

## **PUBLIC DEBT AND PERFORMANCE OF SMES: EVIDENCE FROM LEBANON**

*With the outbreak of the civil war in 1975, economic problems began in Lebanon. Lebanon experienced financial crises in 1982, 1994 and still faces such crises. Despite the measures taken by the many times replaced cabinets of ministers, the dynamics of economic cycles, Lebanon today has a public debt in the amount exceeding 102 billion dollars. The political crisis has not been resolved; macroeconomic indicators do not allow us to speak of the emerging stability. The explosion in Beirut caused new financial problems. Small and medium-sized enterprises, which in Lebanon occupy 95 % of all companies, found themselves in the most vulnerable position at this time. On May 22, 2020, the Council of Representatives passed a law to open up special funding for this sector to support the agriculture, industry and crafts sectors. The study is aimed at studying the prospects for overcoming the protracted crisis.*

**Keywords:** *small and medium business; Lebanon crisis microcredits; government debt; investment financing.*

## **ГОСУДАРСТВЕННЫЙ ДОЛГ И РЕЗУЛЬТАТЫ ДЕЯТЕЛЬНОСТИ МСП: ДАННЫЕ ЛИВАНА**

*С началом гражданской войны в 1975 г. в Ливане начались экономические проблемы. Ливан пережил финансовые кризисы в 1982, 1994 гг. и до сих пор сталкивается с ними. Несмотря на меры, принимаемые много раз сменяемыми кабинетами министров, динамику экономических циклов, Ливан сегодня имеет государственный долг в сумме, превышающей 102 млрд дол. Политический кризис не разрешен, макроэкономические показатели не позволяют говорить о намечающейся стабильности. Взрыв в Бейруте повлек новые финансовые проблемы. В наиболее уязвимом положении за это время оказались малые и средние предприятия, которые в Ливане занимают 95 % всех компаний. Совет представителей 22 мая 2020 г. принял закон об открытии специального финансирования указанного сектора для поддержки секторов сельского хозяйства, промышленности и промыслов. Исследование направлено на изучение перспектив выхода из затяжного кризиса.*

**Ключевые слова:** *малый и средний бизнес; Ливанский кризис; государственный долг; микрокредитование; финансирование инвестиций.*

### **Introduction**

The Lebanese economy is a free economy that depends on individual initiative, however, the investment climate includes: corruption, pledge documents tariffs, tariffs and fees, outdated legislation, and insufficient protection of intellectual property rights [1].

The private sector acquires more than 75 % of the economy's total business [2], occupies capital in all economic sectors and is considered the mainstay of economic development. In addition to the free banking sector, which operates more than double the economic sector.

Lebanon's economic problems began with the outbreak of the civil war in 1975 and lasted 15 years, affecting the infrastructure of the Lebanese economy and reducing national product by half.

At the end of the war in 1990, the state began to regain its prestige and collect taxes, and re-control the ports, airports and government institutions so that GDP (Gross Domestic

Product, abbreviated as GDP, is the total value of goods and services produced in a country) per capital rose in 1990. Later, Lebanon's economic recovery returned and the banking system financially supported small and medium-sized enterprises through family transfers and banking services.

Here, we find an intense competition and strength in Lebanon, and the Lebanese economy is service economy of the Organization for Economic Cooperation and Development (OECD) in the field of banking and tourism. In addition to the fact that the Beirut Stock Exchange is the only stock exchange in Lebanon, which dates back to the year 1920 during the time of the French Mandate, and witnessed the Beirut Stock Exchange period to be the Golden in the 1950s and 1960s before it witnessed a recession due to the war in 1975.

In 2005, the assassination of the Lebanese Prime Minister and the outbreak of 2006 war affected the infrastructure, low-yield tourism in Lebanon, in addition to political and social problems. On October 17, 2019, there was a revolution against the sectarian system, or the so-called System of quotas plus, in addition to the collapse of the currency against the dollar by five or six times what it was, and to the explosion of Beirut port on August 4, 2020 which destroyed Beirut and became a barren desert port.

Lebanon has not escaped this obstacle over the years despite the multiplicity of ministries and economic cycles, and the studies and structures related to this sector. Unfortunately, Lebanon has fallen into debt, and today its debts exceed 92 billion dollar [3].

From this standpoint, the following problems arises: What is the financial and economic situation of Lebanon in 2020? How can the financial crisis negatively affect the private sector, especially small and medium-sized enterprises? To answer these questions, we will ask intermediate questions: What are the characteristics of the Lebanese economy? How Lebanon fell into the debt crisis. What about addressing it?

