A LEBANON FOR THE DIGITAL ERA

Jeremy Arbid

The years since unrest swept across the Arab world have shown that the response of partial reforms and economic measures were not sufficient. Instead, new social contracts are required to develop economies and human capital, and to emphasize political participation of proactivity over favoritism. This decade has been marked by two shocks, the first being the unrest of populations that led to unrest, revolutions, conflict and civil war in some countries, and the second being the decline of oil prices. Similar to other economies in the region, but not in form, Lebanon's is rentier because the state largely ignores productive sectors and instead focuses its fiscal and regulatory policymaking to the benefit of the financial and real estate sectors. So while Lebanon's situation is certainly different from its neighbors in the region its question is the same: now is the time to develop a more peaceful and prosperous society, so what should that look like? Artificial intelligence and the Internet of Things will have a great impact on countries around the world, including Lebanon. However, Lebanon's current economic model is unfit for the digital era and not agile to adapt to economic innovation and rapid technological change. In the short term, Lebanon will need to invest in the economy by building and rehabilitating infrastructure and it will need to implement a reform agenda. By doing so, a more dynamic economy can be built.

The Current Situation

Lebanon's economic model is not sustainable. This has been understood for years now but has been allowed to keep operating, even though it has been known that the currency peg to the USD was not designed or engineered for the long term. According to the International Monetary Fund (IMF), public debt was estimated to reach $85 billion in 2018 with GDP expected at $57 billion, for a debt-to-GDP ratio of 150 percent. Meanwhile, economic growth has slowed from 8 percent in 2010 to 0.6 percent in 2017, as measured by the Central Administration of Statistics.

For 2018, the IMF has projected GDP growth at just 1 percent. In the same period, 2010-2017, Lebanon's spending deficit (including interest payments on debt) averaged $3.6 billion each year according to ministry of finance figures. The economic model relies on internal USD circulation, and depends on the financial and services sectors, tourism, foreign direct investment mainly in the form of real estate, and remittances.

In recent years, not enough dollars have been entering the economy to offset dollars exiting at an increasing rate. From 2000 to 2014, the average annual deficit of the current account – the flows of goods, services, primary income, and secondary income between residents and nonresidents – stood at $5.1 billion each year. By 2015, $9.1 billion more flowed out of Lebanon than in, and that figure has risen sharply since 2015. For 2018, the IMF projects a current account deficit of $14.5 billion, and $15.2 billion in 2019. For the foreseeable future, the lira-to-USD currency peg can be maintained, which the IMF recommends. This is thanks to large reserves held at

Banque du Liban, Lebanon’s central bank.

According to the IMF, official reserves – foreign currencies, other assets denominated in foreign currencies, and gold reserve – stood at $36.7 billion in 2015 and rose to $40.2 billion and $40.6 billion in 2016 and 2017, respectively. The IMF calculated official reserves at $36.4 billion in late 2018, and projects reserves to decline to $31.1 billion in 2019. Public bank officials and commercial bankers insist Lebanon is not at risk of a forced devaluation because of the level of foreign currency reserves held by the central bank. The state plans for a course correction With a new government in place Lebanon may now work toward restructuring the economy. The starting point for this was in April 2018 at the CEDRE for infrastructure investment.

In Paris, Lebanon presented donors and investors with a Capital Investment Plan (CIP) to develop the country’s infrastructure and ease supply-side bottlenecks. According to state officials, the CIP was prepared to address specific economic shortcomings: tremendous challenges in public finances, monetary policy that has exhausted all options to maintain stability, low growth rates, high unemployment, increasing levels of poverty, and the balance of payments problem. Lebanon needs 5 percent growth to stabilize the economy and maintain the economic model but has been reluctant to invest in the economy and the country’s infrastructure is worn down because of years of low state investment and overstretched because of the large refugee population plus a growing national population.

To rehabilitate and expand the nation’s infrastructure, the CIP would raise debt and called for an investment need of $20.4 billion, plus land expropriation costs of $2.6 billion for 250 projects that could generate some 178.3 million labor days over three phases each lasting about four years, from now until 2030.

At CEDRE, the CIP pitch was generally well received with donor countries and multilateral institutions pledging $11.3 billion mostly in low-interest loans on the condition that Lebanon commit to reforms. The reforms promised by the state involve fiscal discipline measures – mainly through the reduction of the debt-to-GDP ratio by decreasing the deficit by one percentage point of GDP over the next five years and reducing the subsidy to the failing public electricity utility, Électricité du Liban (EdL), which averaged $1.6 billion per year between 2010 and 2017 according to figures from the ministry of finance, and by shoring up revenue to the treasury by increasing the tax base.2 In February 2019, Lebanon’s Economic and Social Council – an advisory body to the government – issued a report on fiscal measures the state should adopt to address fiscal imbalances, including: elimination of the EdL deficit over the next three years; to reduce the cost of public debt servicing by at least 10 percent through a mechanism that the government, BdL, and commercial banks agree on; and, to reform public sector pension systems and benefits, review public sector personnel and positions, and freeze hiring for the year. To spur economic productivity and enhance the private sector environment international organizations have advised Lebanon adopt an evolving list of structural and sectoral reforms and doing business measures.

The state commissioned management consulting firm McKinsey & Company to draft a vision for growing Lebanon’s current productive sectors and enhance productivity and recommend what sectors Lebanon should focus on in the future. At its core, the vision aims to channel investments to industries and productive sectors that would have a multiplier effect, create jobs, and distribute income and wealth. The elements of the report include repetition of known analysis, assessment of reform needs and priorities, improvements of productive sector performance, and supervision mechanism for achieving deliverables for the productive sectors and projects.

Components of this vision require individual assessments. Addressing and adopting the measures promised at CEDRE, advised by McKinsey, and recommended by international organizations will only be a starting point in correcting for nearly 2 decades of inactivity or nondecision making by the state.

However, implementing reforms and thinking toward the future is not so simple for Lebanon. On the one hand, politicians and officials have been repeating since before CEDRE that reforms are necessary and that reforms will be painful to the political elite. If this is so, then maybe we are witnessing an alignment of politics to reality, and the adjustment of culture to support or translate into action takes a long time. On the other hand, Lebanon’s political economy of sectarianism means the political elite are only interested in maintaining the system of clientelism and patronage networks. How these reforms will serve the interests of the elite in this political economic system is unclear. Another problem is that Lebanon’s politicians and officials are thinking where the country needed to be 25 years ago. The challenge is the speed of innovation, and today when a highway or bridge is built it is not guaranteed they will be viable solutions as critical infrastructure. Why? Because of three factors: on the social side of self-reliance of urban environments and the ability of communities to produce what they need could grow exponentially, then the need to trade with neighbors and the paradigm of growth under capitalism may no longer be applicable; if global commerce continues then using non-road based technologies like information transmission to remote locations (such as 3D printers or drone transport) could actually make highways or bridges obsolete. At the current phase Lebanon is still betting on traditional transportation as our viable economic need for 20 or 30 years and beyond when we should have had them 20 or 30 years ago. Another example is the building of power plants with natural gas instead of coal. This fuel source is more efficient and less polluting, but it still exposes Lebanon to fossil fuels and commodity price increases and supply reliability.

