LEBANON'S PUBLIC FINANCIAL *MIS*MANAGEMENT

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About ALDIC

Established in 2012, the Lebanese Association for Taxpayers' Rights (ALDIC) is dedicated to advancing tax ethics and compliance. Its mission revolves around enlightening citizens about their rights and obligations, while motivating them to advocate for enhanced oversight of public funds at all administrative levels.

ALDIC actively promotes improved governance, grounded in the conviction that proficient management of public finances is essential for a modern State to effectively fulfill its mandate of safeguarding citizens' well-being. This extends to ensuring access to education, health, employment, retirement, and maintaining high-quality public services overall. The association is committed to raising awareness of the indispensable role civil society plays, emphasizing that active citizen participation is crucial for the proper management of public funds.

Officially established and recognized by the Lebanese Ministry of Interior & Municipalities in 2012 with registration number 1399, ALDIC is also registered at the Ministry of Public Finance under number 2989418. As of 2021 and 2022, ALDIC holds membership in the 3RF Consultative Group and its Independent Oversight Board. The association upholds its commitment to being an apolitical, non-partisan, and non-denominational Lebanese entity. It steadfastly ensures the advocacy of all taxpayers' rights without discrimination, maintaining complete independence in its endeavors.

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Introduction

Rationale and Purpose

The efficient allocation of resources is a fundamental feature of a sustainable economic development model that can achieve optimal socioeconomic outcomes. Securing such a feature is dependent on a set of processes and institutions that underpin the state's allocation policies, constituting its fiscal policy, in what is known as Public Financial Management (PFM).[1] Modern PFM frameworks are intended to design a regulatory and institutional framework for governments to achieve a budgetary cycle that meets policy-oriented fiscal objectives and enhances transparency and accountability in the management of public finances.

The financial and economic crisis in Lebanon has had a severe spillover onto the country's fiscal situation, exacerbating its already feeble and ill-designed position. An inclusive stabilization rests on the government's ability to adopt a clearly defined fiscal policy that intends to reactivate state institutions, incentivize economic sectors, and ensure socioeconomic equity. This report aims to assess the PFM landscape in Lebanon, with the aim of identifying structural and crisis-induced gaps and building recommendations that can guide its reform as a necessary step in fiscal stabilization efforts.

Country background

Lebanon is facing one of the most severe financial and economic crises of the past century.[2] The country is caught in a vicious cycle of inflation after facing a currency shock that wiped out more than 95% of the value of the Lebanese Pound. Meanwhile, the financial sector is in ruins, with zombie banks only operating limited intermediation functions, allowing the cash economy to proliferate, estimated to constitute half of the economy in 2022. Moreover, while GDP contracted by 69% since the onset of the crisis, the state has lost around 85% of the value of its budget, paralyzing the work of the public administration and leading to extreme losses in state capacity.

Faced with this reality, very little has been done in the way of stabilization. The country has a staff-level agreement with the International Monetary Fund but failed to deliver on the pre-conditions that it outlines. Moreover, the country still does not have a 2023 budget, eight months into the year, with the proposed budget currently being discussed in government.

The breakdown of Lebanon's fiscal policies is not new, however. In fact, the country's notorious mismanagement of public funds, both in its treasury and central bank, are central drivers of its chronic twin-deficit and sit at the core of Lebanon's present-day financial crisis. The dismal record of public finance management manifests most egregiously in the state's failure to produce a budget law in 12 out of the past 20 years. As such, public trust in the government's ability to manage resources is alarmingly weak, severely impacting the country's social contract. In this context, Lebanon's current crisis is dependent on the government's adoption of a fiscal policy that is not only part of a macroeconomic recovery framework, but also anchored in modern PFM systems that restore transparency and trust in public administrations.

The PFM framework: why and how?

International PFM best practices ultimately aim to achieve desirable fiscal and budgetary outcomes by implementing an open and orderly PFM system. For the purpose of this report, the assessment will be based on the Public Expenditure and Financial Accountability (PEFA) framework,[3] which identifies the key elements of such a system and consist of the following six dimensions:[4]

1. Budget credibility: The government's budget is realistic and implemented as intended, ensuring that actual revenues and expenditures align with the approved budget.

