Weekly Insights 18 Feb 2021: The GCC Labour Market & Remittances – A Forward-looking Viewpoint

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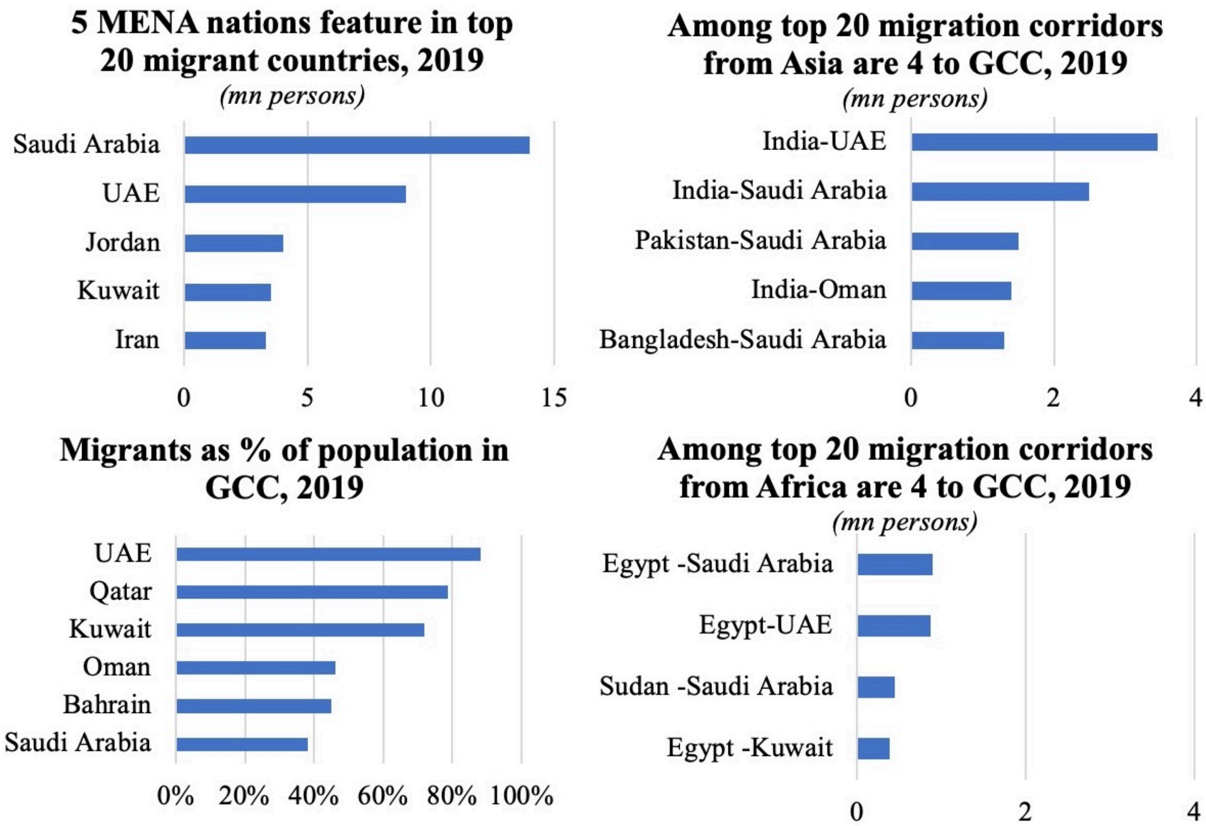
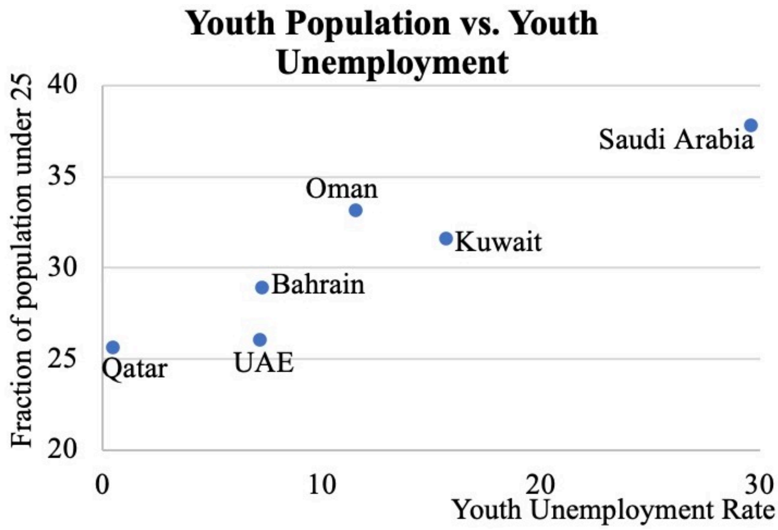


Source: World Migration report, UN DESA International Migrant Stock 2019
Charts created by Nasser Saidi & Associates.

It is no secret that the GCC is home to one of the largest migrant communities globally. **Five MENA nations feature in the top 20 migrant attracting nations globally (by number of persons).** Expat share in population across the GCC varies from Saudi Arabia's less than 40% to UAE's high 88%. According to the UN, top 20 migration corridors from Asia and Africa include those to the GCC nations: in 2019, India-UAE was the second-largest migration corridor in Asia (but, second only to refugee movement from Syria to Turkey), while migration from Egypt to Saudi and UAE occupied the top 5th & 6th spots among African

nations.
Burdened by Covid19 and lower oil prices last year, **job losses in the GCC and return migration has raised key concerns about the sustainability of dependence on expatriate labour.** With published monthly data of labour/ employment lacking in most GCC nations, reliance on anecdotal evidence is high. Official NCSI data showed that more than 270k expats left Oman between end-2019 to Nov 2020 (roughly 16%). This Covid19-related "expat exodus" coupled with recent moves to nationalize various professions and replace expats with nationals in senior positions at state-run firms, highlight a growing predicament facing many GCC nations – **how does a government justify the need to hire expatriate labour amid rising youth unemployment levels?**



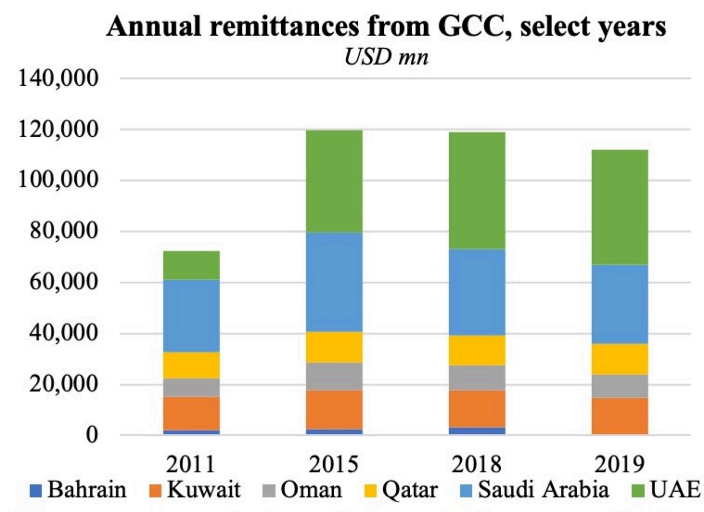
Source: World Bank, UN
Chart created by Nasser Saidi & Associates.