However, this might not be the only solution to match electricity supply to need. Lebanon might find decentralized technologies (such as solar photovoltaic) and smaller scale centralized power generation as more efficient and cost productive.

Lebanon is committed to solutions that were conducive in 1999 and therefore there is too much opacity in developing and implementing solutions. There is uncertainty because no one knows what new technologies will come along; there is opacity because we do not know how diligent the CIP and other studies were conducted and whether they are or are not silo-esque; plus, the experts that have been hired to design these visions or plans are definitely not going to tell Lebanon to not buy their products. Beyond correcting the omissions of the last 20-25 years Lebanon must continuously evaluate and prioritize economic and infrastructure needs and pursue solutions aligned with the emerging digital future sure to arrive within the next decades.

Lebanon’s Socioeconomic Situation

Lebanon must be positioned for the digital era in addressing the top socio-economic challenges: that of the lack of gainful employment, rising inequality, and promoting inclusive political participation. The country has grim numbers on unemployment, poverty, income inequality and net worth. The economic bleeding that is visible at the national level in terms of almost a decade of economic stagnation pales in comparison to the situation of individuals. The downturn in Lebanon’s economic output has pushed more people into unemployment or underemployment, increased poverty rates, with income and wealth becoming increasingly concentrated. According to an International Labour Organization (ILO) model, estimates of the total unemployment rate among Lebanese nationals at just under 7 percent in 2018. Unemployment for Lebanese youth is estimated at almost 18 percent. Total labor participation for Lebanese nationals older than 15 (the proportion that is economically active) stood at 47 percent, with the number of people in the labor force above 2.2 million in 2018.

Among the nearly 1 million UNHCR-registered Syrian refugees the ILO in 2017 projected the size of the Syrian labor force in Lebanon at 384,000 and estimated that 36 percent were unemployed.7 McKinsey says Lebanon's unemployment rate is between 15-25 percent, perhaps the consulting firm is attempting to include the informal labor market as part of its calculation. The first target of the UN Sustainable Development Goals for Lebanon is to reduce the poverty rate to zero by 2030. Lebanon is far from achieving this goal, though the available statistics are very outdated. 2008 poverty stats from a Ministry of Social Affairs and UNDP joint study showed back then that “28 per cent of the Lebanese population can be considered poor and eight per cent can be considered extremely poor”. That means that some 1 million individuals in 2008 were living on $4 per day and another 300,000 were living on less than $2.4 per day. According to a Ministry of Finance/UNDP study from 2017, income inequality in Lebanon is very high. The study analyzed tax declarations from 369,279 taxpayers who had a cumulative income of $5.5 billion, and an average yearly income of $14,846: “the top 2 percent income group accounts for a 17 percent share of total income, while the bottom 59 percent accounts for a 22 percent share”.

Wealth in Lebanon is also unequal, according to investment bank Credit Suisse. The net worth per adult was estimated to $33,726 in 2018.10 But a breakdown shows how little the majority of the population actually owns: 77% of Lebanese adults have a net wealth below $10,000.11 On the bright side, according to the World Bank, human capital constitutes the leading amount of wealth for Lebanon.12 However, estimations and projections about the size and composition of the Lebanese labor market entail much that remains uncertain as far as data accuracy. Likewise, labor policy as well as estimations of future Lebanese labor realities, needs, and opportunities in context of the rapidly evolving global digitization of work, or digital transformation of economies, leaves much to be desired. This makes it crucial to develop our human capital and preparedness for labor uncertainties of coming decades.

Addressing Current Challenges to Join the Digital Era

1. To create employment

Determinants of current and future labor markets and historically important processes such as labor unionization, collective bargaining, regulation of admission to specific labor markets, evolution of social insurance in reflection of social and human conditions (such as increasing longevity) in the past and predictable future over the lifetimes of current workforces are in need of new assessment before embarking on development of a new national labor policy. New policy, however, has to be devised and function as a cornerstone for a sustainable future of Lebanese labor if one takes into account that much of the regulatory framework governing Lebanon’s labor-related social insurance system date back to the early days of the Republic, while the framework for the social security fund and other retirement benefits date to the 1960s, and thus, by the very logic of the importance of labor in human societies, are inadequate for managing today’s radically different and rapidly changing role of human capital in our society.

To project unemployment we must know how many people reside in Lebanon. The World Bank estimated Lebanon’s population at just over 6 million in 2017, counting citizens, refugees and others residing in country,13 but Lebanon must conduct its first population census since 1932.

Job creation in the near term is important, but the concern is that Lebanon's labor market will continue to be one where there is not much to apply to. The World Bank announced in 2018 $400 million to create up to 52,000 jobs for Lebanese over the next 15 years.14 Lebanon will need to create more – not just 370,000 "incremental jobs" in the agriculture or construction sectors by 2025, as McKinsey recommends,15 but high-quality jobs in the digital economy because as automation rises robots can take the place of lower-cost labor. However, if Lebanon manages
to be an early adopter of digital business structures among other global communities of similar size and capacity, it could become a potent supplier and competitor of high native human capital and high native marketing potential, and the trade heritage of Lebanon could be translated into an economic force for the country. Another question for the future is how to define fair profit and to control for excesses of inequality. Lebanon is not alone in the necessity to remove economic distortion in the sense of injustice, where today a huge amount of labor goes into unpaid or undervalued work (historically mostly from women), and to work that cannot or may not be desirable to automate in the future (e.g. child rearing or geriatric care). However, society would have to approve the value of "volunteer" labor and current economic paradigms do not have formulas to recognize this.

2. To relieve pressure of despondency and object poverty

To alleviate extreme poverty in the near term, Lebanon's National Poverty Targeting Program (NPTP) must be enhanced and broadened to support more qualifying beneficiaries. NPTP provides support to households living in extreme poverty through a humanitarian asset transfer to eligible recipients in the form of $27 in cash/cash equivalent per household member per month and is partly funded by the World Bank, while the state must include funding to widen the program in the next state budget.

Combating inequality is secondary to the increasing or broadening of social and economic mobility. Lebanon has had provisions of social subsidies but has spent a lot of effort deciding on who gets them, and, unfortunately, has had a lot of experience with political clientelism.

Despite implementation challenges, Lebanon can stimulate economic mobility and redistribute wealth into broader social safety nets through such ideas as universal basic income (UBI), universal basic health (UBH), the expansion of basic provision for education and higher education and guarantees of survivability in times of difficulty. Whichever way this is done should not be discretionary or based on eligibility but universal and without a component of assessment on worthiness of aid.

According to the World Health Organization, Lebanon spent nearly 8 percent of GDP on healthcare in 2016.17 The moral hazard of UBH when the state guarantees payments is that there is no incentive by companies to control pricing, but the state can promise to pay for wellness programs and preventative care plus basic healthcare so that higher costing medical care is less common. Inflation drivers of healthcare are not in the payment for healthcare workers, and the number of workers in Lebanon and their cost is not high when compared to the cost of imported medicines and imported technologies.

