among 180), and overall infrastructure (89 out of 141).

When properly designed, measures to improve public wealth management can help win a war against corruption. Efficient management of public assets can generate revenues to pay for public services, fund infrastructure investments, and boost government revenues without raising taxes. Such outcomes would simultaneously address two of Lebanon's greatest problems: the shortage of infrastructure investment due to the public debt overhang and the undermining of democracy through bad governance and through the capture of public assets by politicians and their cronies.

Reforming Lebanon's Management of Public Assets

The key to unlocking public wealth lies in separating the management of public commercial assets from policymaking and of ownership from regulatory functions. This ensures a level playing field with the private sector and provides a healthy environment for competition. A century of experimenting with public asset management in Asia and Europe has shown that the only effective way of managing public commercial assets is through an independent corporate holding company that is kept at arm's length from political influence.

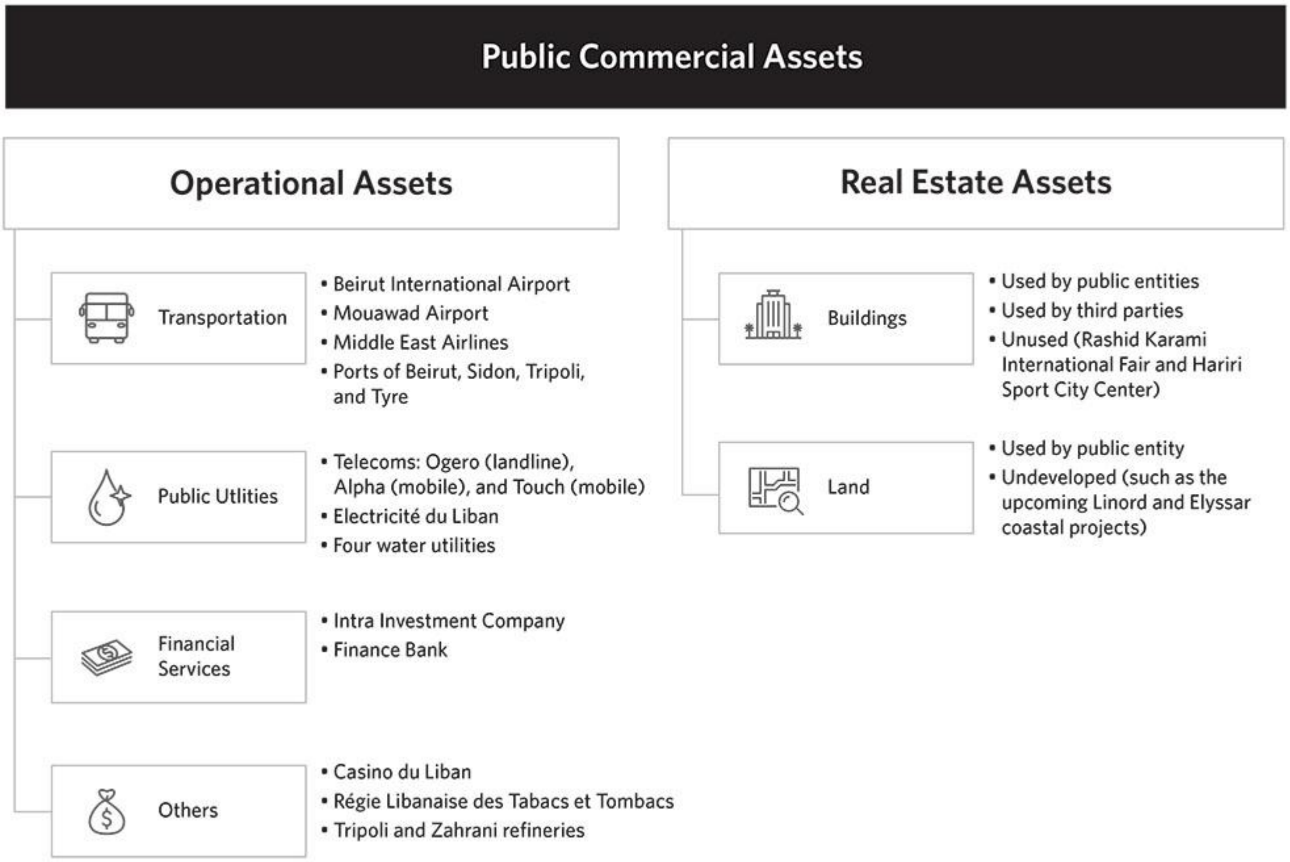
Implementing proper governance reforms should aim not only to improve the performance of operational and real estate assets but also to increase the value of the portfolio of assets as a whole. Without generating a relevant balance sheet as part of the budget process, a state's financial status is unclear—governments focus mainly on debt and cash, without recognizing the existing and potential value of their assets. A financial and fiscal focus on debt and cash alone can lead to bad decisions, such as privatizing an airport to finance infrastructure investment rather than arranging financing against the asset. Recognizing that even a government has a balance sheet consisting of assets and liabilities makes it possible to use net worth (assets minus liabilities) as a fiscal indicator instead of debt to GDP. With a focus on net worth, an increase in debt to finance an investment is matched with an increase in assets. This creates an incentive to invest in government-owned assets rather than to privatize, which is often carried out for the wrong reasons, at the wrong time, and at the wrong price.