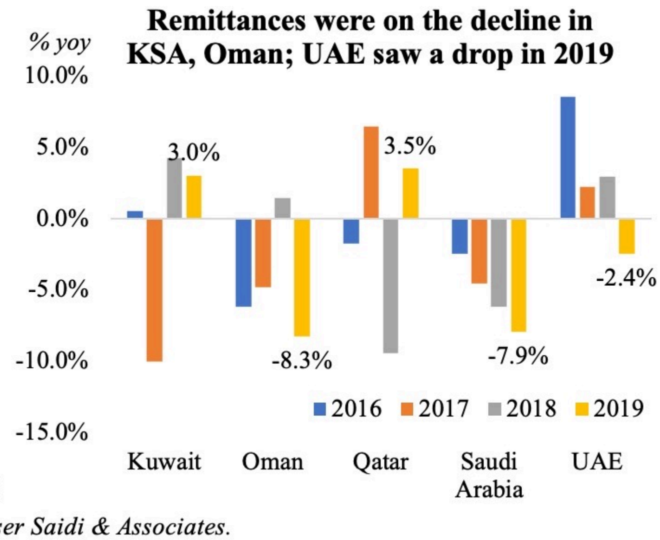
This pressure is building up in nations with high shares of population under the age of 25. Depending on labour force participation rates, the **IMF estimates that the GCC labour force could grow by an additional 2.5mn nationals by 2025.** While similar numbers are more intense in the labour-exporting nations within the MENA region, needless to say that **there are some common challenges**: job creation (in the private sector), gender disparity, preference to wait for a public sector job, address low levels of efficiency and productivity, to name a few.

- An interesting statistic from the ILO, namely **young people not in employment, education or training (NEET) is at a high 16% in the GCC nations** (though it pales in comparison with 40% in non-GCC Arab nations) implies that job creation has not been keeping pace with the growth in youth workforce.

- **Gender disparities are a commonly acknowledged drawback** in the GCC (and wider MENA region). The World Economic Forum's Gender Gap 2020 report highlighted that **it would take the MENA region close to 140 years to achieve gender parity**! The Covid19 pandemic throws another spanner in the works with women being more negatively affected on the job front (globally and in the region). Whereas formal education attainment has improved over the years, issues of mobility, cultural norms/ gender roles continue to be significant barriers preventing women from joining the workforce. Even the previously mentioned NEET levels are much higher for women: in 2019, 51.9% of young women in Arab states were classified as NEET vs 17.8% of young men.
- In the GCC nations, **labour markets remain segmented**: wage premiums in the public sector for lower working hours drives the nationals' preference for public sector employment. However, the higher wage bills (a strain on government budgets) have not translated into an improvement in the quality of public services (UAE is an outlier) and some standalone studies have highlighted a stagnation in public sector productivity levels.

Remittances in the GCC: should they be taxed?

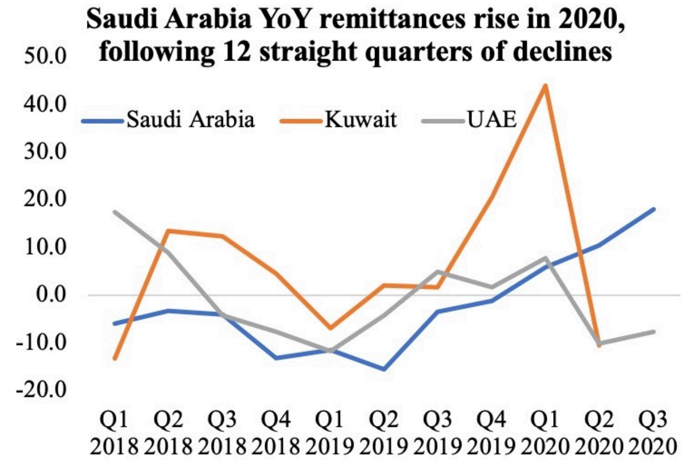


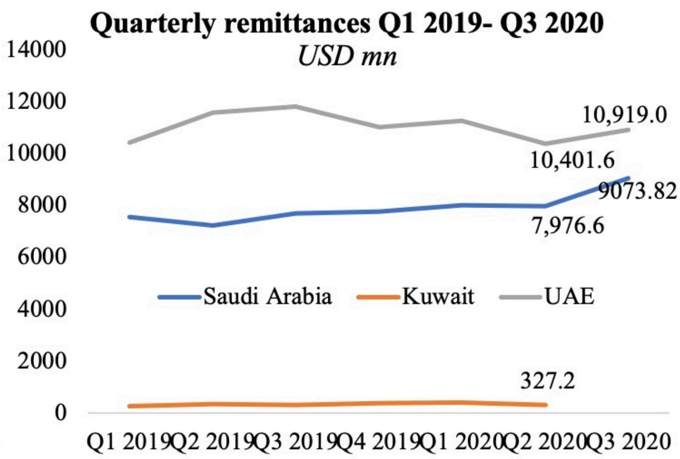


Source: Remittances database, World Bank; Charts created by Nasser Saidi & Associates.

According to the World Bank, **outward remittances from the GCC**

touched USD 112bn in in 2019: while this was a drop of 6% yoy, as a share of GDP it still stood at 11.9% in Oman, 11% in Kuwait and 10.7% in the UAE. Together, UAE and Saudi Arabia account for more than 2/3-rds of total remittances from the GCC. **Did the pattern of remittances change during the Covid19 pandemic?** The combined effect of the pandemic and related job losses alongside lower oil prices were expected to have an adverse effect on remittances. The World Bank expects global remittances to drop by 7% yoy to USD 666bn in 2020 (and by a further 7.1% in 2021) and inward remittances into the MENA region to decline by 8.5% to USD 55bn in 2020 (and by 7.7% to USD 50bn in 2021) negatively affecting labour exporting countries like Egypt.





Source: Central Bank data from Saudi Arabia, Kuwait & UAE. Charts created by Nasser Saidi & Associates.

At the GCC level, quarterly (headline) data are available in Saudi Arabia, UAE and Kuwait. Saudi Arabia has witnessed a continued drop in remittance flows consistent with the oil price declines (it saw 12 straight quarters of yoy declines since 2017), alongside the introduction of nationalization policies in many sectors. While the drop in Q2 was consistent across all three nations, both Saudi and UAE reported an increase in remittances in Q3 (Kuwait is yet to release Q3 data). This could be a result of multiple factors: job losses resulting in transfer of savings to the home country, an increase in digital remittances (versus unrecorded cash during trips home), transfer of excess savings (given lack of travel, leisure activities), exchange rate movements and/ or remittances to support families in the home country. The World

Bank identified a potential (yet to be evaluated) “Hajj effect” when analyzing remittances into Pakistan and Bangladesh – savings that had been set aside for Hajj were sent home instead given travel restrictions and the reduction in the issuance of Hajj visas.

Should remittances be taxed?

While there have been sporadic calls for a tax on remittances, this has yet to take a credible form and is oft refuted by government/ central bank officials. Oman is currently studying a proposal for a personal income tax on high-earners – if introduced, it will be a first in the region and could see similar rollouts across the region (depending on its impact). Though this will raise a question of “taxation without representation”, there are other approaches to encourage expats to retain their saving and invest in the economies (versus investing in their home country). **This essentially boils down to a combination of labour and financial market reforms. Here is a non-exhaustive list**.