3. To minimize the excesses of inequality by redistributive measures and promote inclusive political participation

Before Lebanon can do any forward thinking, it must implement the reform promises of the new government and made at CEDRE and implement the performance enhancements compiled by McKinsey and international organizations. This is a starting point in correcting for almost 2 decades of inactivity or non-decision making by the state and implementing reforms will be a first step in reducing public debt.

The priority is to have accountability of public finance from the past and moving forward, to have public and transparent discussions over fiscal and taxation policy to prioritize stimulation of the economy and improve the internal distribution of wealth, and to have an annual budget and audit in line with the Constitution and public finance rules.19 To begin, the state must fully collect taxes that are already on the books by increasing tax compliance, and it must implement measures from the 2017 tax bill such as leveling fines on built-up property on state or public lands. According to the IMF, tax collection stood at only 50 percent of capacity in 2013.20 Along with shoring up spending and revenue collection comes the need to reduce waste.

Everyone assumes corruption in Lebanon is a serious problem, but the Court of Accounts first needs to measure the problem and Parliament needs to decide what to do with the findings. The state has not conducted an audit of public accounts since at least 2003, and in reconstituting accounts from the 1990s and the 12-year period where there was no state budget, the ministry of finance has said "enormous anomalies" were found.21 So if the state's objective is to spend and collect to meet the people's needs then there must be confidence that taxpayers are not being swindled.

Rather than proposing any sort of administrative decentralization, electoral redistricting, or changes to the political structure, Lebanon must exercise better management of public finances to foster political inclusiveness in two ways: first, to promote ownership by the taxpayer of state decision making; and second, to minimize the power of international markets through the instrument of debt which can be greater than the voting power of citizens.

So that Lebanon can create a situation for a consistent and sustainable economy in the digital era, it must heed the recent advice that the head of the IMF, Christine Lagarde, directed to the Arab world: "We need fiscal space for spending on health, education, social protection, and public investment."22 Lebanon's fiscal policy, therefore, must be focused on meeting people's needs and enhancing the connection between fiscal policy and social safety for a higher certainty of entitlement as a taxpayer, and increasing a sense of justice and mutuality between tax contributions and long-term social benefits.

Recommendations

Lebanon must position itself for the digital era by building a sustainable economy for a more peaceful and prosperous society. This requires job creation in the near term by committing the reform promises made at CEDRE to unlock promises of donor financing for the CIP. Long term planning should consider the predictable future demands of the labor market, the reduction of inequality through job creation, increased economic mobility, the designation of social safety nets, and the redistribution of taxation. To promote ownership of state decision making, and to enhance inclusivity in the political process, Lebanon must commit to sound management of the state treasury and accountability of past public finances.

Labor market and job creation

● Review the mandate of Lebanon's National Employment Office (NEO) to boost labor participation and reduce unemployment.

● Match available labor demand with projects in the CIP for work opportunities in the near term.

● Before embarking on the creation of a new national labor policy for the digital era, Lebanon must fully assess past and present labor market conditions and workforces by setting a statistical foundation, in the form of a population census and other statistical surveys. This would require auxiliary actions such as empowering the nation's public statistics body.

● Draft and adopt a new labor policy for the digital era by addressing such areas as: labor unionization; collective bargaining; regulation of admission to specific labor markets; health, safety and laborers’ rights; and social insurance.

Social insurance and equality

● Develop and implement a poverty reduction strategy.

● Widen the reach of the National Poverty Targeting Program (NPTP) for those living in extreme poverty, and devise and enact viable safety net programs including direct payments for those below the poverty line. Allocate state funding for the NPTP and new programs.

● Review and update legal and regulatory frameworks of social insurance systems and safety nets.

● Review and consolidate current social insurance systems. Create new social safety nets with universal access to stimulate economic mobility and redistribute wealth.

Promoting political inclusivity

● Review and adopt fiscal and state reforms and business enhancement measures promised at CEDRE, documented by McKinsey, and presented by the Economic and Social Council to reduce public spending and stimulate economic productivity.

● Implement a monitoring mechanism to oversee the deployment of CEDRE donor funds to CIP projects, and which contributes to the continuous evaluation and prioritization of economic and infrastructure needs.

● Increase tax compliance and fully collect taxes and fees already on the books to shore up state revenue. Review and commit to public discussions of taxation policies before any revision of the tax code.

● With an international auditor, audit finances from past years as per the 2005 budget law.

● Commit to an annual budget as per the Constitution and public accounting rules.

● Draft and align medium- and long-term fiscal policies to meet people’s needs and enhance the connection with social safety and increase a sense of justice and mutuality between tax and fee contributions and public spending

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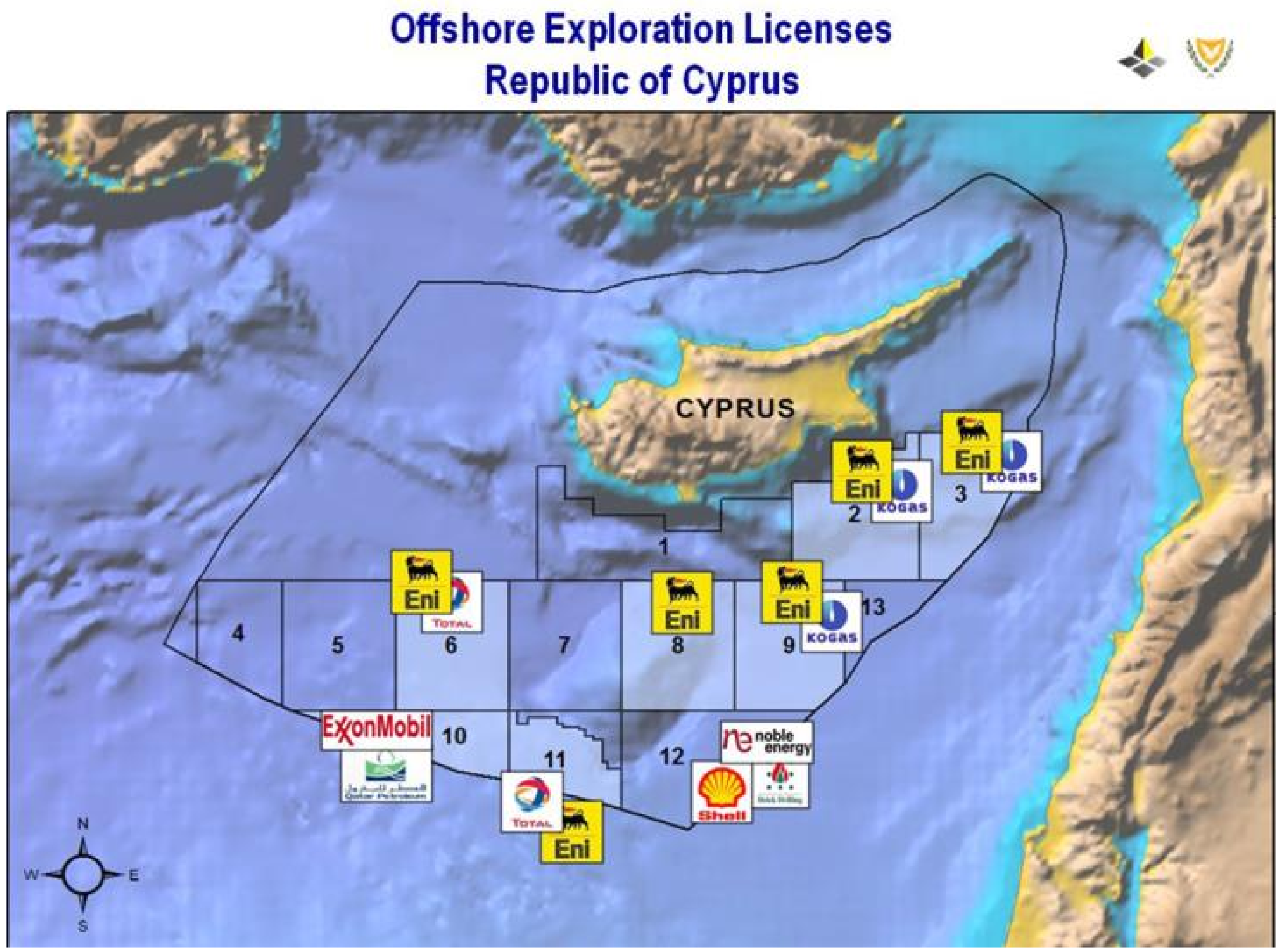
Cyprus warns with international arrest warrant those assisting Turkish drilling in its EEZ, CNA reveals Radio message