2. Transparency and comprehensiveness of public finances: Comprehensive and accessible information on PFM, including budget classification, government revenue and expenditure transparency, and published data on service delivery performance.

3. Policy-based budgeting: Preparation of the fiscal strategy and budget in line with government fiscal policies, strategic plans, and accurate macroeconomic and fiscal projections.

4. Budget execution: The budget is implemented with effective standards, processes, and internal controls to ensure resources are obtained and used as intended.

5. Accounting and reporting: Maintenance of accurate and reliable records, along with timely dissemination of information to meet decision-making, management, and reporting needs.

6. External scrutiny and audit: Independent review of public finances and follow-up on the implementation of improvement recommendations by the executive.

PEFA defines specific indicators within these six pillars, focusing on measurable aspects of the PFM system. The results of these indicators provide an integrated assessment of PFM system performance, which in turn helps evaluate the likely impact on the desired budgetary outcomes: aggregate fiscal discipline, strategic allocation of resources, and efficient service delivery.

This report will assess Lebanon’s PFM landscape through the collection of indicators for each dimension, based on secondary data sources and interviews with senior bureaucrats.

1. Kristensen, J., et al. 2019. “What is PFM and Why is it Important?” World Bank
2. World Bank. 2021. “Lebanon Economic Monitor – Lebanon Sinking (to the Top 3).” World Bank Group
3. PEFA. Framework for Assessing Public Financial Management.
4. A seventh dimension was left out for the scope of this report.

Assessing Lebanon's Public Finance Management

This section aims to assess Lebanon's PFM across the six dimensions, focusing on structural and crisis-induced gaps.

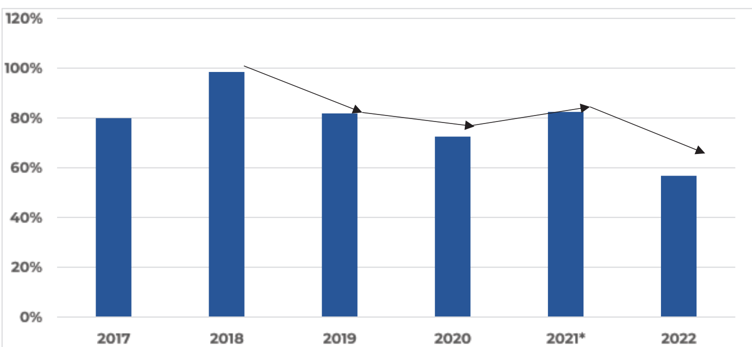
Dimension 1: Credibility of the Budget

A budget is considered credible when it accurately reflects revenue and expenditure estimates, adheres to fiscal targets, and is based on realistic assumptions. The framework outlines aggregate expenditure outturn, composition of expenditure outturn, and aggregate revenue outturn as key indicators to evaluate the credibility of a budget. However, the ability to measure budget credibility in Lebanon is particularly compromised as national budget laws between 2017 and 2023 have been issued seven months past the constitutional deadline on average.[5] With the privilege of retrospect, the fact that Lebanon's expenditure and revenue outturns were within acceptable ranges is not indicative of its quality of public finance management.

1. Aggregate expenditure outturn:

This indicator measures the deviation between the budgeted total expenditure and the actualized one. Expenditure outturn has been within an ideal range of the budgeted amount in only one year between 2017 and 2022, with an actual-to-budgeted ratio of 98% in 2018 (Figure 1). The spread between the projected and actual expenditures reached almost -20% in 2017 and 2019, and averaged an alarming -29% during the crisis period, which reflects a decline in budget planning due to macroeconomic instability and capacity losses in budget administrations. Still, given that the budget law has been passed almost seven months past its constitutional deadline between 2017 and 2022, the estimated numbers are mostly done with the privilege of retrospect, increasing the likelihood of their accuracy.