- Economic **diversification into job-creating non-oil sectors** (including knowledge-based sectors). This also requires a supportive business environment with the necessary legal framework to ease the cost of doing business as well as additional measures to support SMEs (supporting entrepreneurs)
- **Allowing 100% foreign ownership** would encourage FDI inflows, create jobs and prompt entrepreneurs and businesses to re-invest into the domestic economy
- Increased **labour mobility**: a rollout of residency visas versus job-linked visas would encourage expats to stay longer, thereby encouraging investments in the domestic economy (e.g. UAE’s 10-year visas for skilled professionals). Similarly, undertaking pension reforms as well as introducing unemployment insurance schemeswould help retain workers and reduce turnover and training costs.
- **Encouragement of investment of domestically mobilized**

savings in the local economy needs the backing of a deep, broader and more liquid financial market. The introduction of a housing finance/ mortgage market could be one of the ways in addition to facilitating investment in domestic equity/ debt markets.

- Programs for **capacity development** to resolve skill mismatches via vocational and on-the-job training programs
- Supporting **increased participation of female workforce** through paid maternity/ paternity leaves and access to childcare facilities. Encouraging women to work increases growth and productivity, not only because women jobseekers typically have higher than average education, but also because this can increase mobility across sectors and jobs and increase household earnings, thereby increasing consumption and investment in housing.

In the backdrop of the Covid19 pandemic, the UAE introduced many expat-friendly schemes to attract and retain a high-skilled workforce, essential to support its vision for the 4th Industrial Revolution future. Even if we consider the "expat exodus" from the country last year, there are silver linings: in early Nov, the Indian Ambassador revealed that more than 200k Indians were returning to the country (this compares to the 600k persons that travelled after May); PMI's employment sub-category is finally in the expansion territory after months of sub-50 readings. Rather than focusing on inward facing nationalization policies, other GCC nations could take a leaf out of the UAE's example to encourage job creation (including for their citizens). This would be an enlarge the cake, win-win policy as opposed to taxation of remittances.

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"How knowledge-based human capital can drive UAE’s diversification efforts", Oped in The National, 27 Nov 2020

The article titled “**How knowledge-based human capital can drive UAE’s diversification efforts**” appeared in the print edition of The National on 27th November 2020 and is posted below.

How knowledge-based human capital can drive UAE’s diversification efforts

Nasser Saidi & Aathira Prasad

Recent structural reforms related to labour will help remove distortions in the market, attracting high-skilled professionals and investment

The UAE recently announced an expansion of its current 10-year golden visa to include medical doctors, scientists and data experts as well as PhD holders, in a bid to attract professionals to the country. The liberalisation comes on the heels of visas for retirees and options for remote working in Dubai: these provide added incentives for expatriates to remain, invest and contribute further to the country’s development.
Currently, an expat’s UAE residential status is linked to an

employer, and in the event of job loss, the person has 30 days to either find a new job or secure a new visa. With Covid-19 changing the outlook for jobs globally, these steps come at an opportune time for the country to retain the best talent.
Traditionally, construction and services were the largest sectors offering employment within the UAE’s private sector, according to the UAE central bank’s quarterly report. This data, however, excludes free zone activities. For example, the DIFC is home to 2,584 firms and over 25,000 employees while the DMCC last reported 17,500 member companies in its free zone.
The UAE has also made great strides in increasing the private sector’s participation in the economy as it set sights on greater economic diversification. According to the 2019 Labour Force Survey by the UAE’s Federal Competitiveness and Statistics Authority, the share of the private sector in the UAE has increased to 70 per cent in 2019 from 58 per cent in 2009 – a positive move that underscores diversification efforts.
By economic activity, a few sectors have seen an increase in their share: manufacturing (9.2 per cent in 2019 vs 7.7 per cent in 2009), construction (17.5 per cent vs 12.3 per cent), hotels and restaurants (5.4 per cent vs 4 per cent). The real estate sector has seen a significant drop during the decade, which is not surprising given the boom prior to 2010.

Another interesting insight from the Labour Force Survey offers a morale booster for women – women are relatively are more educated than their male counterparts (about 50 per cent of employed Emirati women have a bachelor’s degree while 10 per cent have a bachelor’s and above). The comparable numbers for expat women are at 42.8 per cent and 33 per cent, respectively. A high proportion of women work as professionals and managers as well. This shows that though women are transforming the labour force they still face a glass ceiling. It is time that we have more women on boards and at top management levels in the private sector.

The survey also showed that the public sector, with better salaries and benefits, continued to outweigh the private sector in terms of appeal. Though wages by sector breakdown is not available (publicly), it is safe to assume the government sector has relatively higher salaries where close to three-quarters of citizens work. According to the UAE's Labour Force Survey, more than one-third of Emirati respondents disclosed receiving monthly wages between Dh20,000 to 35,000 (versus just 5 per cent of expats in the same income bracket).

But for long-term growth and to further increase the private sector's contribution to GDP, it is important to increase the proportion of UAE nationals in privately-held firms.

While attracting foreign talent to take up such jobs in the near-to-medium term is necessary, it is also critical to reform the education sector and invest in building a knowledge economy.

There is a persistent skill mismatch in the country compared to market requirements. Though spending per capita is high and student-teacher ratios are comparable to OECD levels, the outcomes are not strong: the PISA 2018 scores, for example, reveal that UAE students are placed 50th in maths, 49th in science and 46th in reading. It is time to invest in curricula that support job readiness, 'Digital Education-for-Digital Employment', early exposure to the workplace (summer internships and labour policies that facilitate such changes, for example), vocational and on-the-job training. Increasingly, emphasis should be to invest in and promote STEM (Science, Technology, Engineering and Mathematics) – especially given the official policy focus on innovation and a shift to the digital economy in the UAE and the region.

The recent structural reform related to labour will help remove distortions in the market, attract high-skilled professionals and help the UAE diversify further while also supporting domestic investment (including in the real estate sector). This will happen in tandem with a reduction in outflow of remittances, which in turn will boost the balance of payments. Last year, outward remittance flows from the UAE

reached $44.9bn.
Long-term residents will be keen to invest in medium- and long-term financial instruments, secure mortgages and invest in start-ups and growth companies.

"Overcoming Lebanon’s economic crisis", viewpoint in The Banker, Oct 2020

This article, titled “Overcoming Lebanon’s economic crisis”, appeared as a viewpoint in the Oct 2020 edition of The Banker. The article, posted below, can be directly accessed on The Banker’s website.

Overcoming Lebanon’s economic crisis

Lebanon’s financial and economic crises can only be solved with meaningful reform, without which it faces a lost decade of mass migration, social and political unrest and violence.
Violence and crises have shattered Lebanon’s pre-1975 Civil War standing as the banking and financial centre of the Middle East. Lebanon is engulfed in overlapping fiscal, debt, banking, currency and balance of payments crises, resulting in an economic depression and humanitarian crisis with poverty and food poverty affecting some 50% and 25% respectively of the population. The Lebanese Pound has depreciated by some 80% over the past year, with inflation running at 120% and heading to hyperinflation. A Covid-19 lockdown and the Port of Beirut horrendous explosion on August 4th created an apocalyptic landscape, aggravating the economic and unprecedented humanitarian crises. The cost of rebuilding is estimated to exceed $10 billion, more than 25% of current GDP, which

Lebanon is incapable of financing.

The economic and financial meltdown is a culmination of unsustainable fiscal and monetary policies, combined with an overvalued fixed exchange rate. Persistently large budget deficits (averaging 8.6% of GDP over the past 10 years), structural budget rigidities, an eroding revenue base, wasteful subsidies, government procurement riddled with endemic corruption, all exacerbated fiscal imbalances.

Meanwhile, a monetary policy geared to protecting an increasingly overvalued exchange rate, led to growing trade and current account imbalances and increasingly higher interest rates to attract deposits and capital inflows to shore up dwindling international reserves. Deficits financed current spending, with limited real investment or buildup of real assets, while high real interest rates stifled investment and growth.