Cyprus calls on the Turkish drill ship “Fatih” and supporting vessels to immediately cease illegal actions in the country’s exclusive economic zone and warns with a message through Radio Cyprus that individuals and companies supporting illegal actions will face all consequences, including an international arrest warrant.

CNA obtained a copy of the message of Radio Cyprus to “Fatih” and supporting vessels, which reads as follows:

“You are conducting illegal operations in the exclusive economic zone and the continental shelf of the Republic of Cyprus. Your actions are violating the international law and maritime safety procedures and you are committing serious criminal offences under the laws of the Republic of Cyprus.

(CNA)

Fight corruption to reclaim Europe’s soul

Laura Codruța Kövesi, the highly effective former head of Romania’s anti-corruption office and a candidate to fill a similar role at the EU level, is now the subject of a smear campaign and trumped-up criminal charges. Her case is a perfect example of why Europe needs stronger mechanisms to uphold its values.

RUSSELS – As the head of Romania’s National Anti-Corruption Directorate (DNA) between 2013 and 2018, Laura Codruța Kövesi presided over hundreds of high-profile convictions and became a darling of the international transparency movement. In a country struggling to build an honest justice system following its 2007 accession to the European Union, she stood out as a dogged advocate for the rule of law.

In July 2018, Kövesi was forced out of the DNA by Romania’s justice minister, Tudorel Toader, at the behest of Social Democratic Party (PSD) leader Liviu Dragnea, whom the DNA convicted in 2015 on charges of campaign fraud. She is now the European Parliament-endorsed candidate to lead the new European Public Prosecutor’s Office (EPPO), and yet Dragnea is doing everything he can to discredit her.

Though Dragnea is barred from holding office, his party leads Romania’s coalition government, and a PSD-run watchdog agency has indicted Kövesi on trumped-up corruption charges to prevent her from traveling outside Romania. Dragnea’s cronies claim that Kövesi has exceeded her authority, which is another way of saying that she has been too effective in pursuing corruption in the Romanian political class.

Kövesi’s ouster from the DNA outraged the Romanian public, and 100,000 signed a petition calling for her to be reinstated. Since her departure, the DNA appears to have ceased functioning, and Romania’s international standing has suffered for it. Despite Kövesi’s best efforts, Romania already ranked among the most corrupt EU member states in Transparency International’s 2017 Corruption Perceptions Index (after Bulgaria and Hungary). And now, the situation is worsening. Spurning warnings from the Council of Europe’s Venice Commission, more than 180 Romanian lawmakers have backed legislation that would protect politicians from corruption charges.

Romania’s future as a prosperous liberal democracy now lies with its people. One hopes that the rule of law will be reinstated, and that the country will return to the path of reform. But that can happen only if Romanian citizens support those standing against corruption and nepotism.

The response from the rest of the EU, first and foremost, should be to join the European Parliament in supporting Kövesi’s candidacy to lead the EPPO, which will be launched by the end of 2020. As matters stand, the European Council, whose revolving presidency is currently held by Romania, has backed another candidate. Beyond that, the European Commission must do more than merely criticize the PSD-led government’s backsliding on the rule of law. Real pressure must be brought to bear on the Romanian authorities.

After the European Parliament elections later this month, a new Commission will be formed under the leadership of a new president. One of its top priorities should be to develop a binding pact committing all EU member states and institutions to protect democracy, the rule of law, and fundamental rights.

As the past few years have shown, the EU needs more credible and effective instruments for scrutinizing breaches of its core values and holding violators to account. All of the main EU party groupings have already committed to pursuing a new arrangement for enforcing the principles enshrined in the bloc’s founding treaties. Following the elections, European citizens must keep the pressure on their elected representatives to ensure that they follow through.

Moreover, the European Council and Parliament should adopt legislation allowing for the suspension of EU subsidies to member-state governments that flout the bloc’s rules and standards. Governments that systematically undermine the rule of law and the free press should not be benefiting from cohesion funds that are intended for precisely the opposite purpose.

This is a critical moment for the EU. Donald Trump’s presidency in the United States, the chaos of Brexit in the United Kingdom, and the rise of populism across Western democracies have provided political cover for unscrupulous politicians to undercut the principles of liberal democracy. But the bill for the fanciful promises made by Europe’s so-called illiberal democrats is now coming due.

Liberal democrats have an opportunity to reverse the damage populists have wrought, but they must act fast and assertively. Pro-Europeans are too often pigeonholed as proponents of the *status quo*. This must change. With politicians who disdain democratic principles and the rights of their citizens coming under increasing scrutiny, liberal democrats must make it known that they are offering effective new instruments for ensuring accountability. The EU's new anti-corruption czar is just such an instrument, and Kövesi seems certain to make the EPPO a vigorous and dynamic champion of justice.

The EU was once regarded as a bastion of hope for those living under tyranny, despotism, and kleptocracy. It is time to reclaim that mantle. Kövesi's courageous and highly effective career fighting corruption in Romania has shown what one person, empowered by law, can accomplish. The EU must embrace her and everything she stands for. The fight against corruption in Romania and elsewhere is a battle for Europe's soul.

When facts change, change the pact

By Jean Pisani-Ferry/Paris

The European Union’s Stability and Growth Pact, which sets fiscal rules for its member states, is like the emperor’s new clothes. Almost everyone sees it has none, yet few admit it openly. This disingenuous silence is bad economics and bad politics.

For starters, the pact’s rules are so hopelessly complex that almost no government minister, let alone member of parliament, can decipher them. There are now various reform proposals that aim to simplify things, including by a group of French and German economists to which I belong.