A public financial management system that provides better information based on audited accrual data plays a crucial role in facilitating fiscal decision making. Without this information, any level of privatization offers tempting opportunities for quick enrichment through crony capitalism, corruption, or dysfunctional regulation. Privatization should not be undertaken without first also establishing a regulatory framework that includes politically independent competition and the oversight of regulatory authorities. Regulators should be recruited through a competitive, merit-based, and transparent system. Proper regulatory analysis must outline how best to structure market participants and the value chain in order to ensure maximum benefit to consumers, taxpayers, and society.

Empirical evidence internationally shows that waste and corruption can be reduced considerably by improving fiscal transparency and disclosure as well as by ensuring quality procurement systems, expanding digitalization, and reducing the administrative burden. Efficient use of public assets will result in increased overall productivity growth and innovation by encouraging investment and raising private sector productivity growth, thereby contributing to fiscal recovery and stability. Once they are well managed and subject to competition, public assets are ideal for lowering the degree of government ownership—provided that former monopolies are restructured, unbundled, and broken up to help create a fully transparent and competitive environment.

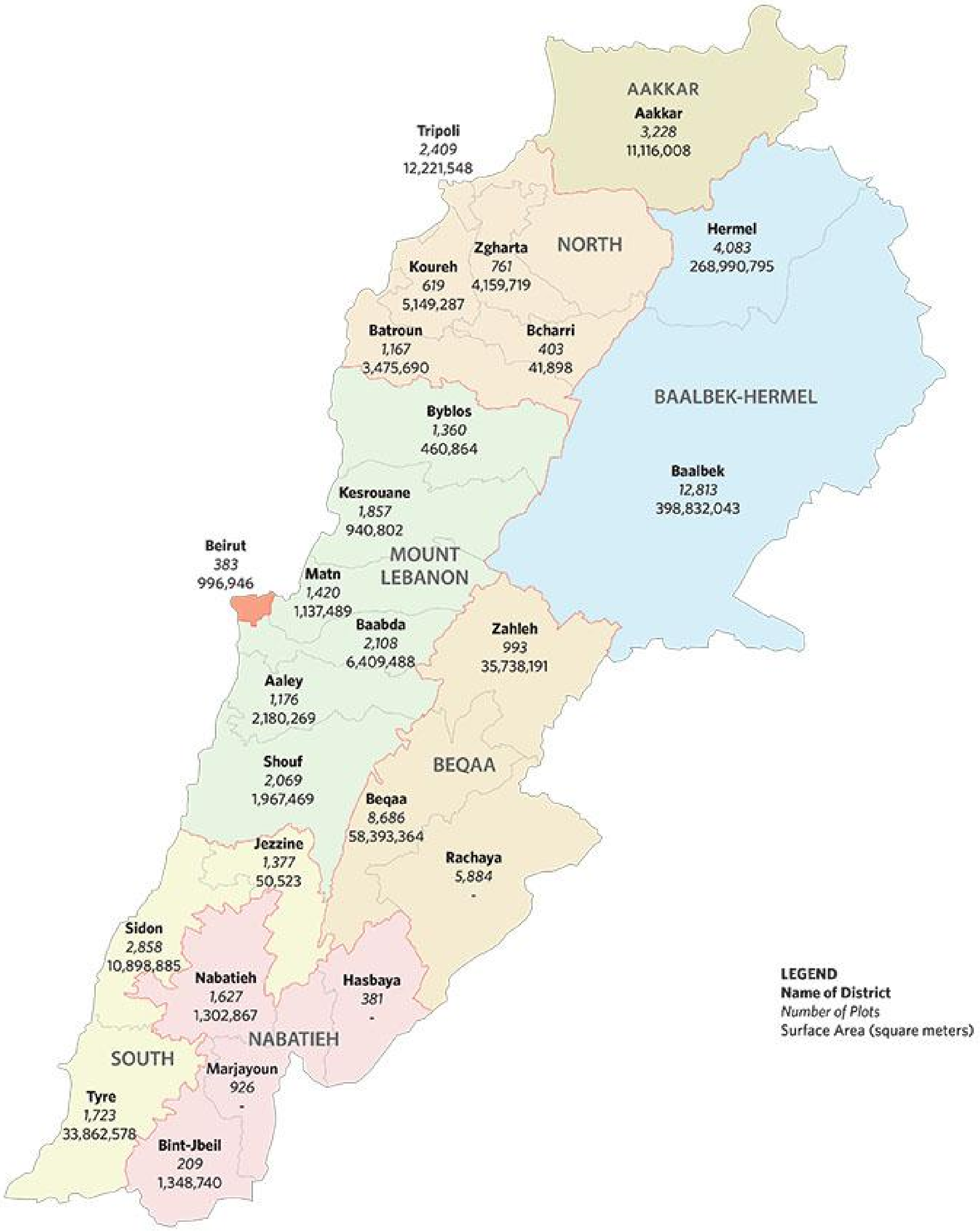
Lebanon’s portfolio of public commercial assets comprises a wide range of operational assets. These include telecoms infrastructure, such as the Ogero fixed network and the Alfa and Touch mobile networks; Electricité du Liban, which is responsible for electricity production and transmission; and four water utilities. The government also owns Middle East Airlines; the Rafiq al-Hariri and Rene Mouawad airports; the Beirut, Sidon, Tripoli, and Tyre ports; the Casino du Liban; the Régie Libanaise des Tabacs et Tombacs; the Intra Investment Company; the Finance Bank; and two refineries in Tripoli and Zahrani (see figure 1).