**Methodology.** This article aims to explain the Lebanese public debt and its direct and indirect effects on the private sector in general and on small and medium enterprises in particular. The public debt, which extends for about 30 years, is in its first stages. The article aims to explain the country's financial situation, its beginnings, and its stages.

In the second section, we will try to understand the Lebanese economic situation and the impact of public debt on economic growth and gross domestic product.

The last section aims to explain the means of treatment and the accumulation of debts. The main question that arises here, will addressing debts be in more debts? Will Cedar Conference be the savior for Lebanon?

## Section I: Lebanese Financial Crisis and the Public Debt

**Lebanese debts.** As a result of the political conflicts and the ongoing economic crises in Lebanon, the Lebanese economy witnessed a significant decline and negative repercussions on the financial and economic situation.

In 1999 the economic growth rate fell below  $-1\%$  and the balance of payments recorded a deficit of 289 million dollars in 2000, with the public deficit increasing by the end of 2000 to  $23\%$  of GDP.

Lebanon was affected economically and politically during the Syrian crisis, and three years before the Syrian crisis Lebanon witnessed an annual growth rate of  $8\%$ . But with the outset of the war in Syria, Lebanon welcomed large numbers of Syrians, and the growth dropped to  $1\%$ .

According to the World Bank, Lebanon's loss in GDP due to the Syrian crisis was one billion US. dollars until 2015.

Hence, we must recall Lebanon's financial history and the debts it owes, and we must bring back to the forefront the three Paris conferences and the financial commitments adopted by the international community.

**Paris I.** In the late 2000s, the government of Prime Minister Rafic Hariri moved to revive the Lebanese economy by completing the political, administrative and economic reform programs that had been initiated by Hariri since 1992.

In 1999 and 2000, Lebanon entered a period of economic recession and public debt rose to 151 % of the GDP in 2000 [4].

Rafik Hariri worked to stimulate the private sector to be the main engine of growth, as well as to reduce rates of debts and unemployment, and thus propel poverty to achieve monetary stability and control inflation.

The Paris I conference was held on February 27, 2001 in the French state at the Elysee Palace and was attended by the French President Jacques Chirac, the president of the World Bank, the president of the European Commission and the French minister of Finance... Under the title «The New Economic Strategy of the Lebanese Government», the Paris I conference approved the international community's pledge of 500 million euros [5], and agreed to organize subsequent conferences to be the Paris 2 conference on November 23, 2002.

**Paris II.** After the Paris I conference was held to help Lebanon economically and financially, the Paris II conference was held on November 23, 2002 [6], in the presence of former French President Jacques Chirac and President Rafic Hariri in addition to the European Commission and donor countries. At that time, Lebanon returned to present a strategic plan to support all sectors to improve the country's financial and economic situation, in addition to some reforms that did not differ from the reform paper that was proposed in Paris I.

Lebanon obtained 2.6 billion dollars in financial facilities and 1.3 billion dollars in loans (treasury bonds and deposits), and the average cost of the debt was about 13 %.

In 2002, the Lebanese public debt reached nearly 30 billion dollars.

**Paris III (Beirut 1).** On February 14, 2005, the Lebanese Prime Minister, Rafic Hariri, who presided over the Paris I and Paris II conferences, was assassinated. The main disagreements between the Lebanese parties began, and Lebanon was economically affected, especially with the friends of Omar Karami's government at that time.

The Paris III conference [7] was held as an alternative to the Beirut I conference, after it was held several times due to the political situation in Lebanon.

The Beirut I conference was approved at a meeting in New York in September 2005 at the United Nations headquarters, in the presence of Fouad Saniora, who represented Lebanon.

As for the Paris III conference, it was held on June 14, 2005 without the presence of any representative of Lebanon or any Arab country.

**Cedar Conference.** Cedar conference [8] was held on April 6, 2018, and more than 50 countries met in the French capital, Paris, in addition to some Arab countries, the United States and China, trying to bring Lebanon back to life after the three conferences we mentioned earlier, Paris I, II, and III.

The World Bank and the European Investment Bank participated in the conference, and the Lebanese government headed by Saad Hariri (is a politician who served as from 2009 to 2011 and 2016 to 2020; he is the second son of former Lebanese Prime Minister , who was assassinated in 2005) presented the investment and reform program in Lebanon, and on the basis of which the donor countries decided to support the Lebanese program in multiple stages according to specific conditions and mechanisms.