Most of these proposals would place less emphasis on estimating member states’ cyclically-adjusted budget deficits – a notoriously difficult calculation – and focus instead on monitoring growth in public spending. Concretely, each government would commit to expenditures consistent with the country’s economic growth outlook and expected tax receipts, and in line with a medium-term debt target. There would be less micromanagement by EU institutions, more room for national decision-making, and more responsibility for individual governments.

Ministers have so far shown no appetite for such radical reform. But there is now a second reason to overhaul the EU's fiscal framework: today's economic conditions are very different from those when the pact was designed over two decades ago. "When facts change, I change my mind," John Maynard Keynes famously said. And the facts have certainly changed.

The pact entered into force in 1997. At the time, the median public debt among the 11 EU countries that would initially adopt the euro was 60% of GDP, while the forecast was 3% growth and 2% inflation. The risk-free long-term interest rate – at which most eurozone countries would soon borrow – was 5%. Stabilising the debt ratio at its prevailing 60% level therefore required governments to keep their budget deficits below 3% of GDP – or, put another way, to maintain a primary budget balance (revenues minus spending, excluding interest payments) of zero.

Such guidelines made sense. If growth faltered, revenue shrank, or markets started pricing in a default, there would be a real risk of debt spiralling out of control – as Europe's sovereign-debt crisis of 2010-2012 later showed. The 3%-of-GDP deficit threshold that triggers the activation of a stronger policy monitoring procedure was thus a rough but reasonably calibrated benchmark. Moreover, it was wise to aim for significantly lower deficits, in order to maintain a safety margin.

In 2019, the median debt for the same 11 countries is 70% of GDP, while the International Monetary Fund currently forecasts 1.5% growth and 2% inflation (debt is a bit lower and growth a bit higher if all eurozone members are included). True, projected growth is half the level it was in 1997. Nonetheless, stabilising the debt ratio requires keeping budget deficits below 2.5% of GDP, which remains close to the pact's 3% limit.

The big change from two decades ago, however, is the collapse in interest rates. Investors were recently willing to buy ten-year German government bonds yielding essentially nothing. Taking inflation into account, the real cost of German debt is significantly negative – as it is, to a lesser degree, for France, Spain, and most other eurozone members. Even Italy, with debt exceeding 130% of GDP and dismal growth, was able to borrow at 2.6%, or 2.4 percentage points less than Germany in 1997.

Under such conditions, a budget-deficit limit of 3% of GDP is, in fact, fairly lax. If long-term interest rates remain near zero for a few more years, governments will be able to run primary deficits greater than 2% of GDP without exceeding that limit. Many EU countries are likely to use this opportunity to finance current spending on the cheap. But should financial conditions change abruptly, they will be forced to adjust precipitously.

The European Commission insists that the 3% threshold is only an upper limit. Reforms to the pact in 2011 have tightened the screws. Eurozone countries are expected to keep their structural budget deficit (corrected for cyclical effects) close to zero, and those with a debt ratio exceeding 60% of GDP are mandated to reduce it.

However, the resulting constraints are too tight. The zero target for the structural deficit prevents governments from borrowing at today's negative real interest rates to finance investments and reforms. And, as Olivier Blanchard of the Peterson Institute has forcefully argued, there is no compelling economic reason to cut debt when borrowing is costless.

The EU sits between a rock and a hard place. It should not let member states make a habit of financing recurring current expenditures with debt. But nor should it prevent them from taking advantage of persistently low interest rates to finance economically sound investments that will benefit future generations.

Europe should therefore reform its fiscal framework. Deficit hawks (especially in Germany) will no doubt protest, but prohibition without a rationale is politically unsustainable. Why wouldn't EU citizens accept channelling debt-financed public investments into environmental research, renewable energy, clean transportation systems, and other efforts to contain climate change, when financial conditions would make such investments collectively profitable? Longstanding criticism of the pact for neglecting the distinction between investment and current spending is valid, to the extent that investment is defined economically rather than in accounting terms.

The EU should therefore agree on a set of goals – such as the transition to a low-carbon economy, broader access to employment, and output-enhancing economic reforms – that justify public spending temporarily in excess of the fiscal rule (unless, of course, the country is in a financially precarious state). Such an exemption should be conditional on long-term interest rates remaining exceptionally low. If rates were to rise, governments would have to trim and eventually discontinue these investments.

The need to revise the EU's fiscal rules is clear. The main political parties competing in May's European Parliament elections should recognise it and make the case openly. At a time when the EU's very purpose is being questioned, economics taboos are the last thing Europe needs. – Project Syndicate

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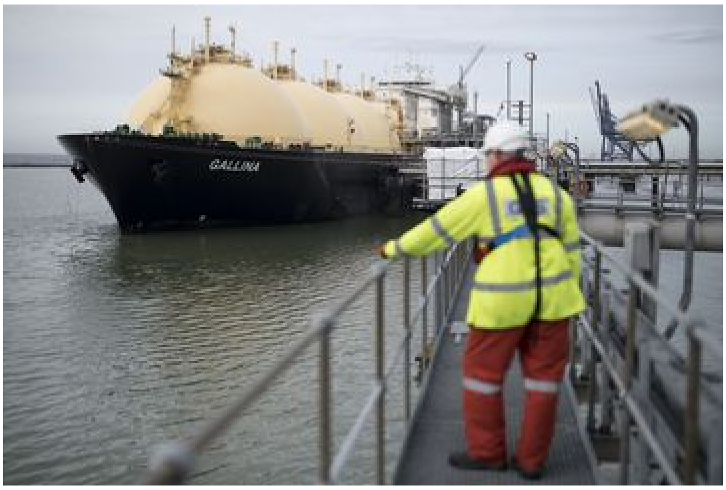
Britain Is Brimming With Natural Gas



Britain’s appetite for natural gas usually declines in the summer, but this season is different with a record number of LNG tankers due to land this month.

The incoming cargoes show no sign of slowing, and will keep the pressure on benchmark prices already trading below their five-year seasonal average. That’s good news for factories and households as Brexit clouds the nation’s economic outlook.

“We can expect a significant pressure on prices this summer,” said Murray Douglas, a research director for European gas at Wood Mackenzie Ltd. “The global LNG market is strong, we will still have a lots of LNG turning from the Asian to the European markets and we still see lots of LNG deals” and approvals for new projects.

Cargoes are heading to the U.K. and other northwest European nations because thanks to the extensive infrastructure and traded hubs they can absorb any global surplus as well as handle a growing worldwide production boom. Britain is still taking imports of the super-chilled commodity even after its gas export pipeline shut for repairs this month.

LNG prices in Asia, the biggest consumer of the fuel, have also been too low to spur traders to ship cargoes east. Cooler weather is also supporting demand in the U.K.

While Asian LNG spot prices have regained their traditional premium over European hubs, Atlantic basin suppliers such as the U.S. and west Africa are still sending most of their cargoes to Europe, their nearest liquid market. Longer term, more plants are due to start producing LNG and a number of projects from Mozambique to Russia are nearing investment decisions this year.

U.S. President Donald Trump may use Europe’s increased appetite for LNG to promote his country’s fuel in the region when he visits the U.K. in June, according to Leslie Palti-Guzman, president and founder of consultant GasVista LLC in New York. In addition, the European Union and the U.S. will hold a forum in Brussels on May 2 to discuss bringing natural gas originated from shale fields in the U.S. to nations from Germany to Greece.