The unsustainable twin (current account and fiscal) deficits led to a rapid build-up of public debt. Public debt in 2020 is running at $111 bn, including $20 bn of debt at Banque du Liban (BdL), the country's central bank. This figure represents more than 184% of GDP— the second highest ratio in the world behind Japan, according to the the IMF, Most of this debt is held by domestic banks and BdL, with 13% held by foreigners.

Financing government spend

The BdL's financing of government budget deficits, debt monetisation, large quasi-fiscal operations (such as subsidising real estate investment) and bank bailouts, created an organic link between the balance sheets of the government, the BdL and banks. In effect, depositors' monies were used by the banks and the BdL to finance budget deficits, contravening Basel III rules and prudent risk management.

BdL policies led to a crowding-out of both the private and public sectors, and to disintermediation: the government could no longer tap markets, so BdL acted as financial intermediary i.e. paying high rates to the banking system, while allowing the government to borrow at lower rates. The higher rates increased the cost of servicing the public debt, with debt service representing some 50% of government revenue in 2019 and over one third of spending. Credit worthiness rapidly deteriorated, leading to a 'sudden stop' in 2019, with expatriate remittances and capital inflows moving into reverse.

The crisis Lebanon is now experiencing is the dramatic collapse of what economists describe as a Ponzi-like scheme engineered by the BdL, starting in 2016 with a massive bailout of the banks equivalent to about 12.6% of GDP. Ina bid to protect an overvalued LBP and finance the workings of government, the BdL started borrowing at ever higher interest rates, through so-called "financial engineering" schemes, which evolved into a vicious cycle of additional borrowing to pay maturing debt and debt service, until confidence evaporated and reserves were exhausted.

With the BdL unable to honour its foreign currency obligations, Lebanon defaulted on its March 2020 Eurobond and is seeking to restructure its domestic and foreign debt. The resulting losses of the BDL exceed $50 bn, equivalent to 2019 GDP, a historically unprecedented loss by any central bank.

With the core of the banking system, the BDL, unable to repay banks' deposits, the banks froze payments to depositors. The banking and financial system imploded. The bubble burst in the last quarter of 2019, with a rapid depreciation of the LBP during 2020. The BDL's costly attempt to defy the "impossible trinity" by simultaneously pursuing an independent monetary policy, with fixed exchange rates and free capital mobility resulted in growing imbalances, a collapse of the exchange rate and an unprecedented financial meltdown.

Economic disaster

A series of policy errors triggered the banking and financial crisis, starting with the closure of banks in October 2019, ostensibly because of anti-government protests decrying government endemic corruption, incompetence and lack of reforms. A predictable run on banks ensued, followed by informal capital controls, foreign exchange licensing, freezing of deposits, inconvertibility of the LBP and payment restrictions to protect the dwindling reserves of the BDL. These errors precipitated the financial crisis, generating a sharp liquidity and credit squeeze, the sudden stop of remittances and the emergence of a system of multiple exchange rates.

The squeeze severely curtailed domestic and international trade and resulted in a loss of confidence in the monetary system and the Lebanese pound. With the outbreak of Covid19 and lockdown measures came a severe drop in tax receipts, resulting in the printing of currency to cover the fiscal deficit, generating a vicious cycle of exchange rate depreciation and inflation. The black market exchange rate touched a high of LBP 9800 in early July, before steadying to around LBP 7400 in early September (versus the official peg at 1507). In turn these policy measures led to a severe economic depression, with GDP forecast to decline by 25% in 2020, with unemployment rising to 50%.

In response to the crisis, the government of Hassan Diab prepared a financial recovery plan that comprised fiscal, banking, and structural reforms as a basis for negotiations with the IMF. In effect, the Diab government and Riad Salameh, governor of the BDL deliberately implemented an inflation tax and an illegal ‘lirafication’ – a forced conversion, a spoliation, of foreign currency deposits into LBP to achieve internal real deflation. The objective is to impose a ‘domestic solution’ and preclude an IMF programme and associated reforms.

The apocalyptic Port of Beirut explosion on August 4, compounded by official inertia in responding to the calamity, has led to the resignation of the Diab government and appointment of a new PM, Mustafa Adib. Economic activity, consumption and investment are plummeting, unemployment rates are surging, while inflation is accelerating. Confidence in the banking system and in macroeconomic and monetary stability has collapsed.

Rebuilding the economy

Prospects for an economic recovery are dismal unless there is official recognition of the large fiscal and monetary gaps, and a comprehensive, credible and sustainable reform programme is immediately implemented by a new Adib government. Such a programme needs to include immediate confidence building measures with an appropriate sequencing of reforms. The government must immediately passing a credible capital controls act to help restore confidence and encourage a return flow of remittances and capital inflows. Immediate measures need to be taken to cut the budget deficit, including by removing fuel subsidies and all electricity subsidies (which account for one-third of budget deficits). The removal of these subsidies is necessary to stop smuggling into neighbouring Syria, which has been a major drain on international reserves.

Monetary policy reform is needed to unify the country's multiple exchange rates, moving to inflation targeting and a flexible exchange rate regime. Multiple rates create market distortions and incentivise more corruption. In addition, the BdL will have to repair and strengthen its balance sheet, stop all quasi-fiscal operations and government lending. Credible reform requires a strong and politically independent regulator and policy-maker.

There is a need to restructure the public domestic and foreign debt (including BdL debt) to reach a sustainable debt to GDP in the range of 80 to 90% over the medium term; this implies a write down of some 60 to 70% of the debt. Given the exposure of the banking system to government and BDL debt, a debt restructuring implies a restructuring of the banking sector whose equity has been wiped out.

A bank recapitalization and restructuring process should top the list of reforms, including a combination of resolving some banks and merging smaller banks into larger banks. Bank recapitalisation requires a bail-in of the banks and their shareholders (through a cash injection, sale of foreign subsidiaries and assets) of some $25 bn to minimise a haircut on deposits. As part of such far-reaching reforms, Lebanon

needs a well-targeted social safety net to provide support for the elderly and vulnerable segments of the population
Crucially, the new government needs to rapidly implement an agreement with the IMF. Lebanon desperately needs the equivalent of a Marshall Plan, a “Reconstruction, Stabilisation and Liquidity Fund’ of about $30 to 35bn, along with policy reform conditionality.
A comprehensive IMF macroeconomic-fiscal-financial reform programme that includes structural reforms, debt, and banking sector restructuring would help restore faith in the economy in the eyes of the Lebanese diaspora, foreign investors/aid providers and help attract multilateral funding from international financial institutions and Cedre conference participants, including the EU and the Gulf Cooperation Council. This would translate into financing for reconstruction, access to liquidity, stabilise and revive private sector economic activity.
Without such deep and immediate policy reforms, Lebanon is heading for a lost decade, with mass migration, social and political unrest and violence. If the new government fails to act, Lebanon may turn into “Libazuela”!

How to save Lebanon from looming hyperinflation, Article in The National, 31 Jul 2020

The article titled “How to save Lebanon from looming hyperinflation” was published in The National on 31st Jul 2020. The original article can be accessed here & is also posted below.

How to save Lebanon from looming hyperinflation

To bring the country's economic chaos to an end, it is important to examine how it all began

In June 2020, Lebanon's inflation rate was 20 per cent, month-on-month. In other words, prices in the country were, on average, 20 per cent more than they were a month before. Compared to a year earlier, in June 2019, they had nearly doubled.