FIGURE 1
Public Commercial Assets



The real estate side of the portfolio is less well understood, due mainly to the absence of an accurate land registry and an official information system identifying relevant data on all geographical objects, including boundaries and ownership. Nevertheless, the government claims ownership of some 60,000 land plots with a total area of more than 860 million square meters (the exact sizes of 30,000 of the total plots are unknown). The land is distributed across Lebanon’s eight governorates, with the highest number of plots and surface areas in Baalbek-Hermel (see figure 2). The majority of plots are less than 1,000 square meters. Due to the lack of proper accounting, there are no valuations of land or buildings—not even of valuable seaside properties captured by politicians, their cronies, and political clients. However, more details are available for property developments such as the Rashid Karami International Fair, the Hariri Sports City Center, and the Linord and Elyssar real estate projects.

FIGURE 2
State Land in Lebanon's Eight Governorates (Plots and Surface Areas)



Historically, public assets have benefited only a small group of elites, largely due to the influence of politicians. Public assets, ultimately owned by the taxpayers, should benefit the consumers and serve the welfare of all citizens. Without proper transparency, SOEs are allowed to be unproductive and unsustainable, while receiving sizeable government support through budget transfers, subsidized inputs, and cheaper public funding, including loans at below-market rates. Their policies and activities are open to political interference, and as a result, nepotism, cronyism, and clientelism are rife. In addition, weak or nonexistent governance standards, with boards and management dominated by political appointees, have led to corrupt practices, high costs, and inefficiency through overstaffing and unproductive investment.

