Summary

Relaunch: Roadmap and its prerequisites

The economy and the government, including the Central Bank and its other institutions, are on-going concerns, in spite the challenges they are facing. They are not in a state of stoppage. All political and economic stakeholders have agreed to this. Therefore an economic growth approach should be followed rather than a plan for liquidation.

In practice, most 'Recovery' plans so far proposed by the government (and most others) are tantamount to a liquidation approach, and leading towards it. These plans have focused almost solely on the financial sector, leaving behind the fiscal, public administration, social, and economic components. These proposals and (former and present) government decisions are devoid of serious public sector and economic reforms.

In these plans, major challenges are being addressed independently from each other, such as default, subsidies, capital control and lack of, banking secrecy, maintaining an official exchange rate, and many other measures, leading to results in the opposite direction of their intentions:

- Default has led to less available liquidity instead of preserving it
- Subsidies resulted to a severe shortage of basic goods consumed by the poor and depletion of FX reserves, especially in the electricity sector
- Unofficial capital controls caused capital flight and lack of FDI
- Sustaining an official artificial lira exchange rate brought about a mafia-controlled foreign currency exchange system and multiple exchange rates,

Fixing, face-lifting, or embellishing the current plans will not lead to better outcomes. **An alternative approach must be proposed** and lobbied for with a totally different set of priorities and action measures.

The alternative plan must emanate from a participatory approach and should include as many economic stakeholders as possible, such as Trade and Business Organizations, Labor Unions, Professional Associations, and others.

On determining value of 'losses' and their distribution

Starting a recovery plan with the estimation of losses and their 'fair' distribution is in practice a liquidation approach. While resolving the problems of the past are necessary, it should be the last agenda item – not the first. It should become the exit step from the crisis rather than the entry to crisis management and resolution. A successful economic revival plan will ensure a reduction of 'losses' as asset values improve leading to an increase in the amount of deposits available to be returned to their owners. More time is needed to determine the share of responsibility of each stakeholder (State, BDL, Banks, and Large Depositors). The various models currently being proposed are too arbitrary, and are based solely on past, rather than on future ability to produce cash flows. The arbitrary approach is politically untenable, as noticed since the first Lazard draft, up to the latest government proposal to Parliament.

The future first

More than half the citizens – and they are the poorest half – never had, or no longer have, deposits in banks. Their concerns are to find jobs or to increase their current meager incomes. Therefore, relaunching the economy, creating job opportunities, raising wages, especially for public sector employees, and creating a balance between state revenues and expenditures, should take priority over booking losses on paper. Actually, they are prerequisites to address the issue of deposits. Managing the future should take precedence over dealing with the past.

Agreement to replace contention

The State – if it wants to be successful and gain trust – should start with issues that can gather near consensus, or at least the largest extent of agreement. Right now, it is starting from the point that creates the most contention. Presently, it will be impossible to reach a point where enough political backing can be garnered to support any level of determination of losses and their distribution. The political battle will overwhelm any compelling distribution of 'financial losses'. The current government's approach is focused on financial restructuring, i.e. dealing only with deposits in banks, and proposing ad-hoc laws, hastily written, uncoordinated with other measures. There are many problems with this approach including its potential unconstitutionality, lack of outlook for the future, lack of economic growth drivers, and grave pitfalls in a budget proposals and forecasts for revenues and expenditures, and independent from impact of other government actions (or lack of).

Alternative Plan: Relaunch the Economy

An alternative plan should prioritize economic growth oriented, immediate-results yielding, and confidence building measures. The plan should be sequenced to start with areas of consensus and slowly navigates towards contentious issues, with the expectation that the results of the first actions will partially minimize the pain caused by the requirements of the financial restructuring. Priority should be given to helping economy growth which will engender increased revenues to the Treasury and other economic benefits. The plan should be comprehensive, announced as a full package with an associated timeline of reforms and measures.

Relaunch measures: 10-points

The alternative **Economic Relaunch** plan should be focused on immediate measures to be initiated by the government in collaboration with the private sector. The plan can be agreed to and announced even before reaching a final agreement with the IMF.

The following is a simulation of what a (near) consensus plan may look like – but stakeholders can agree to a different scheme. In no particular order, because all points must be undertaken simultaneously, the comprehensive plan may include the following:

1. New Socio-Economic Pact

Negotiate and declare a new socio-economic pact, as a comprehensive and balanced package that determines policy for public sector wages, minimum wage in the private sector, social protection measures, and taxation scheme that includes direct and indirect taxation mechanisms. The pact should include an immediate plan to rescue and recapitalize the NSSF.