U.K. shipments are mainly sourced from the biggest exporter Qatar, as well as countries such as Nigeria and Norway, but the U.S. is becoming a bigger supplier. Britain is now among the top-10 importers of American LNG this year.

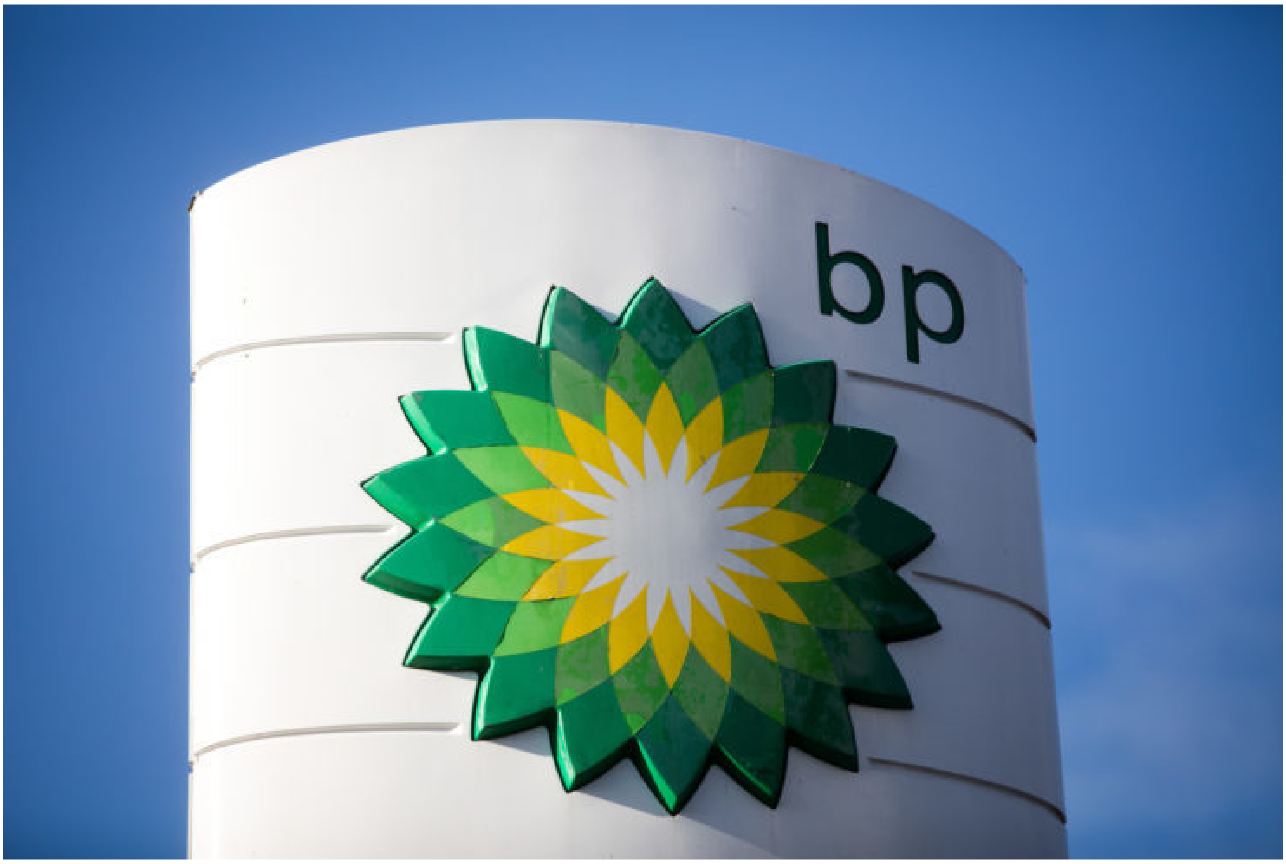
“This surge in U.K.-U.S. trade flow will bode well with the June visit of President Trump to the U.K., who has repeatedly used U.S. LNG as a tool in trade negotiations,” Palti-Guzman said by email. “The U.K. will be able to trumpet the increase in U.S. LNG imports to reinforce its trade relationship with the U.S., especially post-Brexit.”

Since March, Norway has reduced its overall gas shipments by about 16 percent for pipeline maintenance, cutting flows into the U.K.’s key Easington terminal by more than 80 percent. Meanwhile, the main U.K. export route, the Interconnector pipeline between England and Belgium, closed for repairs last weekend until May 1, cutting off a key transit route for flows into mainland Europe.

“April looks like being a record high import month for LNG into the U.K., and the Interconnector being offline means the U.K. market has no way of shipping gas back to the continent via pipeline," said Alun Davies, director of Europe power and gas at IHS Markit.

— With assistance by Kevin Varley

BP 'resilient' amid boost to pre-tax profits



Energy giant BP boosted its pre-tax earnings in the first three months of 2019, which it said showed "resilience" in a "volatile period".

Pre-tax profits were £3.6bn, more than double that of the previous quarter at £1.7bn and higher the same period last year at £3bn.

However, the firm said its underlying replacement cost profits were £1.7bn, down from £1.9bn from the same period last year reflecting weaker oil prices and margin environment at the start of the quarter.

Capital expenditure was significantly lower compared to Q4 last year, which included £1.3bn as part of an asset swap agreement for ConocoPhillips' 16.5% stake in the Clair field in the West of Shetland in December.

Upstream production was two percent higher than the previous year at 2.6billion barrels of oil equivalent per day, thanks to the acquisition of BHP Billiton's assets.

Revenues were £52.1bn, down slightly from £53.4bn in Q1 2018.

BP said it was hit by the weaker oil price at the start of the quarter which has since recovered to around $70 a barrel.

The firm also made £463m in payments for the 2010 oil spill in the Gulf of Mexico this quarter.

One of the key events for the firm in the period was the final investment decision being taken on the Seagull development in the Central North Sea, as well at Atlantis Phase 3 in the Gulf of Mexico and Azeri Central East in Azerbaijan.

Chief executive Bob Dudley said: "BP's performance this quarter demonstrates the strength of our strategy.

"With solid Upstream and Downstream delivery and strong trading results, we produced resilient earnings and cash flow through a volatile period that began with weak market conditions and included significant turnarounds.

"Moving through the year, we will keep our focus on disciplined growth, with efficient project execution and safe and reliable operations."

Cyprus ponders gas monetisation options

New natural gas discoveries offshore Cyprus have revived the possibility of the island hosting an LNG plant

Cyprus is finally in a position where it can realistically start exploring a number of ways of getting natural gas to market. Seven years after the first discovery in Cyprus' offshore economic exclusion zone (EEZ) – the Aphrodite field in Block 12 (4.5tn ft^3 of gas in place) – the island has notched up two more finds.

Last year, an Eni-Total consortium struck gas at Calypso in Block 6 (estimated 3-5tn ft^3). The most recent newcomer is Glaucus-1 (5-8tn ft^3) in Block 10, discovered by ExxonMobil, partnered by Qatar Petroleum.