Figure 1: Expenditure outturn compared to budget



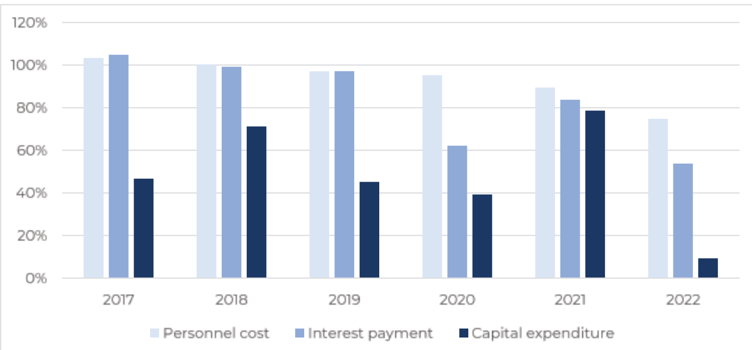
Source: Budget projections retrieved from budget laws, except for 2021 which was collected from the draft law; Outturn collected from MoF's Public Finance Reports and Institut des Finances.

2. Composition of expenditure outturn:

This indicator measures the deviation between the budgeted expenditures and actualized ones across economic classifications. The indicator is meant to help determine the extent to which a deviation in aggregate expenditure is driven by reallocation of fiscal resources from certain budget lines to others during the fiscal year.

In Lebanon, personnel cost, debt servicing, and capital expenditure make-up roughly 80% of total annual budgets. Before the crisis, governments were accurately executing expenditures related to personnel cost and interest payment, with the spread between budgeted and actual spending low and consistent year-on-year, averaging 101% and 100% respectively (Figure 2). The spread for capital expenditure, however, averaged 60%. During the crisis, the accuracy in the execution of personnel cost remained in 2020 but gradually decreased in 2021 and 2022 (75%)—although the budget law was passed more than nine months into the fiscal year. Moreover, interest payments hovered 60% of projected spending in 2020, indicating a lack of awareness during the budget preparation process that a sovereign default on Eurobonds was looming only one month later.

Figure 2: Ratio of actual-to-budgeted spending, by top economic classification

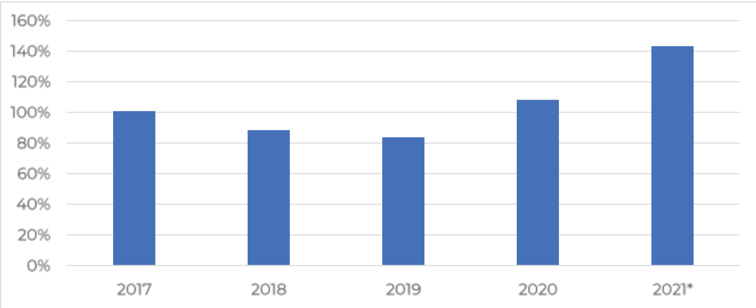


Source: Budget laws, Ministry of Finance Public Finance Reports, and Institut des Finances.

3. Revenue outturn, aggregate and composition:

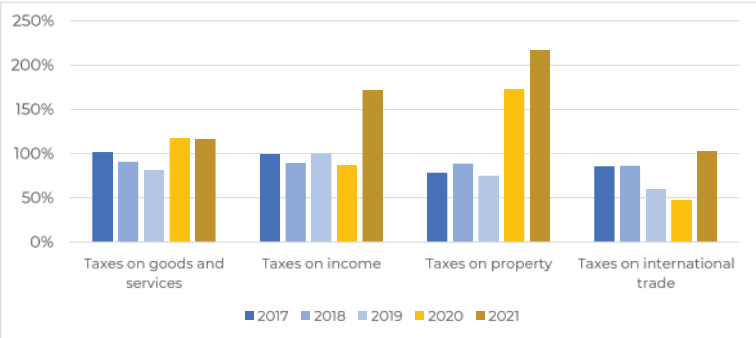
This indicator measures the deviation between the budgeted total revenue and the actualized one. Between 2017 and 2021, the spread between projected and actual revenues ranged from a minimum of 84% in 2019 to a high of 143% in 2021, with an average difference of -9% between 2017 and 2019 (pre-crisis) and +26% in the crisis period (Figure 3). The counterintuitive increase in the size of actual revenues compared to budgeted revenues in the crisis period is largely due to the depreciation of the local currency, by 73% in 2020, 90% in 2021, and 95% in 2022. Many traders and consumers settling their arrears and expediting the payment of their fees at the official exchange rate to secure a significant discount in the real value of tax submissions. In fact, the crisis period witnessed a significant increase in the submission of taxes on property, surpassing budgeted estimations by 73% in 2020 and more than threefold in 2021 (Figure 4). Similarly, the realization in income taxes exceeded projections by 72% in 2021.