2. Special rules for fresh funds

Restart banking activity with 'New Money' where fresh funds attracted by banks, as equity or debt, would be shielded (i.e. not diluted) from past liabilities (old money – pre Oct 2019), and where loans in fresh funds given to individuals and companies must be repaid also in fresh funds. Pre-crisis equity, assets, and liabilities are addressed in the 'Dealing with the Past' section.

3. Free the exchange rate

Freeing the exchange rate will render unnecessary for the Central Bank to require and keep large foreign exchange reserves and will also ensure a balanced Current Accounts since outflows will necessarily not be able to exceed inflows.

4. Public debt restructuring
Debt restructuring will include State debt forgiveness by the Central Bank. There are several possible mechanisms to achieve that. This would erase two thirds of outstanding public debt. Debt in foreign currency (mostly Eurobonds), held by non-bank entities can be repurchased on the open market at a 75-90 percent discount or rescheduled with current holders. Eurobonds held by local banks will become part of the bank restructuring mechanism and could be converted into perpetual non-interest bearing bonds (rendering them as equity), or treated in an alternative matter.

5. Offloading to the private sector
Electricity, telecom, and other public utilities should immediately be handled by the private sector, and services should be priced at a premium to actual cost. The management of these public utilities should be offloaded to the Sovereign Holding Company (see point 6). All rate subsidies must be removed and replaced by subsidies to needy families as per the Poverty Alleviation Fund (see Point 7). The State should retire completely from telecom and the production and sale of electricity. Electricity can be sourced from private sector producers and/or procured from other regional countries such as Turkey, Jordan, Egypt, and the UAE, either through a direct cable or via the Arab Electrical Grid.

6. Sovereign Holding Company
A 'Sovereign Holding Company' (SHC), fully-owned by the government, managed by a Board of Directors appointed by a steering committee of multilateral development organizations (IFC, EIB, etc.). The SHC will take possession of all utilities, unused property and real estate, and income generating infrastructure projects. It will be responsible to corporatize them, and place them under private sector management and depending on each case may have its ownership privatized, partially or fully, at an early or later stage. The State should withdraw totally from productive activities such as electricity generation, operating telecom companies, etc. Net revenues from the SHC will go to the State Treasury, the Poverty Alleviation Fund, and the equity of the Central Bank.

7. Poverty Alleviation Fund
All product subsidies should be eliminated – except very expensive medical treatments (limited to low-income patients not covered by NSSF or other insurance schemes) – utility rates, and other subsidies. Direct subsidy or cash transfer to needy families will be provided instead. A Poverty Alleviation Fund will instituted and financed by the Treasury, partial receipts of the SHC (point 6), and donor countries and organizations.

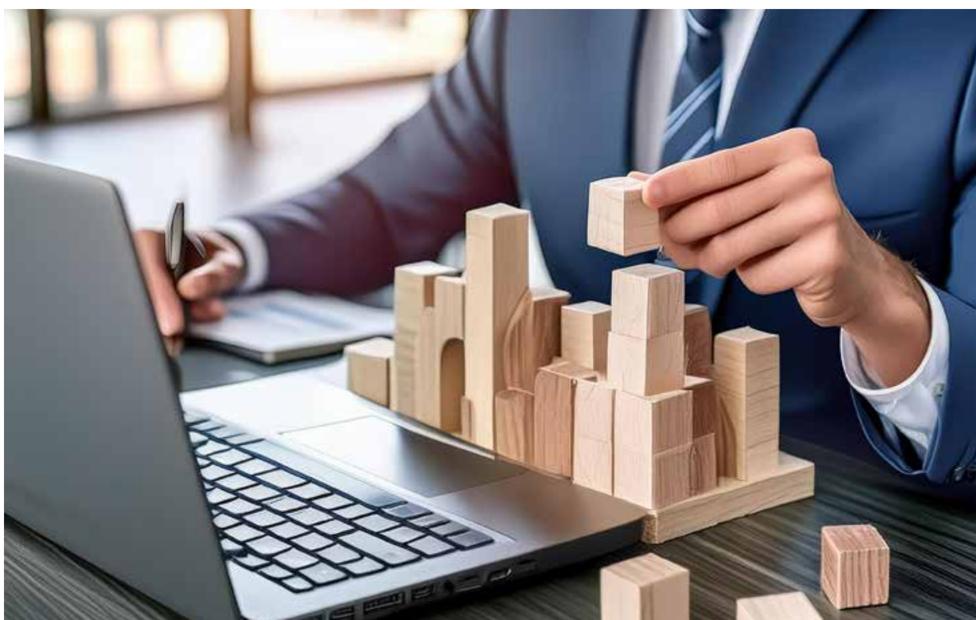
8. Fiscal policy
Reforming public finance must be implemented in phases. During the first phase, the focus should be on what is practically achievable, even if it is not optimal. For example, direct taxation should be (temporarily) eliminated on individuals and companies except for financial sector, insurance, and large holding companies who currently constitute almost the totality of receipts. Indirect taxation should be increased to its maximum tolerable levels. VAT rates may have four levels: zero rate for currently exempted good and services (food, residential rents, etc.), maintained at the current level for locally produced products and services, increased to 20 percent for imported necessities (such as small cars, home appliances and electronics, etc.) and 30 percent for imported luxuries (large cars, perfumes and clothing, furniture, etc.) After stabilization (3-5 years) and reaching a balanced budget, the tax system can be overhauled, with a progressive direct taxation implemented in parallel to a total modernization of the tax estimation and collection mechanisms. The IMF and other donors may bridge the budget deficit during the period of stabilization and reaching a primary surplus.