However, political and sectarian conflicts always take the center stage of such projects. On October 17, 2019, the revolution of the Lebanese citizens began against the ruling class and the covenant in general, due to high prices, high inflation, poverty, in addition to the collapse of the dollar exchange rate against the Lebanese pound. The Lebanese people are still waiting for the implementation of the Cedar conference to come back and stand again. Will Cedar be the savior of Lebanon and the Lebanese people? Or it will stand in the line of Paris I, II, and III?

## Section II: The Impact of Public Debt and Financial Collapse on SMEs

SMEs in Lebanon are an essential source of economic growth, because more than 95 % of companies are SMEs. This type of enterprises is not capitalist, but its contribution in employment is very important. To add, SMEs present a wide range of activities.

In Lebanon, a deep and complex financial crisis arose since the 1975 war in which the Lebanese economy began to deteriorate in addition to the accumulation of debts that began in 1993 until the end of 2019 and the beginning of the revolution in October 17 against the government and the failed financial policies. At the beginning of 2020, the banking restrictions began to seize deposits for depositors resulting in a total seizure of all dollar deposits, and the national currency «Lebanese pound» collapsed against the dollar from 4 to 5 times what it was. Prime Minister Hassan Diab refused to pay the Eurobonds because Lebanon is a country unable to pay.

In addition to the broad negative repercussions of the impact of the spread of Corona virus around the world, which affects the economies of countries in general, and small and medium-sized companies in specific.

**SMEs in Lebanon and the Impacts of Public Debt.** After the social turmoil in Lebanon due to the financial collapse and the collapse of the pound against the dollar, the state began seeking to achieve precautionary economic policies to prevent this collapse.

According to the role of small and medium enterprises in Lebanon, which occupies 95 % of all companies in Lebanon [9], the House of Representatives issued on May 22, 2020, a law to open a credit worth 1,200 billion Lebanese pounds to support the agricultural, industrial and craftsmen sectors, which supports for small and medium enterprises.

However, this step is not progressing and is not sufficient due to the problem in Lebanon, according to the number of poor families in Lebanon, which have become higher than the normal rate. More than 50 % of the families are poor and need support at all levels [10]. Although this program is not sufficient regarding the size of the problem in Lebanon, but it suggests distributing funds to poor families, wage subsidies, and temporary tax exemptions for low-income families and small and medium enterprises.

In the same context, the director of the Lebanese Center for Studies, Sami Atallah, suggested a solution to the issue of economy and reconsidered it so that it become productive. He indicated that if Lebanon continues in this way with its economic problems, it will lose human capital, which will not be for Lebanon's sake.

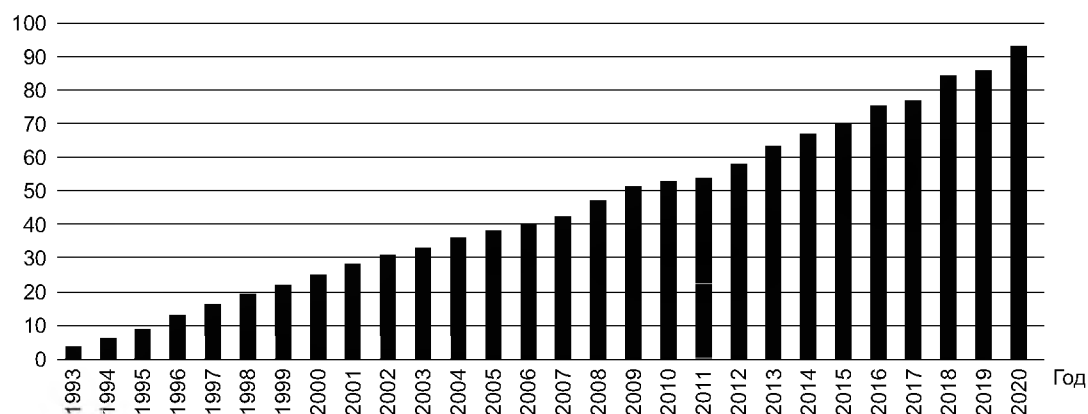


Fig. 1. Lebanese Public Debt, billion US dollars

Source: developed by the author on the basis of Research by J. Ajaki.