Lebanon is well on its way to hyperinflation – when prices of goods and services change daily, and rise by more than 50 per cent in a month.

Hyperinflation is most commonly associated with countries like Venezuela and Zimbabwe, which this year have seen annual inflation rates of 15,000 per cent and 319 per cent, respectively. Lebanon is set to join their league; food inflation surged by 108.9 per cent during the first half of 2020.

When hyperinflation takes hold, consumers start to behave in very unusual ways. Goods are stockpiled, leading to increased shortages. As the money in someone's pocket loses its worth, people start to barter for goods.

What characterises countries with high inflation and hyperinflation? They have a sharp acceleration in growth of the money supply in order to finance unsustainable overspending; high levels of government debt; political instability; restrictions on payments and other transactions and a rapid breakdown in socio-economic conditions and the rule of law. Usually, these traits are associated with endemic corruption.

Lebanon fulfils all of the conditions. Absent immediate economic and financial reforms, the country is heading to hyperinflation and a further collapse of its currency.

How and why did this happen?

Lebanon is in the throes of an accelerating meltdown. Unsustainable economic policies and an overvalued exchange rate pegged to the US dollar have led to persistent deficits. Consequently, public debt in 2020 is more than 184 per cent of GDP – the third highest ratio in the world.

The trigger to the banking and financial crisis was a series of policy errors starting with an unwarranted closure of banks in October 2019, supposedly in connection with political protests against government ineffectiveness and corruption. Never before – whether in the darkest hours of Lebanon's civil war (1975-1990), during Israeli invasions or other political turmoil – have banks been closed or payments suspended.

The bank closures led to an immediate loss of trust in the entire banking system. They were accompanied by informal controls on foreign currency transactions, foreign exchange licensing, the freezing of deposits and other payment restrictions to protect the dwindling reserves of Lebanon's central bank. All of this generated a sharp liquidity and credit squeeze and the emergence of a system of multiple exchange rates, resulting in a further loss of confidence in the monetary system and the Lebanese pound.

Multiple exchange rates are particularly nefarious. They create distortions in markets, encourage rent seeking (when someone gains wealth without producing real value) and create new opportunities for cronyism and corruption. Compounded by the Covid-19 lockdown, the result has been a sharp 20 per cent contraction in economic activity, consumption and investment and surging bankruptcies. Lebanon is experiencing rapidly rising unemployment (over 35 per cent) and poverty rates exceeding 50 per cent of the population.

With government revenues declining, growing budget deficits are increasingly financed by the Lebanese central bank (BDL), leading to the accelerating inflation. The next phase will be a cost-of-living adjustment for the public sector, more monetary financing and inflation: an impoverishing vicious circle!

We are witnessing the bursting of a Ponzi scheme engineered by the BDL, starting in 2016 with a massive bailout of the banks, equivalent to about 12.6 per cent of GDP. To protect an overvalued pound and finance the government, the BDL started borrowing at ever-higher interest rates, through so-called “financial engineering” schemes. These evolved into a cycle of additional borrowing to pay maturing debt and debt service, until confidence evaporated and reserves were exhausted.

By 2020, the BDL was unable to honour its foreign currency obligations and Lebanon defaulted on its March 2020 Eurobond, seeking to restructure its domestic and foreign debt. The resulting losses of the BDL exceeded $50 billion, equivalent to the entire country’s GDP that year. It was a historically unprecedented loss by any central bank in the world.

With the core of the banking system, the BDL, unable to repay banks’ deposits, the banks froze payments to depositors. The banking and financial system imploded.

As part of Lebanon’s negotiations with the IMF to resolve the situation, the government of Prime Minister Hassan Diab prepared a financial recovery plan that comprises fiscal, banking and structural reforms. However, despite the deep and multiple crises, there has been no attempt at fiscal or monetary reform.

In effect, Mr Diab’s government and Riad Salameh, the head of the central bank, are deliberately implementing a policy of imposing an inflation tax and an illegal “Lirafication”: a forced conversion of foreign currency deposits into Lebanese pounds in order to achieve internal real deflation.

The objective is to impose a ‘domestic solution’ and preclude an IMF programme and associated reforms. The inflation tax and Lirafication reduce real incomes and financial wealth. The sharp reduction in real income and the sharp depreciation of the pound are leading to a massive contraction of imports, reducing the current account deficit to protect the remaining international reserves. Lebanon is being sacrificed to a failed exchange rate and incompetent monetary and government policies.

What policy measures can be implemented to rescue Lebanon?

Taming inflation and exchange rate collapse requires a credible, sustainable macroeconomic policy anchor to reduce the prevailing extreme policy uncertainty.

Here are four measures that would help:

First, a "Capital Control Act" should be passed immediately, replacing the informal controls in place since October 2019 with more transparent and effective controls to stem the continuing outflow of capital and help stabilise the exchange rate. This would restore a modicum of confidence in the monetary systems and the rule of law, as well as the flow of capital and remittances.

Second is fiscal reform. It is time to bite the bullet and eliminate wasteful public spending. Start by reform of the power sector and raising the prices of subsidised commodities and services, like fuel and electricity. This would also stop smuggling of fuel and other goods into sanctions-laden Syria, which is draining Lebanon's reserves. Subsidies should be cut in conjunction with the establishment of a social safety net and targeted aid.

These immediate reforms should be followed by broader measures including improving revenue collection, reforming public procurement (a major source of corruption), creating a "National Wealth Fund" to incorporate and reform state commercial assets, reducing the bloated size of the public sector, reforming public pension schemes and introducing a credible fiscal rule.

Third, unify exchange rates and move a to flexible exchange rate regime. The failed exchange rate regime has contributed to large current account deficits, hurt export-oriented sectors, and forced the central bank to maintain high interest rates leading to a crowding-out of the private sector. Monetary policy stability also requires that the BDL should be restructured and stop financing government deficits and wasteful and expensive quasi-fiscal operations, such as subsidising real estate investment.

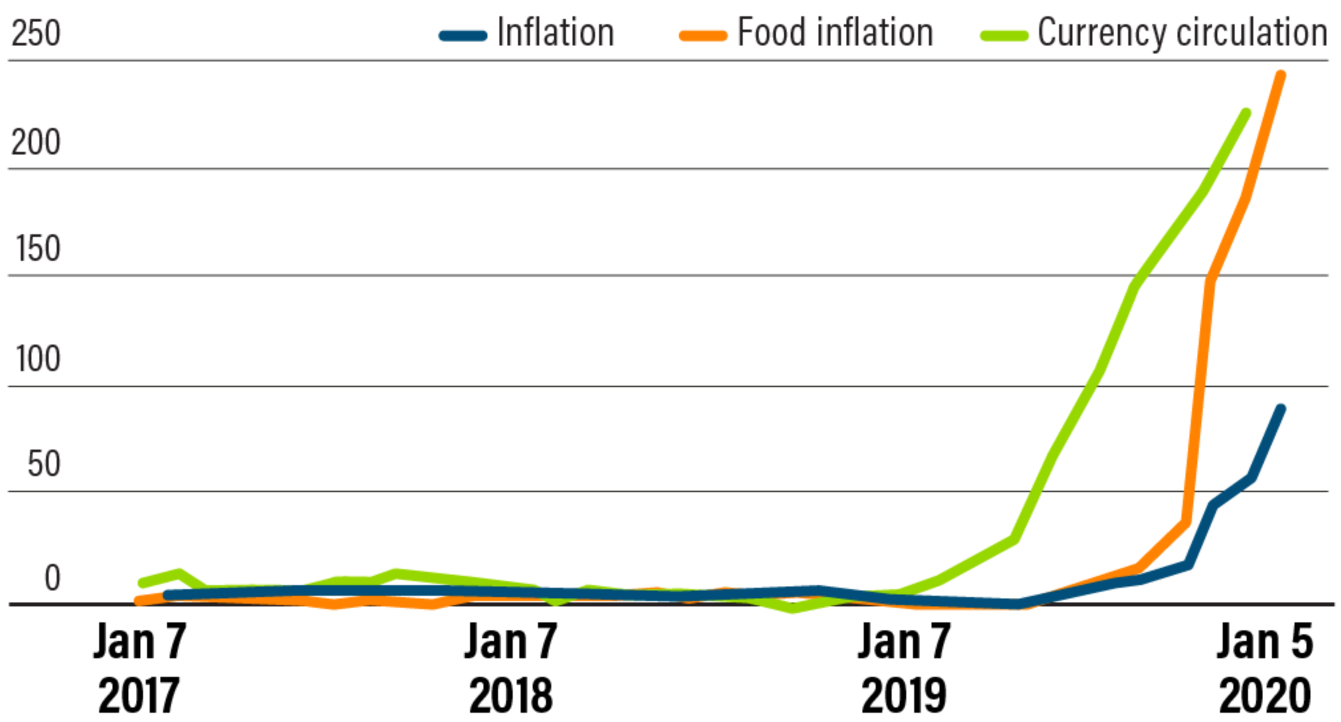
Fourth, accelerate negotiations with the IMF and agree to a programme that sets wide-ranging conditions on policy reform.