9. Growing the private sector one sector at a time
More than 250 measures have been identified (See section III) that together will remove barriers and incentivize the private sector. These include sectoral as well as across-sector measures. A large portion of these measures do not require much financing and can be passed by ministerial decrees or laws in Parliament.

10. Oil&Gas
Attention has been so far focused on the county's southern maritime borders. Attention should shift to uncontentious maritime blocks. They should be tendered out, all simultaneously, in order to speed up exploration. Any achievement in this field, will improve the country's risk profile.

Short term expected results
Major yearly GDP growth, natural increase in private and public sector wages, job creation and reduction of unemployment, improvement in revenues to the Treasury, freeing the exchange rate, growth in consumer spending, spurring of investment in SMEs and large companies, improvement in the Current Account deficit (from tourism, exports, and remittances), restoring the health of the financial sector and start restoring and growing relationships between banks and their clients, and taking the first steps towards restoring confidence in the State and the financial system.

Medium-term objective: Administrative reform
The current structure of the public sector, dating from decades ago, needs a full revamp. There is a glut of employees in many areas, and a severe shortage in others. A new structure must be designed, taking into account administrative decentralization where necessary, in parallel to further centralization towards digital systems. Several ministries can be consolidated or be outright eliminated.



Dealing with the past

Obviously, the plan would be a non-starter if it does not include a reasonable and achievable plan on dealing with liabilities to depositors and debt holders.

1. Deposits have evaporated

Acknowledge officially that the deposits have mostly evaporated, and servicing the debt at its face value has become impossible. A portion of the deposits in foreign currency was the result of internal money creation, i.e. not from inflows. They were used to finance a large deficit in the balance of payments, and a deficit in the public finances.

2. Rights are preserved

Acknowledge that the rights of depositors and debtors are fully and legally preserved. Declare a total moratorium on repayment to depositors and debt holders during the revival phase (3-5 years) – with exceptions of small deposits to the maximum possible extent – during which time the authorities and banks will negotiate repayment terms with each class of right holders, in light of financial results from implementation of revival measures.

3. Restating financial figures in real terms

The needed financial and fiscal adjustments that donors have called for have actually occurred for the most part. The public accounts have been almost zeroed out but at a tremendous the social and economic cost.

- The public debt had reached nearly $100 billion in 2019, a third of which was in foreign currency. The Eurobonds' market value (most of foreign currency debt) is a small fraction of its nominal value ($31 billion plus accumulated interest). Debt in lira outside of the Central Bank is almost nill.
- The debt-to-GDP ratio has declined from around 180 percent to probably less than 30 percent, depending on how GDP is going to be calculated.
- The State has reached a fiscal stalemate, resigning most of its duty to collect or spend. It is levying a small fraction of what it should in revenues, and unable to shore up its expenditures to make up for the loss of purchasing power of the heavily devalued national currency. Public revenues and expenditures have both declined tremendously to result in a small budget deficit when expressed in real dollars.

4. Vast reserves are still exist
It should be recognized that the $25 billion in gold and more than $10 billion in foreign currency reserves (totaling more than $35 billion or more than 100 percent of GDP) are more than enough to restart the economy – especially if the exchange rate is totally freed and no longer requires large foreign currencies reserve at the Central Bank. These assets should not be used to support erasing past liabilities, but rather to support future economic growth.

5. Deposit restitution
It is obvious that the banks have lost almost all their equity due to the depreciation of the lira, the conversion of dollar into 'lollar', government default, and losses in the commercial market. Banks have retained a substantial part of their fixed and human assets such as branches, information technologies, processes, and bank employees. They have an immediate ability to survive with the 'new money' scheme proposed (Item 2 in the revival plan outlined in the previous section).

There have been a number of proposals, from the IMF, official plans, and plans proposed by others to deal with how to restitute the deposits to their rightful owners.