Figure 3: Revenue outturn compared to budget



Source: Budget projections retrieved from budget laws, except for 2021 which was collected from the draft law; Outturn collected from MoF's Public Finance Reports and Institut des Finances.

Figure 4: Revenue composition outturn compared to budget



Source: Budget projections retrieved from budget laws, except for 2021 which was collected from the draft law; Outturn collected from MoF's Public Finance Reports and Institut des Finances.

5. Lebanon did not issue a budget law in 2021.

Dimension 2: Transparency and comprehensiveness

Public finances are considered comprehensive and transparent when the budget follows a universal classification of revenue and expenditure structures and provides accessible documentation to the public. This covers central and sub-national government finances, off-budget finances, as well as the status of public service delivery. In recent years, Lebanon has made important progress to improve the transparency of public finances and administrations. In fact, parliament passed a law in 2017 that requires state institutions to disseminate financial information, and the Ministry of Finance (MoF)—with its knowledge centre named Institut des Finances—has been publishing since 2017 accessible statistics on public finances to foster citizens' financial literacy. However, compliance with the Access to Information has been chronically low,[6] and the timeliness of MoF's reports has been lagging slow, particularly amid a collapsed IT department during the crisis.[7] Moreover, the Lebanon lacks a legal framework that defines public institutions that qualify as "state-owned organizations" perpetuates financial opacity, with a dozen entities having financial and administrative autonomy and allowed to conduct spending outside of the national budget.[8]

1. Budget classification:

This indicator evaluates whether the classification of Lebanon's national budget is in-line with international standards, namely the International Monetary Fund's Government Finance Statistics Manual (GFSM). The GFSM is an internationally adopted framework that structures the presentation of public finances according to administrative, economic, and functional classification.[9] The administrative classification assigns a budget line to the ministry/institution in charge of spending the allocated funds, the economic classification categorizes government transactions based on the economic nature of the activities, such as salaries, interest payment, and capital expenditures. Meanwhile, functional classification groups government transactions based on the purpose of the expenditure as a determinant of policy objectives, such as education, health, and public order and safety.[10]

In this regard, Lebanon's preliminary budget proposal prepared by the Ministry of Finance, the draft budget reviewed by the Council of Ministers, and the budget law ratified by parliament follows the three-level classification outlined in the GFSM. However, the budget, throughout its preparation cycle, lacks programmatic assignments of budget lines. It is important to note that even GFSM does not provide a uniform framework for programmatic classifications, and thus Lebanon's application of it without developing broad-level policy objectives constrains the function of a budget document as an accounting procedure.

2. Budget documentation:

This indicator evaluates the provision of supplementary information in the budget document forwarded by the Council of Ministers to parliament for legislative scrutiny. The supplementary information contains a set of 12 elements (four basic and eight additional) including the budget proposals, fiscal forecasts, outturn of previous years, and macroeconomic assumptions, among others. In Lebanon, due to the lack of consistent and accessible budget documentation, this report assesses only the budget documentation pertaining to the 2022 budget law. The documentation for the 2022 fiscal year is particularly illustrative as it provided the rationale behind the issuance of the 2022 budget law, which came after the government's signing of the Staff-level Agreement with the IMF and aimed to restore fiscal discipline and unify the multiple exchange rates.

Following a careful review of the documentation for the 2022 budget law, Lebanon only complied with three of the 12 elements (Table 1). This, in turn, undermines the budget's legislative scrutiny when it reaches parliament.