Absent an IMF programme, the international community, the GCC, EU and other countries that have assisted Lebanon previously will not come to its rescue.

Lebanon is at the edge of the abyss. Absent deep and immediate policy reforms, it is heading for a lost decade, with mass migration, social and political unrest and violence. If nothing is done, it will become “Libazuela”.

Nasser Saidi is a former Lebanese economy minister and first vice-governor of the Central Bank of Lebanon

LEBANESE CENTRAL BANK’S MONEY SURGE IS FUELLING INFLATION (%)



Source: Central Administration of Statistics, BDL, Nasser Saidi & Associates

Comments on Lebanon's links to Syria's economy in Gulf News, 16 Jul 2020

Dr. Nasser Saidi's comments appeared in the Gulf News article titled "Syria's collapse compounded by COVID-19", published 16th July 2020.

Comments are posted below:

"Economic collapse in Lebanon lowers the demand for imports from Syria and leads to the firing and rising unemployment of

Syrian workers in Lebanon," said Nasser Saidi, a Lebanese economist and former minister. Speaking to Gulf News, he added: "This results in a decreased flow of remittances to Syria. The freezing of the deposits of Syrians (individuals and businesses) in Lebanese banks results in an inability to finance Syrian imports and trade through Lebanon."
He added: "The financial, banking and fiscal crisis in Lebanon means increasing pressure in supplying/smuggling of fuel, wheat and other subsidised commodities into Syria."

To halt Lebanon's meltdown it is imperative to reform now, Article in The National, 4 Jul 2020

The article titled "To halt Lebanon's meltdown it is imperative to reform now" was published in The National on 4th Jul 2020. The original article can be accessed here & is also posted below.

To halt Lebanon's meltdown it is imperative to reform now

The country's currency has lost about 80% of its value against the US dollar and poverty and unemployment are on the rise

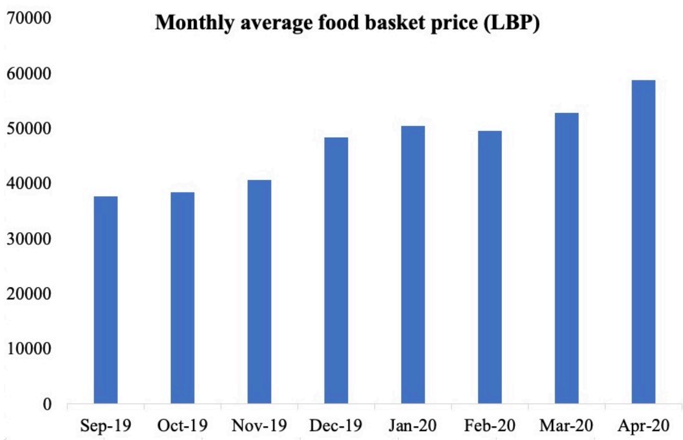
Lebanon is in the throes of an accelerating economic and financial meltdown. Unsustainable monetary and fiscal policies and an overvalued pegged exchange rate led to persistent fiscal and current account deficits.

Public debt which reached more than 155 per cent of gross domestic product in 2019, is projected rise to 161.8 per cent in 2020 and 167 per cent in 2021, according to International Monetary Fund estimates. That is the third highest ratio in the world after Japan and Greece.

Informal capital controls, foreign exchange licensing, freezing of deposits and payment restrictions to protect the dwindling reserves of Lebanon’s central bank, precipitated the financial crisis, generated a sharp liquidity and credit squeeze and the emergence of a system of multiple exchange rates.

The squeeze is severely curtailing domestic and international trade and resulted in a loss of confidence in the monetary system and the Lebanese pound. Multiple exchange rates created distortions in markets and new opportunities for corruption. The result is a sharp, double-digit contraction in economic activity, consumption and investment, surging bankruptcies, and rapidly rising unemployment rates estimated at above 30 per cent.

A dangerous inflationary spiral has gripped the country with the currency’s value against the dollar nosediving as much as 80 per cent. Inflation is on the rise and reached an annual 56 per cent in May, according to Lebanon’s Central Administration of Statistics. A Bloomberg survey of economists conducted in June, projects inflation will average 22 per cent in 2020 compared with a forecast of 7.7 per cent from a previous survey.



Source: WFP Retail POS Data Warehouse, Lebanon, May 2020.

The minimum wage has shrunk from the equivalent of $450 per month while food prices have surged. Since the end of a 15-year civil war in 1990, extreme poverty has hovered at between 7.5 to 10 per cent, while about 28 per cent of the population is poor, according to the World Bank. In November, the World Bank warned if the economic situation in the country worsened, those living below the poverty line could rise to 50 per cent.

Given the collapse of the long-maintained peg, there is no anchor for expectations of the future value of the Lebanese pound.

The Central Bank of Lebanon does not have the reserves to support the pound. There is great uncertainty concerning the macroeconomic outlook, fiscal and monetary policies, exchange controls and structural reforms.

The government approved a rescue plan, the basis for negotiations with the IMF, but failed to set a credible roadmap for structural reforms and none of the promised reforms have been undertaken. There is a loss of confidence in the banking system and in macroeconomic and monetary stability. As a result, people want foreign currency to protect themselves, as a hedge against inflation and further depreciation of the pound.

Transfer restrictions have led to a sudden stop of capital inflows and remittances from Lebanese expatriates, who fear their transfers will be frozen. Remittances accounted for 12.9 per cent of GDP in 2019.