Energy minister Yiorgos Lakkotrypis, addressing Gulf Energy's Eastern Mediterranean Gas Conference in Nicosia in early March, said the "quality of the reservoir in Block 10 allows us to be optimistic about the very high recoverability potential" of the ExxonMobil discovery. Last year, the first well drilled on Block 10 failed to find commercial reserves. With the Glaucos success, "we are waiting for the remodelling or re-calibrating of geological data and will look again at Block 10 targets".

Sounding upbeat, Lakkotrypis was keen to move on to the subject of how to monetise "the discoveries we've had – and hopefully we'll be having some more". At present, the plan is for gas from Aphrodite to be exported to Egypt by pipeline. As for the other resources, "a number of parameters will determine what choice we will make, and until that moment comes we will be maturing all options together".

LNG option favoured

According to Andreas Koutsoulides, commercial manager of the state energy firm Cyprus Hydrocarbons Company (CHC), four monetisation options are under review. The first would involve the construction of an LNG plant at Vasilikos on the southern coast of Cyprus. In the aftermath of the Aphrodite discovery a plant site was prepared and a master plan drawn up. But the scheme was deemed commercially unviable, given the limited discoveries off Cyprus at the time. Koutsoulides adds the venture would require "a minimum threshold of 10-15tn ft^3 of resources to enable such a plant to go ahead". The LNG proposal "is number one in terms of strategy because not only is it a solution that can bring upstream revenue to the country, but it will also have additional effects on the domestic economy in terms of employment and significant industrial activity".

The second option is to export gas to the Egyptian market. The

CHC executive sees potential demand in the domestic Egyptian market and for liquefaction, with capacity in the two existing LNG plants, Idku and Damietta. Plans for monetising Aphrodite gas “are crystallising towards Egypt because of the supply and demand structure there, the availability of infrastructure and changes in the gas market regulatory framework”.

The third option is for a floating LNG plant, which offers “tried-and-tested technology and we are looking at that very seriously. A floating facility gives lots of flexibility to move onto another field. Also, the threshold for the resources required to get a project up and running is lower than for an onshore facility.”

Pipeline to Europe

The final option is the East Med Gas Pipeline project that envisages natural gas from Israel and Cyprus being transported for sale in the markets of northern Europe. “There has been a sharp decline in Europe’s energy supply,” Koutsoulides says, “and they have been looking for years for diversification of supply.” FEED studies for the project have started.

In the view of East Med energy consultant Charles Ellinas, the Cypriot authorities should concentrate on the first of the four options: an onshore LNG plant—” a three-train facility to keep the unit costs down.” The gas resources could come from fields offshore Cyprus, and from the Leviathan field off Israel (22tn ft^3 of gas in place). The Leviathan project, Ellinas says, “is having some troubles finding customers”. Future finds from fields offshore Israel operated by Energean might also find their way to Cyprus for liquefaction. A company spokesman tells *Petroleum Economist* that Energean is “examining all potential export routes for its gas fields in Israel”.

Attracting Israeli gas to Cyprus could be geopolitically advantageous for the island. Turkey, which opposes the exploitation of Cypriot gas while the island remains divided and which claims sovereignty of some of Cyprus' EEZ, says it plans to drill off southern Cyprus—a potentially destabilising prospect for the Cypriot energy sector. But such a move could also threaten Israel's interests, if its gas reached the island; and Turkey might think twice before risking confrontation with Israel.

Imports enthusiasm wanes

Another factor that both Cyprus and Israel have to take into account is Egypt's rising gas production and its diminishing hunger for imports. Egyptian company, Dolphinus Holdings, has signed a 10-year contract with Noble Energy and Delek Drilling for gas supply from Israel's offshore fields to Egypt. But a number of technical and security issues have yet to be resolved. Also, new discoveries, such as the one expected at Eni's offshore Nour field, will boost still further Egypt's reserves, adding to the 30tn ft^3 at the mega-giant Zohr field. Enthusiasm for importing gas from elsewhere is likely to fall sharply.

In the chaotic aftermath of the 2011 popular uprising, Egypt was forced to import LNG. Now it is resuming its own LNG exports. "If the minister of petroleum is allowing Egypt to export, then he must be confident Egypt will have sufficient production to do so," says Ellinas.

A question mark, therefore, hangs over the plans for the sale of the relatively small volume of Aphrodite reserves to Egypt. If there was no urgency for Egypt to access these when the country was short of gas, it is hard to see the Cairo authorities making the project a priority today.

Get LNG going

Ellinas considers the Aphrodite plan a distraction. "Cyprus should start developing LNG now and not wait. If Aphrodite gas was sold to Egypt, it would delay things another two-to-three years. And the longer you leave it, the more difficult it becomes. ExxonMobil has mega-projects elsewhere. Just because they made a discovery in Cyprus, it isn't a game-changer for them."

As for the idea of a pipeline to take East Med gas to Europe, Ellinas says it simply is not commercially viable. "To produce gas in Israel costs $4-5/mn Btu. By the time you add on pipeline costs and a profit, it is arriving in Europe at $8-9/mn Btu. Gazprom can deliver gas to Europe at a profit at $4.50/mn Btu. Even US LNG is finding it difficult. It is a very competitive market."

So, with geopolitics keeping the vast and hungry Turkish market next door off limits, it could well be LNG or nothing for Cyprus' offshore gas finds.

Some analysts say Cyprus could become an East Med energy hub. Others, more realistically, see Egypt taking that role, leaving Cyprus as a regional service centre. But even the more limited goal will not be met, companies say, if they are not allowed more space to operate.

The Cypriot government has approved the development of Vasilikos, the site of the proposed LNG plant on the southern coast, as a dedicated energy port. But this will not be ready until 2023. Until then, energy sector companies will share space at the island's main commercial port, Limassol. And it is proving to be a tight fit.

Alessandro Barberis, managing director of Eni Cyprus, says "currently, we as operators are forced to use the only oil and gas space available, at Limassol port. It is not enough if simultaneous drilling operations are under way. The Vasilikos port project is targeted for 2023, but we need to think of the medium term." Dalio Vitale of Halliburton agrees: "Vasiliko is important, but it's five years away. We need something in the shorter term.

Varnavas Theodossiou, head of ExxonMobil in Cyprus praises the island’s stable investment climate, well-defined legal system and robust tax regime. But he, too, is frustrated by the cramped working conditions. “Maybe Cyprus can expand Limassol port, maybe we can use Larnaca,” he says. “But the current port situation is not sustainable for operators.”

In the view of Yves Grosjean, general manager of Total, Cyprus should put aside any notion of becoming an energy hub – that would take five-to-10 years to achieve. “However,” he adds, “when we talk about an oil and gas service centre we are talking about an urgent need that won’t go away.” Space is needed without delay because “in some cases there are up to 20 different companies working with one operator for drilling one well”.

Jorgen Berg managing director of Schlumberger Cyprus, says it is “important to assess the needs of the industry, and certainly a port is one of those needs. If the issue is not addressed adequately, then “we as operators will follow our own interests elsewhere”. Other deep-water ports such as Malta could fit the bill. Cyprus’ “advantageous position will not last for ever”. As it is, the lack of space seems certain to slow down IOCs’ drilling schedules, with Eni-Total planning five wells at the end of this year, ExxonMobil two next year. It is hard not to see a queue forming at Limassol port.