Table 1: Elements listed in budget documentation for 2022 budget law

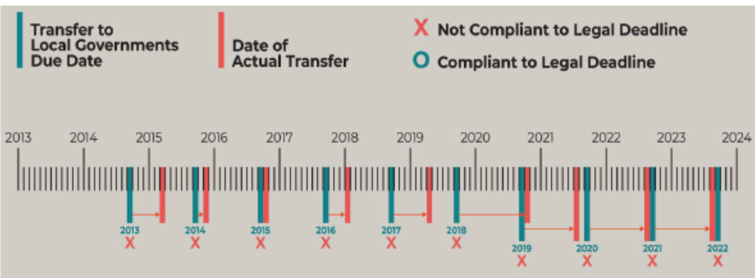
	Elements	**Compliance in 2022**	**Note**
Basic elements	Forecast of fiscal deficit	✓	Mentioned in 2022 Fazlake, page 15
	Budget outturn of previous year	X	Not in fazlake, budget law, nor citizen budget MoF usually issues monthly expenditure and revenue reports, but did not for 2022
	Current fiscal year's budget presented in the same format as the budget proposal	✓	
	Aggregated budget data for both revenue and expenditure according to the main heads of the classifications used, including data for the current and previous year with a detailed breakdown of revenue and expenditure estimates	✓	
Additional elements	Deficit financing	X	The fazlake computes debt servicing and assumes settling it at a new exchange rate of USD/LBP 20,000, however it lacks a plan to negotiate with creditors following 2020 sovereign default
	Macroeconomic assumptions (at least: GDP growth, inflation, interest rates, and exchange rate)	X	Exchange rate and GDP growth are projected without substantiation; inflation rate and interest rates not elaborated, except for debt interest Overall, budget document not anchored in fiscal strategy
	Debt stock	X	Information is available on public debt, but Lebanon failed to endorse a debt restructuring strategy after 2020 sovereign default
	Financial assets	X	
	Fiscal risks	X	
	Explanation of budget implications of new policy initiatives	X	
	Medium-term fiscal forecasts	X	Exchange rate and GDP growth are projected without substantiation; inflation rate and interest rates not elaborated, except for debt interest Overall, budget document not anchored in fiscal strategy
	Quantification of tax expenditures	X	

3. Transfers to sub-national governments:

This indicator assesses the transparency of intergovernmental transfers, taking into account the system in place for allocating transfers as well as the timeliness in the disbursement of funds to local governments. Lebanon has a one of the highest concentrations of local governments relative to the size and population of the country, as the municipal count stood at 1,085 in 2020.[11] That municipalities chronically suffered from critical shortage in human resources is a characteristic that was true even in the early stages of the crisis, with 38% of municipalities having as little as one employee.[12] Putting aside the need to restructure the clustering and administrations of local governments, Lebanon's system for transferring funds to municipalities is managed by the Intergovernmental Municipal Fund (IMF).[13] The fund is notorious for suffering from key constraints,[14] of which two are relevant for the sake of this assessment.

First, the IMF's disbursements, which are unlocked by a decree signed by the prime minister, minister of finance, and minister of interior and municipalities, suffers from chronic delays (Figure 5). In fact, the disbursements for the 2013 and 2014 fiscal years were done in 2016, those of 2020 were made in 2022, and those of 2022 have yet to be made. Second, the IMF's operational system is structurally unfair and opaque. This is largely due to the centralization of authority at the central government level, municipal councils' lack of awareness over how funds are assigned, and the archaic deduction formula that fails to take into account real population levels in the municipality due to the inaccuracy in the number of registered residents.[15]

Figure 5: Schedule of Intergovernmental Municipal Fund's disbursements



Source: Official Gazette.

4. Performance information for service delivery:

This indicator assesses Lebanon lacks a regularized system that monitors and assesses the quality and scope of public service delivery. It is important to note, however, that there has been recent effort by IMPACT—Lebanon's e-governance platform managed by Central Inspection—to survey municipalities and villages on the status of public service delivery across regions. The scope of data collection is still at its early stages and thus requires validation before conclusions can be drawn and comparisons can be made year-to-year.

5. Public access to fiscal information:

This indicator assesses the extent to which fiscal information is comprehensively available to the public. The fiscal information includes five basic elements, of which Lebanon complied with none, and five additional elements, of which Lebanon complied with one between 2017 and 2023 (Table 2).