Political interference and the absence of strong regulatory authorities have resulted in a lack of accountability. In the case of the electricity, telecommunications, and oil and gas sectors, such authorities were established by law but were emasculated by their respective ministries. The lack of transparency and disclosure—with few publicly available, audited, or published accounts—has led to extremely low or negative returns on assets, with operational losses adding to budget deficits. The most visible case is Electricité du Liban, where annual deficits exceed $1–1.5 billion, representing some 30 percent of Lebanon's budget deficit and 14 percent of overall noninterest spending.

Lebanon's SOEs are, in fact, nonperforming assets and an integral part of the organized structure of corruption. Problems with inefficiency, low productivity, and lack of innovation have increased costs, lowered private sector productivity, and negatively impacted households more generally. These outcomes have had multiplier effects in the economy by crowding out the private sector and diverting capital and labor to inefficient public assets. Infrastructure quality is a major factor in determining investment and attracting foreign direct investment. The mediocrity of government-provided infrastructure services has reduced domestic and foreign investment, further dampening national productivity and economic growth.

Setting up Lebanon's National Wealth Fund

The Diab government's financial recovery plan aims to set up a Public Asset Management Company "tasked with the restructuring of public companies in its portfolio." However, it does not offer a clear strategy, objectives, or governance mechanism. Is this a prelude to privatization? Will a consolidation of assets without proper governance and regulation enable further abuse by politicians? Meanwhile, the Association of Banks in Lebanon and other analysts have proposed creating a fund that includes public assets. It would serve to repay the central bank's debts to commercial banks. But this implies giving preferential access to public assets to one set of creditors, namely banks, to the detriment of taxpayers and the public.

That is why Lebanon must establish an independent corporate holding company, such as a National Wealth Fund (NWF), that would own and manage public commercial assets for society's benefit. The law establishing it would therefore include a fiscal rule stating that any dividend transferred to the government must be used to pay for public services that help alleviate human suffering and rebuild the economy. Monies generated from the better management of the assets, as well as the occasional divestiture or privatization, should first be used to further develop the portfolio so that basic services such as water, electricity, and transportation become more efficient. This to the benefit of the end users, the people, and the economy. In addition, with a commercial capital structure and dividend policy in place, the NWF would be able to produce a yearly dividend to the government—as a complement to revenues from taxes and other measures—to help fund other government requirements.

Professionalizing the management of public assets is a simple two-step process. The first step is to create a central public registry of all commercial public assets (both operational and real estate assets) and assign an indicative value to them. This should be done swiftly to help inform a feasibility study demonstrating what kind of yield and additional revenues could be expected from the NWF. The second step is to transfer these assets into the NWF. The responsibility and accountability of developing the NWF portfolio should be delegated to a professional, experienced, and politically independent board and management team.

With the institutional structure in place, the portfolio should be governed according to the same requirements as any privately owned company and thereby aim for similar returns based on three core principles: transparency, a clear objective, and political insulation. Transparency and disclosure are prerequisites for holding the fund's board and management team broadly accountable. The NWF should operate according to the highest international norms, as if it is a listed company. Ultimately owned by the taxpayers, it is a truly public company.

Given that the assets in the portfolio are commercial in nature and would be subjected to competition, the NWF's sole objective should be to maximize the value of the assets by being as financially focused and nimble as a private equity fund. Always aiming to achieve the best possible return would help avoid crowding out private sector initiatives.

Finally, political insulation will be critical for combating corruption and for managing the NWF in a truly commercial manner. That means delegating responsibility and holding the board of directors fully accountable for the day-to-day management of the assets, thereby enhancing the board's professionalism. Creating an unambiguous separation between the government's regulatory function and the fund's ownership of public assets will also improve the likelihood of increased private sector investment and foreign direct investment—as additional ways to enhance and develop the assets in the portfolio.

Furthermore, there is no reason why the board and managers should not be subject to the same legal framework and requirements as private sector owners. In many countries, the functions and responsibilities of boards are clearly defined by law, with government-owned companies having the same accountability as boards in private joint-stock companies. Establishing a level playing field for private and publicly owned companies ensures that they operate under a single legal framework and that managers of public assets can use all the tools of the private sector.