Why The IMF Is Wrong About

Saudi Arabia Needing $85 Oil

Once again, the International Monetary Fund (IMF) has made outlandish and inaccurate claims that Saudi Arabia needs—absolutely NEEDS—to push the price of oil higher to fund its government. This time, the IMF claims Saudi Arabia needs the price of Brent to be at least $85 per barrel. The problem with this claim is that it inaccurately implies that Saudi Arabia must work to achieve higher oil prices. However, this isn't true and Saudi Arabia does not base its oil policy on the budgetary break-even price per barrel of oil.

In September, the IMF forecast that Saudi Arabia needed $73 per barrel. Back in the fall of 2017, I explained the faults in IMF logic when it claimed that Saudi Arabia needed $70 per barrel oil to balance its budget. Among the misunderstandings underlying the IMF calculations, I highlighted that:

1. Aramco oil revenue and Saudi revenue from Saudi Aramco are not interchangeable
2. The 2017 IMF forecast seemed to ignore the tax rate on Aramco
3. Aramco has the lowest cost of production
4. Saudi Arabia had—and still has—significant cash reserves

5. The Saudi government is trying to spend less on welfare expenses
6. Saudi Arabia has easy access to cheap debt
7. There is nothing wrong with Saudi Arabia running a deficit, especially while interest rates are relatively low
8. Historically, Saudi Arabia has sought to maintain reasonable oil prices instead of prioritizing only high prices, because high oil prices lead to global recessions which depress oil demand

Now, we know even more about Saudi oil revenue and how it is determined. When Aramco released a bond prospectus at the start of April, we learned many of the company and the kingdom's financial secrets. Among them, we learned that the government funds about 63% of its budget from Aramco through a mixture of income tax (at a 50% rate), royalties (a marginal rate) and dividend. The royalties depend on the amount of oil produced and the price of Brent. The income tax is largely impacted by the price of oil as well. However, the dividend is adjusted quarterly.

Essentially, the dividend is used as a quarterly check to the government to cover whatever the government needs after Aramco's income taxes and royalties and after the government's other sources of revenue. In the first quarter of 2019, the government miscalculated how much it needed in dividend and took too much from Aramco. This lead to a $7.41 billion surplus for the government in Q1 2019, despite oil prices that ranged from $54 to $69. Clearly, in Q1 the Saudi government did not NEED $85 oil.

Climate change issue may influence European Parliament election

Climate change may be a key issue influencing the outcome of the four-day European Parliament election, which begins on May 23.

A recent opinion poll showed that up to 77% of potential voters identified global warming as an “important criterion” when deciding who to vote for at the election.

The survey by ‘Ipsos MORI’ revealed how much climate change has climbed up on the priority list of European voters. The aim of the survey was to understand the importance of environmental issues in election.

Millions of youngsters marched across European cities over the last months to demand stronger action from politicians on climate change, part of a movement which mobilised millions more worldwide.

“Many young people are going to vote in the elections for the first time and are likely to choose MEPs who support more climate action,” said Wendel Trio, director of Climate Action Network Europe, an environmental organisation.

“This could bring about real change in the future European institutions,” he predicted.
But the violent protests against the carbon tax in France are also a reminder that climate policies can bite back on policymakers if they are not accompanied by social measures to lessen the impact on the poorest.
The survey revealed some common trends among countries. The impact of high electricity and gas prices, for instance, was identified as the top environmental priority in Poland (86%), Spain (88%), and Belgium (82%).
But the single most important environmental issue for voters is to produce food in a healthy, sustainable way. This was rated as the top issue in Slovakia (87%), Austria (86%), Italy (85%) and France (81%) – with an average rating of 82% across the 11 countries surveyed.
There are national divergences too. In Spain for example, voters consider solar energy as an important election topic, while Slovaks also mention wind power.
Meanwhile, French respondents tended to identify organic farming and pesticides as their top environmental concern.
A total of 751 Members of the European Parliament (MEPs) currently represent more than 512mn people from some 28 EU member states.
In February 2018, the European Parliament voted to decrease the number of MEPs from 751 to 705, if the United Kingdom were to withdraw from the European Union on March 29 this year.
However after an extension of the Article 50 process, the United Kingdom is now due to participate alongside other EU member states.
The UK is due to leave the EU on October 31, after Brexit was delayed, amid continuing parliamentary deadlock.
It means the UK must now hold European elections on May 23, or leave on June 1 without a deal.
Every five years, EU countries go to the polls to elect members of the European Parliament. The European Parliament is directly elected by EU voters.
Each country is allocated a set number of seats, roughly

depending on the size of its population. The smallest, Malta (population: around half a million) has six members sitting in the European Parliament while the largest, Germany (population: 82mn) has 96.

Turkey gives banks $3.7bn lending boost to spur growth

Bloomberg/Istanbul

Turkey’s sovereign wealth fund bolstered the capital ratios of five state-owned banks by €3.3bn ($3.7bn) in a bid to keep credit flowing in the economy.

A market stability fund within the government-controlled investor bought debt issued by the lenders under a recapitalisation programme announced on Monday, which will see a further €400mn flow to Islamic banks.

The Turkish administration is seeking to rekindle growth with cheap loans, while tasking the firms with salvaging industries and helping consumers in the hopes that private firms will follow.

State-owned lenders rushed to extend loans before municipal elections at the end of March as their commercial and international peers pulled back. That helped increase their market share by 3 percentage points to 43% between August and the end of February, according to data compiled by Bloomberg.

TC Ziraat Bankasi AS, the country’s biggest lender, received the most, selling €1.4bn of bonds.

Turkiye Halk Bankasi AS signed an agreement with the fund for a five-year loan of €900mn, the first interest payment of which will be made at maturity. That will improve Halkbank’s Tier 1 ratio by 210 basis points, which is “more than sufficient” to keep it above minimum thresholds, Ates Buldur, a banking analyst at Credit Suisse Group AG’s Istanbul unit, said.

The fund invested in Turkiye Vakiflar Bankasi TAO’s issuance of €700mn of five-year subordinated bonds. Vakifbank bonds have 5.076% coupon rate, although the Treasury earlier said they would have a zero-coupon.

Development bank Turkiye Kalkinma ve Yatirim Bankasi AS, which is being restructured, and Turkiye Ihracat Kredi Bankasi AS, also known as Eximbank, signed agreements for five-year subordinated loans of €150mn each.

Under the plan, the Treasury issues special-purpose government bonds to the stability fund, which then sells the notes to state lenders in exchange for subordinated debt. Islamic lenders Ziraat Katilim, Vakif Katilim and Emlak Katilim will also get funding.

Capital ratios have fallen as the country’s lenders have undertaken nearly $28bns in debt-restructuring requests. They’re also facing a growing pile of bad loans in the wake of the currency’s plunge last year, which has spurred inflation and increased funding costs. The government last year recapitalized three of its banks by selling bonds to its unemployment fund.