Table 2: Fiscal information available to the public, 2017-2023

	Elements	**Compliance (2017-2023)**	**Note**
Basic elements	Annual executive budget proposal available to the public within one week	X (cannot be retrieved)	Ministry of Finance publishes budget circulars but exact date cannot be retrieved at this point
	Enacted budget is published within two weeks	X	Only the 2019 budget law was published within two weeks of ratification
	In-year budget execution reports	X	Ministry of Finance issues in-year reports but not routinely
	Annual budget execution reports	X	Last annual report was issued by the Ministry of Finance in 2017
	Audited annual financial report, incorporating, or accompanied by external auditor's report	X	
Additional elements	Prebudget statement issued at least four months before fiscal year	X (cannot be retrieved)	Ministry of Finance publishes budget circular but not at least four months before fiscal year
	Other external audit reports	X	
	Summary of the budget proposal	✓	Ministry of Finance issues scaled-down budgets, known as "Citizen Budget"
	Macroeconomic forecasts	X	Forecasts are not made as part of the budget law, but rather as part of supplementary documents. Authors were only able to retrieve 2022 fazlake
	Fiscal risks	X	

6. Gherbal Initiative. 2020. "Transparency in Lebanese Administrations 2020."
7. Based on key informant interview with senior bureaucrat.
8. Financially Wise. 2022. "Off-budget spending: A risky business for Lebanon."
9. See International Monetary Fund. 2014. "Government Finance Statistics Manual 2014."
10. International Monetary Fund. 2014. "Government Finance Statistics Manual 2014."
11. Democracy Reporting International. 2020. "Restructuring Subnational Governance in Lebanon: Towards Efficient Public Spending and Reduced Regional Inequalities."
12. Ibid.
13. Legislative Decree 118/1977.
14. Atallah, S., R. Baassiri, and J. Harb. April 2014. "Municipal finance must be reformed to address Lebanon's socio-economic crisis." Lebanese Center for Policy Studies.
15. Ibid.

Dimension 3: Policy-based budgeting

A policy-based budget preparation process posits that a national budget should be anchored in a fiscal strategy and in-line with desired fiscal outcomes and macroeconomic projections. In Lebanon, this is not the case. The budget formulation strictly follows a line-item structure and falls short off drawing programmatic fiscal objectives,[16] let alone being bound by a medium-term planning or fiscal strategy. To this end, while assessing this framework requires a review of macroeconomic forecasting, fiscal strategy, medium-term budgeting, the budget preparation process, and legislative scrutiny, this report suffices by reviewing the last two indicators.

1. Budget preparation process:

This indicator reviews the presence of a budget calendar along the budget planning cycle, its clarity of the division of roles across institutions, and the timelines of submitting the preliminary draft to parliament. Lebanon's budget calendar is governed by regulatory and constitutional deadlines, but the government and parliament are notorious for violating them.

In theory, the budget planning cycle is initiated following a circular issued by the minister of finance in early April ahead of the fiscal year. Between April 15 and May 31, public administrations across ministries should have sent the Ministry of Finance their projected expenditure and revenue structures. By end of July the directorate of budget expenditure control should complete its review of the compiled documents and refer it to the minister, who then has until August 31 to forward it to the Council of Ministers. The cabinet is granted one month to review the preliminary budget and send it to parliament's finance and budget committee, which is mandated to perform a careful legislative scrutiny until the end of the year. The constitution sets the final deadline for parliament to ratify the budget by end of January of the ongoing fiscal year.

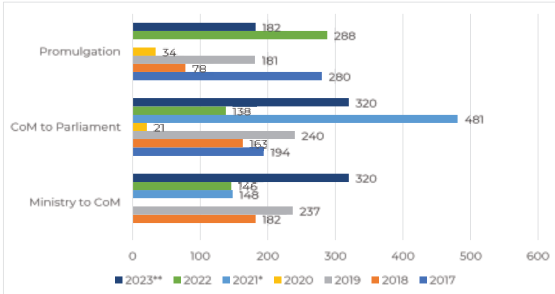
In practice, the national budget law was never passed within the constitutional deadline in the past six fiscal years. The cabinet, as well, has never respected the regulatory deadline of referring the draft budget to parliament by end of September. The closest it got to submitting it in time was for the 2020 budget, when the government approved the draft budget in October 21. 2019 (Table 3 and Figure 6).