An important advantage of consolidating all state assets under a common corporate structure is the ability to develop an asset to its full potential using the strength of the entire balance sheet of the holding company, instead of being tempted to privatize assets in a fire sale as part of the yearly struggle to close the budget deficit in a political budget process. The timely disposal of assets is instead part of the broader business plan for maximizing yield across the entire portfolio, until the asset has reached a fair value.

The efficient management of assets contributes to higher rates of real GDP growth, generates dividends for the government budget, and lowers operating costs. By making the value of the assets visible to the capital markets and debt holders, the government would improve key financial soundness metrics that the three global rating agencies use in their sovereign rating models. All together, these outcomes help to bolster a country's governance and institutional strength and, in turn, can improve its sovereign credit rating and lower the cost of borrowing.

Properly managed, the NWF would be able to generate an annual dividend that could help fund socially important functions, ranging from healthcare to infrastructure. This would also ensure that the fund enjoys public support to fight the endemic corruption currently characterizing the management of public assets. Eventually, the NWF would also help reduce the public sector debt load, strengthening the government's net worth as a buffer against future economic challenges.

Conclusion

Lebanon's economic and financial meltdown cries for a revolution in policy reform, including the creation of an NWF as part of comprehensive macroeconomic and structural reform. The objectives would be to restructure public assets to combat corruption and inefficiencies, help achieve fiscal sustainability, revive economic growth, and create additional revenues for the benefit of Lebanese society as a whole. Of course, setting up an independent NWF would be a leap of faith and break with the past. The government and the public would need to act together, as a nation, to dismantle the long-standing fragmented political kleptocracy.

About the Authors

Dag Detter is an investment adviser on public assets and the former president of the Swedish government holding company.

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How public assets can help revive Lebanon, Oped in FT

Alphaville, 30 Jun 2020

The article titled "How public assets can help revive Lebanon" appeared in FT Alphaville on June 30th, 2020.

How public assets can help revive Lebanon

This is a guest post by Dag Detter, an investment adviser and former president of Stattum, the Swedish government holding company and Nasser Saidi an economist and former Minister and Central Bank Vice Governor in Lebanon, arguing that ***Lebanon should create a national wealth fund to help it maximise the value of public assets and thus better address its debt imbalances****.*

Lebanon is in the throes of a fiscal, banking, currency and debt crisis. It is negotiating a rescue package with the IMF and a restructuring of its public debt which stands at 175 per cent of GDP with an estimated budget deficit of 15 per cent.

Across the globe and in Lebanon, policymakers have focused on managing the debt to get the country back in balance. But they have largely ignored the question of how public assets and real estate can help to alleviate the problem. Governments around the world, including Lebanon, have trillions of dollars of public assets. These are potentially a hidden gold mine in the fight against debt crises, or more pertinently an iceberg because so little of the wealth is visible to sovereign bond investors. Globally, the IMF estimates public assets are worth at least worth twice that of global GDP. Yet the assets are often badly managed and frequently not even accounted for at all. Given that in most countries public wealth is larger than public debt, managing it better could help to solve many debt issues while also providing material for future economic growth.

The idea of public asset wealth may not ring true to anyone familiar with the operational part of the government portfolio in Lebanon. Yet the portfolio plays a fundamental role in the economy because it operates in important sectors on which the broader economy depends. This is why the importance of well-governed SOEs cannot be overstated.

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An efficiently managed National Wealth Fund would cut the drain on the government's budget and resources, increase the value of public commercial assets, provide revenues and would be a major contributor to fiscal sustainability. More efficiently managed assets would contribute to a higher rate of real GDP growth, and lower private sector operating costs.

If properly administered, the move would then bolster faith in Lebanon's credit rating assessment, lowering the cost of borrowing on the international market, thus benefiting society as a whole.

The complete article can accessed directly (paywall) or download the article here.

Interview with Dubai Eye – Jan 15, 2013

Listen to my interview with Dubai Eye on the UAE central bank's cap on mortgages: http://www.dubaieye1038.com/page/Dr._Nasser_Saidi_15.01.2012/85621?feed=5

Mitigating the Risks of Another UAE Real Estate Bubble

Making the case for active approach to real estate lending and management, a version of this op-ed piece was published in The National on Jan 14, 2013 (http://www.thenational.ae/thenationalconversation/industry-insights/property/proactive-approach-can-allay-fears-of-boom-and-bust).