The prospects for better governance

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Hardly a serious narrative on the Lebanese economy is without warnings of an impending calamity. Dreary as the refrain may have become, it admittedly has more than a grain of truth to it. An interesting twist to the saga saw renowned international institutions joining the Lebanese in harping on the theme of disaster, only in much stronger wording and along much better analytical lines of argumentation.

The official international reports that leveled stern criticism at Lebanon's defective system of governance may be expected to have an even stronger negative influence on investments and expectations than the country's unfavorable risk ratings.

Recent political change has rekindled expectations of far-reaching reforms and placed the country in a liminal space between hope and despair. However, the battle for better governance will prove daunting because the rot has metastasized to all layers of government and has led to the emergence powerful partnerships that have acquired political immunity to purge or prosecution.

Seven cardinal failures of governance

On more counts than can be counted Lebanon's economic governance has heightened country risk and led to sovereign debt instruments earning their mediocre marks. As a matter of fact, nearly all key factors scored for the purpose of country-risk assessment conjure up instances of failure. The feat in this regard is that seven cardinal failures of governance are present in one polity.

One, at systemic level, political institutions are growing weaker; they are buckling under the endless rivalries for turfs of influence within the state administration. Evidently, the worn-out, clan-based power-sharing formula has gone awry; it has morphed into a scheme to create confessional fiefdoms within state institutions. This has inexorably intensified corruption and its nefarious impact on investment and competitiveness. Worse, it has undermined what modicum of national cohesion may have existed in epochs past. Currently, the anachronistic power-sharing arrangement is proving to be a formidable impediment to democratic change.

Two, the dismemberment of state institutions has naturally engendered a defectuous policy-making process. Economic management was thus rendered ineffectual as the tools of fiscal policy were neutralized by heavy public indebtedness.

Indeed, the economy still suffers from the failure to do away with unrestrained deficit spending, which has been an ever-receding milestone on the path to fiscal reform and the containment of the public debt. This is compounded by the absence of a clear vision for the structural reforms needed to unshackle economic potential.

Three, the absence of social policy is further degrading economic management. It is surely a sign of deficient governance to entertain the erroneous belief that social policy is not an aspect of economic management and that social spending is the do-good act of a benefactor state.

Through its re-distributional function, its positive impact on employment, and its counter-cyclicality, social spending enhances the effectiveness of other instruments of macro-economic stabilization.

Additionally, social spending is an obligation of any state worth its name toward the nationals of that state; and it is a right mentioned in unambiguous terms in the Universal Declaration of Human Rights.

However, in a failing system of governance, whatever state resources masquerade as 'social spending' are in fact apportioned, recurringly, annually, punctually, to the proxies of the system's guardians. The folly of digging persistently into what is unthinkingly seen as an ever-flowing cornucopia eludes no one but those guardians.

Four, the ineffectiveness of the executive branch of government is exemplified in the decades-long failure to implement any reform, social, economic, institutional, or structural, and the failure to address grave disparities in incomes and wealth, rampant unemployment, accelerating emigration, and growing poverty.

Five, the endemic sloppiness in the enforcement of the rule of law is seen in the failure to prevent or penalize the misappropriation of communal property, the failure to restitute state rights to that property, and the failure to bring to justice violators whose means and 'status' trump the law. And performance is just as miserable in the prosecution of common criminals.

Six, policy inertia and complacency have led to the degradation of the environment and explain the failure to preserve precious natural resources and ration them across generations.

Finally, a long-drawn deficiency in statesmanship was the prime cause of the failure to attenuate the impact of a threatening geopolitical conjuncture on the country and the economy. As a matter of fact, until recently the kakistocracy had left the country helmless, rudderless, and anchorless amidst a mighty regional tempest.

Do these risk-assessment factors warrant the lackluster score on the country risk scale?

To be sure, these failures have been known and condoned for so long that they have become certainties and, as such, they should presently be of limited significance to risk assessment, risk being contingent upon uncertainty.

Country risk assessment, though partly influenced by existing afflictions, is in fact more strongly determined by the threat that negative dynamics could worsen initial ailments. Festering maladies are indeed prone to degenerate into dire sufferings. Barring the chimera of a system reset, a country-rating model worth its salt will therefore factor in a blend of likely worst-case projections.

In an endgame, skyfall scenario, crumbling political institutions could tip the country into a failed state status; bad economic management could trigger a public debt crisis, or worse, outright default; obliviousness to the need for reforms could trigger social unrest; protracted contempt for the rule of law could foster a breakdown of law and order; a degenerating confessional system could splinter the country; the fast degradation of the environment could develop into an ecological crisis; corruption pushed to the extreme paves the way for a kleptocracy; and, in an explosive geopolitical backdrop, petty politicking could lead to loss of territorial integrity.

Are these deficiencies in governance sustainable? Arguably and unfortunately some of them are, at least for as long as Lebanon's gross national disposable income remains larger than gross domestic product by an inordinately wide margin. (And for at least that long, pop 'economists' will carry on struggling valiantly to figure out a composition of GDP that adds up.)

One arrow left in the quiver

With growing difficulty and certainly at a growing economic and social cost, the country has retained its capacity to keep capital flowing in. And most importantly, astute liquidity management – costly as it may have been – was arguably the only option left to preserve monetary stability, given the many deficiencies in governance. Monetary restraint has also forestalled excessive public borrowing that could have expectedly been fueled by senseless reliance on the security of inflows.

Inevitably, the central bank had to finance a mounting portion of the public debt, and its portfolio of that debt's instruments has doubled in size in three years.

However, criticism of that policy seems to be oblivious to the fact that the monetary tool is the only remaining means of macro as well as systemic stabilization.

Of ratios and bright spots

A few metrics expressively depict the twinkle in the gloom. Over the past decade and a half, resident private deposits grew at an average compound rate of nearly nine percent whereas the average growth rate of the net public debt was six percent. Growing at such a faster pace, these deposits are currently twice as large as the net public debt. This is quite an improvement compared with a ratio of net public debt to private deposits of 85 percent earlier in the past decade.

The numbers show an even more pronounced improvement when the resident private deposits in foreign currencies are compared with the foreign exchange portion of the net public. The ratio of the latter metric to the former has gone down by no less than 25 percentage points over the past decade and a half.

These numbers should certainly not be interpreted to mean that there still is a margin for additional public borrowing, nor are they meant to condone fiscal laxity or encourage basking in complacency in the face of the huge public debt overhang. Quite the contrary. Fiscal laxity, fiscal-policy paralysis, and a massive, unrepayable public debt are symptoms of a sinister ailment: that of a failing political system.

Still, there is an intricate story behind the numbers that show net public debt actually falling relative to even a portion of total deposits, a story that stokes hope amid shambles. And the capital inflows metric is central to that story.

In its briefest, the narrative runs as follows:

Where inflows normally raise national disposable income to a level much higher than gross domestic product, a country runs two sets of risks: one relates to demand-pull inflationary pressures, and the other to pressures from the public sector to indulge in inflows-fuelled borrowing and spending.

In Lebanon's monetary context, both sources of instability were successfully contained, as evidenced by the facts that rates of inflation have, for two decades, been mostly confined to the low single digit scale, and the growth of deposits is outpacing – at an accelerating speed – the growth velocity of the public debt.

Success in this 'dual containment' may not fully compensate for debilitating systemic failures, but it does mitigate the harm wrought by some of the lesser deficiencies. And if nothing else, that success at least pushes back the day of reckoning.

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