Table 3: Schedule for cabinet to send budget draft to parliament

Budget draft	Deadline for cabinet to refer budget draft to parliament	Actual date cabinet referred budget draft to parliament
2023	9/30/2022	9/4/2023
2022	9/30/2021	2/15/2022
2021	9/30/2020	1/24/2022
2020	9/30/2019	10/21/2019
2019	9/30/2018	5/28/2019
2018	9/30/2017	3/29/2018
2017	9/30/2016	10/19/2017

Note: Lebanon did not issue a budget law in 2021 and has yet to issue one in 2023.

Figure 6: Yearly delay in budget preparation schedule (in days)



Note: Lebanon did not issue a budget law in 2021 and has yet to issue one in 2023 (as of September 2023).

2. Legislative scrutiny of budget:

This indicator evaluates the scope of legislative scrutiny in the formulation of national budgets. It reviews the extent to which parliament debates and amends the draft budget, taking into account the procedures in place. Lebanon's parliament, for most of the post-war era, has been controlled by the same traditional political parties that have engineered the state's fiscal policy that brought it to collapse. By extension of this, the legislative scrutiny as a determinant of orderly public financial management has lost its function in Lebanon, replaced by a process through which the interests of the political class are maintained.

Upon receiving the draft budget, the parliament's finance and budget committee—which comprise 17-18 parliamentarians—reviews and debates the expenditure and revenue structures as well as the project articles proposed in it. The committee enjoys the authority to redistribute funds but must receive consent from the cabinet before exceeding the total expenditures projected in the draft budget. After finalizing its review, the committee generates a report with amendments on the budget draft and retains the option to send it back to the cabinet for review. When the general assembly is called for a legislative session, parliament votes on the budget, going over its individual articles, beginning with expenditure structures before that of revenues.

The budget formulation process adheres to this division of responsibilities. However, the extent of legislative scrutiny that parliament subjects the budget draft is not substantive. While systematic assessment of parliament's amendments to the government's budget draft is missing, anecdotal evidence suggests that legislative scrutiny is superficial and treats the budget as an accounting document. Parliament typically reviews the draft budget in a handful of sessions to dilute progressive reforms and arbitrarily curb total expenditures. In fact, parliament rejected the government's proposals in 2019 of subjecting the salaries of former and current ministers and parliamentarians to the income tax and levying fees on tinted car windows and licenses to carry arms.[17] Moreover, parliament slashed the Council for Development and Reconstruction (CDR)—Lebanon's biggest public infrastructure agency—three months after the political class pledged to adopt a capital investment program.[18]

16. Institut des Finances. Citizen Budget Dashboard.
17. Lebanese Center for Policy Studies. September 2019. "The Government Monitor No. 6: Draft to Law: Minimal Change to the 2019 Budget."
18. Atallah, S., M. Mahmalat, and G. Dagher. September 2019. "CEDRE Capital Investment Plan: Scrutinizing the Allocation of Projects and Funds Across Regions." Lebanese Center for Policy Studies.

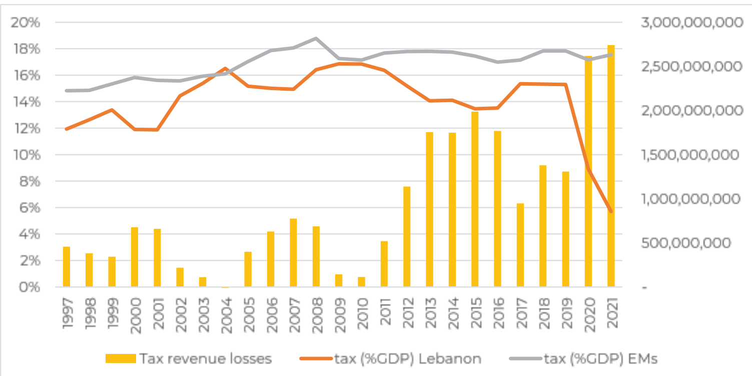
Dimension 4: Control in budget execution

This dimension assesses whether the budget is executed following a systematic internal control process to ensure that resources are allocated and used effectively. Solid controls in budget execution comprise mechanisms and procedures to ensure effective and efficient execution of budgeted expenditures. It prevents fraud, waste, and mismanagement of public funds, ensuring compliance with budgetary regulations.