Lebanon's public debt, as mentioned in the diagram above, shows that [11] (92.9 billion US dollars in April 2020), or 157.81 % of the GDP [12], which means that we are in an economic, financial, and monetary disaster.

The total public debt in Lebanon reached 92.9 billion dollars at the end of April 2020, with the 0.9 % higher than the level recorded at the end of 2019.

The government fiscal deficit recorded an increase in the first four months of 2020 by 26.9 % due to a decrease in revenues by 9.1 %, In return, public expenditures increased by 1 %.

As mentioned earlier, after the November 17, 2019 revolution, the crisis began to increase more despite the high cost of living, excessive inflation, the continuation of successive demonstrations and the formation of a government headed by Hassan Diab after the resignation of President Saad Hariri on October 29, 2019.

Besides, we cannot forget the explosion of Beirut Port on August 4, 2020, which toppled the entire port and destroyed large numbers of buildings, houses, and companies in Western Beirut.

The decline of the private sector seriously threatens the economy, and many companies close their doors to avoid or stop their losses average, while some have laid off or temporarily suspended their staff (the American University of Beirut has laid off 1,500 employees) [13]. According to statistics carried out by one of the companies, 160 thousand jobs lost, entirely or temporarily! The problems these companies face are primarily the deterioration of their financial resources in foreign currency, which prevented many of them from importing goods (by virtue of the economic service structure from outside to inside). Also, bounced checks are becoming numerous and the risk of bankruptcy increases as companies are unable to cover their expenses.

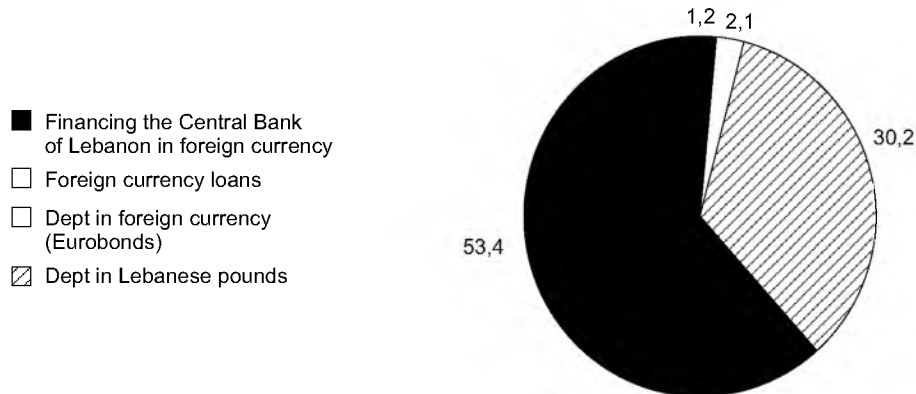


Fig. 2. Distribution of the Lebanese public debt according to its type

Source: developed by the author on the basis of Research by J. Ajaki.

Economic matters began to take a bad turn with the continuing financial economic problems and public debt accumulation that did not take any corrective measures to stop the negative repercussions of the current crisis.

The dismissal of employees has undoubtedly resulted in a high unemployment rate, which now accounts for more than 45 % of the workforce, a dangerous figure that carries the specter of poverty which originally dominated one third of the Lebanese people, and thus this proportion will rise to higher levels, and the World Bank predicted that this proportion will rise to 50 %!

The financial situation is no less dangerous than the economic and social situation. There has been a marked decline in state revenues and treasury incomes estimated since the start of the crisis by more than 400 million dollars [14]. This means that the projected budget deficit for 2019 of 7.59 % will not be respected as it is expected to exceed 10 % of GDP which is a major setback for the public finances and their rating by credit rating agencies.

At this time, the Central Bank of Lebanon covers the state's benefits in foreign currency, keeping the specter of bankruptcy away from the state. However, this cannot continue indefinitely, due to the risk of depleting the central bank's reserves and violating the rules of the financial markets.

### **Section III: Will Lebanon need reform measures to find some solutions to its debts?**

The Lebanese public debt remains the most dangerous point for the Lebanese entity. The public debt amounted to 86.9 billion dollars (June 2019), distributed among 53.4 billion Lebanese pounds, and 30.2 billion in foreign currency (mainly dollars).