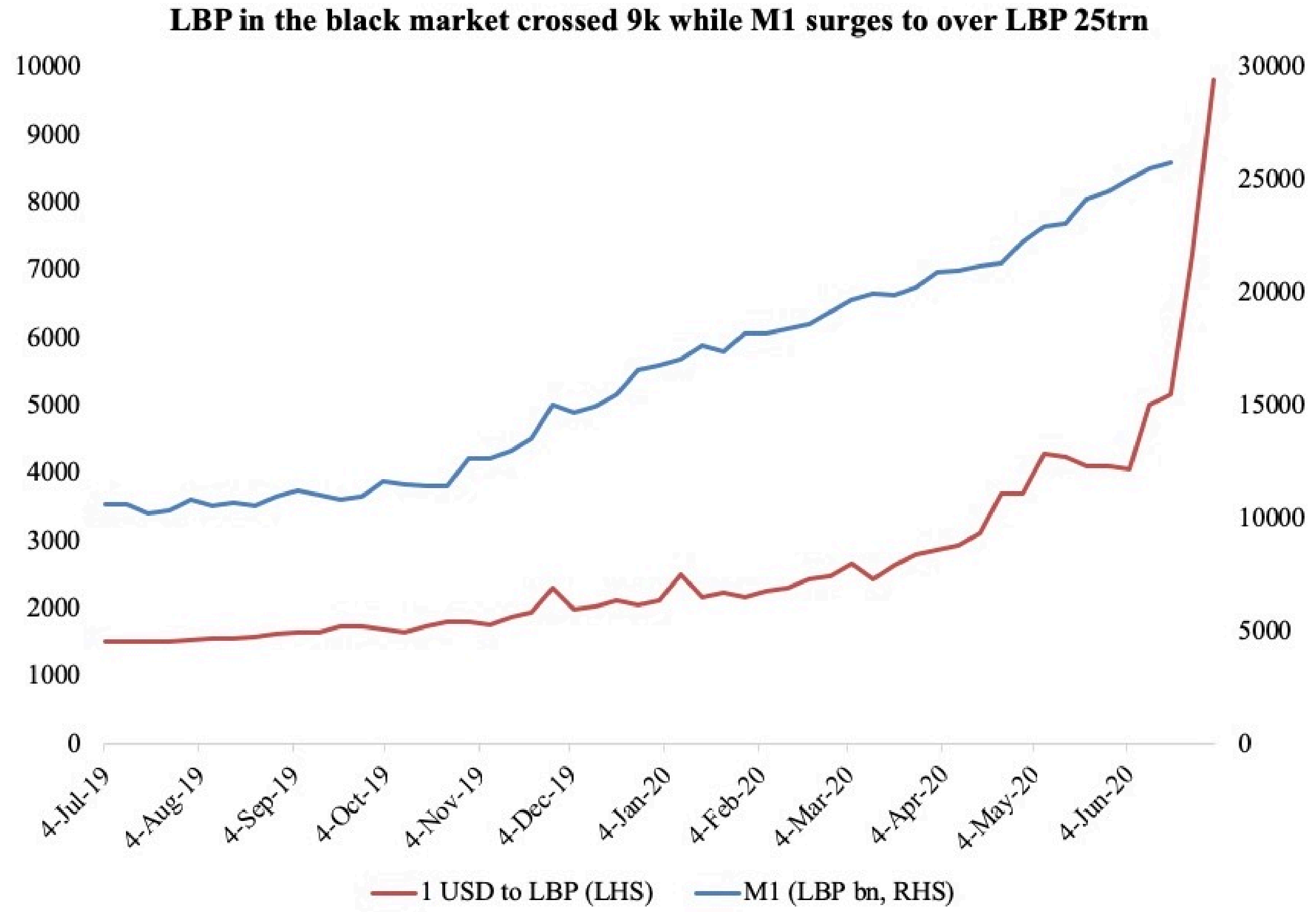
With capital and payment controls and lack of intervention by the central bank, the foreign exchange market became a cash market with little liquidity, therefore highly volatile and subject to large fluctuations, rumours and panic.

Two short-term factors have compounded the currency crisis. The Covid-19 lockdown meant a loss of remittances that would have come in as cash. Media reports cite an accelerated smuggling of imported, subsidised commodities like fuel and wheat into neighbouring Syria these past months due to the increasing bite of international sanctions and a failing wheat harvest.

Panic prevails because of new US sanctions targeting Syria under the Caesar Syria Civilian Protection Act (the Caesar Act) that came into effect last month. Syrians are trying to hedge against inflation and the depreciating Syrian pound by tapping Lebanon’s forex market. In effect it is one market.

More fundamentally, Lebanon’s rising inflation rates are feeding expectations of ever higher inflation rates, which along with the sharp decline in real income because of the deep recession, means a fall in the demand for money and lower demand for the Lebanese pound. As people try to shift out of the Lebanese pound, inflation rises, and the currency depreciates against the US dollar.

The vicious cycle is being fed by the monetary financing of budget deficits. Lebanon’s fiscal deficit increased 26.90 per cent in the first four months of the year to $1.75B from the year-earlier period. With the government unable to borrow from the markets, the central bank is financing the growing budget deficit and, increasingly, a growing proportion of government spending. The printing press is running, with a growing supply of Lebanese pounds on the market chasing a dwindling supply of US dollars. Hyperinflation looms.



Source: M1 Banque du Liban ; black market rate https://lirarate.com/ (updated 3rd Jul 2020)

The deepening crisis requires urgent, decisive, credible, policy action. A capital control act should be passed immediately. That will help rebuild confidence in the monetary system and restore the flow of capital and remittances.

The prices of subsidised commodities and services (fuel, electricity) should be raised to combat smuggling and stem the budget deficit. Smart and targeted subsidies are more effective. The impact of removing general subsidies is less painful than financing budget deficits that accelerate overall inflation and exchange depreciation. Exchange rates need to be unified within a central bank and bank organised market.

Most important, is rapidly agreeing and implementing a financial rescue package with the IMF. That should be based on a comprehensive macroeconomic-fiscal-financial reform programme that includes structural reforms, debt, and banking sector restructuring, which would provide access to liquidity, stabilise and revive private sector economic activity.

Nasser Saidi previously served as Lebanon’s minister of *economy and industry and a vice governor of the Central Bank of Lebanon. He is president of the economic advisory and business consultancy Nasser Saidi & Associates.*

Comments on the economic impact from Covid19 in Washington Post, 16 Mar 2020

Dr. Nasser Saidi's comments appeared an article titled "The Middle East is already wracked by war. Now it must confront the coronavirus, too" that appeared in the Washington Post on 16th Mar 2020.

Comments from the article are posted below. The full article can be accessed here.

Oil producers in the Persian Gulf countries will be forced to cut back spending, and countries elsewhere that depend on remittances from expatriates in the gulf region will also suffer, said Nasser Saidi, a Dubai-based economist and former Lebanese finance minister.

Lebanon is in the throes of a financial crisis that has seen its currency collapse amid widespread street protests. Iraq, which depends on oil for almost all its income, will be badly hit at a time when political protests there have rocked the country.

The region will almost certainly slide into recession, Saidi said.

"It means unemployment will get worse. It means socioeconomic conditions will deteriorate. There will be more distress, more social problems and more political protests," he said. "It's not a pretty picture for the Middle East."

Comments on McKinsey's Lebanon report in Arab News, Jan 2019

Dr. Nasser Saidi's comments (below) appeared in an Arab News report titled "Lebanon's damning McKinsey report: how the experts reacted", on January 7, 2019. The full article can be accessed here and here; the Arab News report can can be downloaded here.

One of the damaging figures reveals that Lebanon's residents spend 50 percent more time than needed on congested roads, only 15 percent of which are in good condition. It also discloses that Lebanon's infrastructure ranks 113th out of 137 countries.

"These numbers come from a variety of sources like the World Bank and others, so these have been assessed by various international parties," Dr. Nasser Saidi, former chief economist and head of external relations at the Dubai International Financial Center, told Arab News.