#### **1. Possibilities and Remedies.**

According to Bank of America, the Bank of Lebanon owns 32 billion dollars, 28.5 billion are in Lebanese pounds and 3.5 billion are in foreign currency. Lebanese commercial banks also own 32.5 billion dollars, including 17.6 billion in Lebanese pounds and 14.9 billion in Eurobonds. Foreign investors own 11.8 billion in Eurobonds. Technically, the picture is bleak, but there is a positive crack in it: only 13.6 % of public debt is owned by foreign investors, i.e. the majority of public debt is domestic.

The absence of fiscal discipline is the main cause behind the accumulation of public debt. Fiscal discipline is analyzed by the state budget restrictions which stipulate that the total spending in the budget for each fiscal year is financed from taxes or from the issuance of treasury bills. If we want to put these constraints into a mathematical equation, we find that [15]:

$$\text{New versions (increased public debt) + Tax revenue} = \text{Public debt service} + \text{Public spending.}$$

Thus, if public spending increases with no growth in tax revenues, the state issues new treasury bonds, and raises public debt service with new issues until the level of public debt reaches dangerous levels (according to international standards, this is 60 % of GDP, while in Lebanon it exceeds 150 %)!

#### **2. Privatization.**

We have also mentioned that there is a discussion in Lebanon about the government's economic reform program in accordance with the decisions of CEDAR conference and the conditions of donor countries. The program covers a series of measures aimed at modernizing the economy and stimulating growth, including privatization and market liberalization. Privatization aims to «reduce the cost of services, improve their quality, expand their scope, increase investments, boost economic growth and activate the participation of citizens and the private sector in ownership of privatized services.»

Privatization is a relatively recent concept; whose prevalence is only three decades. The forms of privatization can be summarized in four:

- 1) privatization of Finance, in the sense of using private funds to finance a public project, removing it from its financial predicament;
- 2) privatization of production, including employment contracts, rather than using direct violence, as in government projects;
- 3) abolition public ownership of the project, i.e. selling its entire shares to the private sector;
- 4) liberalism, in the context of relaxing or removing legal restrictions on competition, prices and others.

**Privatization in Lebanon.** Under Lebanon's more liberal free economic system, the issue of privatization cannot be a shock, or it can indicate profound and radical shifts in the state's economic direction [16]. On the contrary, the transfer of ownership from the public to the private sector has been without any reaction. In the electricity sector, for example, there were companies that had concession to produce and distribute electricity in some areas (Zahle —Aley). At an early stage, the state bought up private companies, which were in troubles, including Lebanon TV, Inter investment and Middle East Airlines. During the past years, some sectors have been privatized, including cell phone, mail, airport facilities (parking) and waste collection in the capital and in some other areas (Soclin and others).

### **3. Does Lebanon need a new financial engineering schemes?**

**The objectives and impact of financial engineering at the Bank of Lebanon.** Financial engineering is one of the departments of financial Sciences which is concerned with assessing and measuring the risks to which funds are exposed, whether at the level of governments, or companies that operate within the economic sector. Financial engineering is also known as the art of dealing with financial operations that provide all investment needs to do a new project.

Lebanon is a country in need of new financial engineering [17], after its current engineering failure over the years, and my study of the general financial situation in Lebanon through my university studies and my scientific and practical experience, Lebanon needs to strengthen foreign exchange assets from the point of view that a strong balance sheet is necessary to maintain stock market stability. The Lebanese government must strengthen the capital base of banks and increase liquidity in local currency as a form of improving the Lebanese pound and quantitative easing to secure financing needs of the public and private sectors at the best cost.

In addition to improving the image of government debt by reducing the cost of borrowing, and improving the balance of payments situation by developing means to increase domestic demand and productivity by supporting small and medium-sized enterprises at all types (industrial, agricultural, and craft), thus promoting growth and development of Lebanese economy.

## **Conclusion**

In conclusion, despite all the negative aspects of the Lebanese financial image, Lebanon and its people are able to reschedule and crystallize debt and resolve the crisis. Lebanon went through financial crises in 1982 and 1994 and surpassed it.

Today in Lebanon, a government is required to address the economic division, and start working on scheduling the public debt and taking advantage of the high exchange rate of the dollar against the Lebanese pound to repay the public debt in the national currency. In addition to supporting small and medium enterprises to continue production because if companies continue to close, unemployment will rise and thus poverty will generate crimes.

Finally, I would like to recall what we have mentioned earlier about the Cedar Conference, from which Lebanon will benefit economically and financially, but Lebanon will have a new share in the public debt. Will Cedar be the savior of Lebanon? Will the government be ready to bring Lebanon back to life through Cedar?

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