"What's more important is the cost of this in terms of productivity and income, because when you spend time on the road you aren't producing anything, so congestion costs are very large in terms of both loss of business opportunities, lost income and lost productivity."

Lebanon's perceived corruption was shown to have increased by 26 points since 2012 to 146 out of 180.

"In terms of governance, it has been deteriorating over the past five to six years on a continuous basis," Saidi said. "It's corruption, bribery and nepotism. In all reports on transparency and corruption, Lebanon is unfortunately one of

the most corrupt (places) in the world, and the importance of it is not only that we want to be able to fight corruption, but that it has become a cancer and it is so pervasive."
He emphasized the issue as it is a major contributor to public finance and the budget deficit. "Corruption is directly related to government procurement and government contracts as well as government revenue," he said. "So there is widespread tax evasion, and corruption is at the core of Lebanon's large budget deficit, which was close to 11 percent in 2018 and likely to be the same or higher in 2019… The economic and fiscal impacts are extremely important."
"If you want to measure the real damage that the civil war and the (Israeli) occupation have done to the country, it's where Lebanon stands vis-a-vis countries that were equivalent to it before the war," he added. "So it has regressed a lot by that measure." Saidi said the poor quality of statistics in the country needs to be improved as the central statistics office lacks resources and figures on key areas including GDP and investment.
He said the lack of field productivity growth and investment means it is unsurprising that there has not been much of an increase in per capita income or real GDP.
The McKinsey report highlighted the country's education system, deeming it to be of low quality and in decline. It said many skills are not being taught to suit labor force needs, partially because the curriculum has not been upgraded since 1997. Experts, however, said this is only the case for public sector schools and universities.
"The picture is diverse and there's a big gap between public and private education," Saidi said. "The major private sector universities are St. Joseph, the AUB and the LAU, which are able to deliver competitive quality education. The evidence for that is that our graduates are able to go to top-notch universities internationally." But the problem is that it is mostly elites who can afford high-quality education, leaving behind most of the population, including Syrian refugees, he said.

He pointed the finger at the Arab world as a whole. "You need to think of two things: Education for employment, which should give you skills to be able to get jobs, and digital education for digital employment, because economies on a global basis and in the Arab world are increasingly going to have to move to become digital."

In terms of the country's diaspora and its $6.9 billion in remittances sent back to Lebanon, the report said they are not largely channelled into productive areas.

"There's very little public investment, and all remittances and the capital coming in from the diaspora go into bank deposits, treasury bills and to finance the budget deficit," Saidi said. "We have one of the highest levels of debt to GDP in the world, in excess of over 158 percent, which makes it the third most indebted country in the world after Japan and Greece."

He attributed the problem to very little public investment, which trickled down to poor infrastructure performance. "It's all going to finance wages, pensions and interests on public debt," he added, calling it a resource curse due to the government's dependency on it. "They're happy to pay high rates just to attract them. Had we not had them, they would've had to adjust on their own and had fiscal reform."

The main issues at hand, he believes, are fiscal reform and corruption, cutting down the budget deficit and the level of public debt.

Reform of UAE's ownership & residency laws: Article in

The National, 25 May 2018

The article titled "Reform of UAE's ownership and residency laws will only improve growth prospects" appeared in The National on 25th May, 2018 and is posted below. Click [here]() to access the original article.

Reform of UAE's ownership and residency laws will only improve growth prospects

The UAE Cabinet announced two major policy initiatives this past Sunday: a 10-year residency visa for skilled professionals along with a 5-year visa for students and ownership reforms allowing foreigners to own 100 per cent of businesses in most sectors.

These long awaited and welcome reforms are promising policy initiatives that can change medium-term growth prospects for the country. We need to await the new laws and implementation decrees for a full assessment of the economic and wider social and cultural implications.

However, the announcements herald broader and necessary structural reforms: removing barriers and opening the economy to foreign direct investment, liberalizing rights of establishment and ownership, and removing distortions in the labour market and immigration system through retaining and attracting higher skilled human capital.

Sound implementation of the new visa rules would attract middle to higher income professionals and gradually change the mix of skills of the labour force towards more educated, higher skilled workers and professionals. The reform enables the UAE to attract as well as retain qualified human capital which would facilitate the transfer of technology and know-how and diversification of the economy into higher value added, more complex activities. In addition, the policy change would increase domestic investment by current foreign residents. Skilled professionals are mainly middle and high income and would invest more and buy assets in the UAE if they are assured of long term residency.

Uncertainty on residency and visa rules increases risk and discourages investment in real estate and long lived assets. There are good economic and financial reasons to extend even the 10-year residency. Singapore is a good example: permanent residency is granted when one invests at least 2.5 million Singapore dollars in a new business or the same amount in the Global Investor Programme which invests in local companies.

Rescinding the Kafala labour sponsorship system, its distortions and its abuses, increasing labour mobility within and between sectors will also benefit the economy. Binding employees to employers for a fixed period of time restricts labour mobility, reduces economic efficiency and productivity growth and the resilience of the UAE economy to economic shocks as well as its capacity to innovate by shifting labour and capital to new activities.

The move to allow 100 per cent foreign ownership could see an immediate impact across all non-oil sectors – retail, manufacturing, with health and education potentially being the “quick-win” sectors, along with the hospitality and real estate (given that longer-term residency would be an incentive for expats to own homes and businesses).

The long awaited Foreign Investment Law should clarify the conditions and scope of the liberalisation of foreign ownership: would it apply across all sectors with exceptions (“strategic sectors”) and would it ease the limit on foreign ownership of listed companies and securities? Liberalisation and reduction of barriers to foreign investment should also be accompanied by steps to reduce the overall costs of doing business and consolidate fees, that have been rising in the past two years.

Removing barriers, reducing and consolidating the plethora of fees would help the country improve its ranking and move up to within the top-20 nations in the World Bank’s Doing Business report. The UAE ranks the highest in the Arab world and and 21 globally.

The aim of the announced policy reforms is to promote economic diversification by boosting the knowledge-based sector. That includes new technologies such as AI, blockchain technologies, fintech, life sciences, clean energy and technology such as solar and wind, space and aeronautics which would augment and complement the UAE’s advanced infrastructure and logistics, and other technologies underlying the 4th Industrial Revolution.

To develop these complex activities requires human capital with STEM (science, technology, engineering and mathematics) skills and know-how. The new visa and residency rules are important in that they can attract STEM human capital.

New visa and residency rules would also provide incentives to reduce the outflow of remittances and capital*:* long-term, protected residency and visas, will encourage residents to invest in the UAE instead of sending their savings abroad.

Outbound remittances from the UAE were about AED 164.3 billion ($45bn) last year alone. Reducing capital outflows and remittances would improve the structure of the country’s balance of payments. In this regard, the time is right to accelerate the development of the financial markets – for example by issuing long-term government bonds and encouraging the issue of high grade corporate bonds- facilitate access to finance, develop the mortgage market, develop a pensions system and otherwise increase the availability of medium and long-term financial instruments. Introducing pension plans for expatriates and allowing retirees to settle in the UAE would also provide incentives to expatriates to remain, invest and contribute further to the country’s development.

Details are not yet available as to how and when the reforms will be rolled out and their applicability to existing businesses and visas. The important matter will be clarity of the rules and regulations and the speed of implementation. Will the visa be related to current jobs (as it is now) or would it be on residency and not linked to employment, meaning that employees made redundant are free to stay in the country and search for another job.

It will be important to translate the cabinet decisions into laws that protect investors’ rights whether it is FDI-related or personal human capital in order to obtain the benefits of liberalisation.