1. Revenue administration:

On the revenue side Lebanon's budget execution has been weak, largely driven by high levels of economic informality and lack of enforcement, yielding substantial losses through tax evasion. Since 1997, the Lebanese government has been consistently yielding less revenue relative to GDP than the global average of emerging market economies, with this difference widening significantly during the crisis, standing at 12% of GDP in 2021. In fact, estimated losses in potential tax revenues have averaged around US$2.2 billion during the crisis, 3.5 higher than the average pre-crisis (US$761 million).[19]

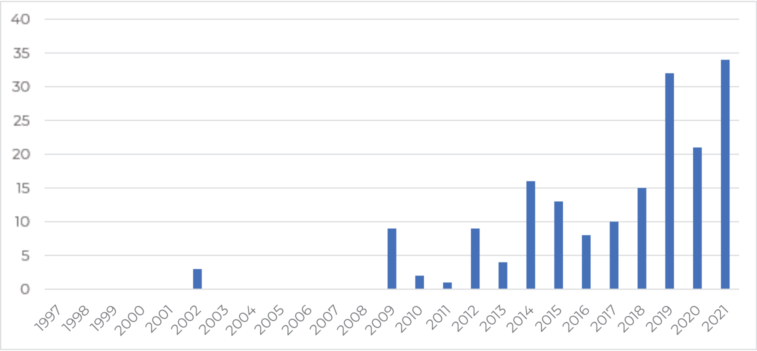
Figure 7: Lebanon's losses in tax potential ($ right scale, % left scale)



Source: International Monetary Fund Fiscal Monitor.

This weak execution on the revenue side can be explained by a high reliance on the extension of tax deadlines as a policy to cope with the decreasing capacity of state institutions to collect on time and with the deteriorating economic situation over the past decade. In fact, there has been an issuance of 34 tax deadline extension decrees in 2021 alone (Figure 8), more than all extensions between 1997 and 2013.

Figure 8: Number of tax extensions issued in the Official Gazette



Source: Official Gazette.

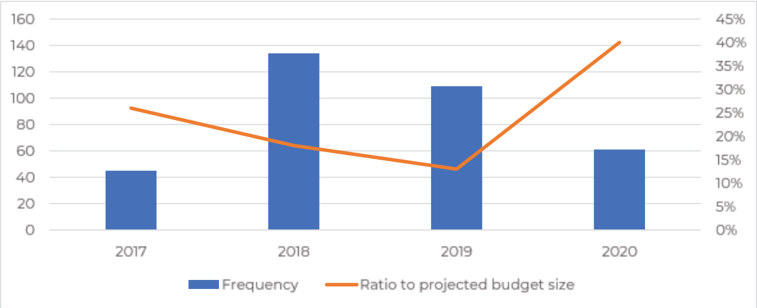
Moreover, information on the rights and obligations of taxpayers is sparse, particularly since the Ministry of Finance's website, which includes useful guides and e-governance systems for tax obligations and dues, has been suffering from consistent outages due to faltering IT capacity in the ministry (much of the IT staff have left for other jobs as salaries collapsed) and depleting funds for digital infrastructure investment and maintenance.

2. Predictability in resource allocation:

This indicator assesses the extent to which the Ministry of Finance (MoF) is successful in forecasting financial commitments to ensure the payment of obligations and the delivery of services across the fiscal year. As of 2023, Lebanon has no internal processes to which institutions adhere regarding commitment ceilings, and by extension the MoF has systematic mechanism by which it can enforce pre-approved appropriations on line-ministries. Moreover, information on the cash balances of ministries and public enterprises at the Central Bank is not available to MoF, let alone the public, which poses a serious threat on the ministry's ability to manage cash flow. As of May 2023, the state has not completed the process of consolidating bank accounts outside of the main account.

One indicator that can be illustrative of the predictability of resource allocation is the significance of in-year budget adjustments. For Lebanon, this is measured through the frequency and/or amount of public spending that occurs through the budget reserve—which is a budget item meant to provide financing for unanticipated events. Factoring out the transfers that happen in the absence of a national budget,[20] the state requested financial transfers an average of 87 times between 2017 and 2020, with an average value of LBP 5 trillion (Figure 9). During the crisis in 2020, while the frequency of transfers decreased to 61, these constituted around 40% of the 2020 budget law—an indication of increasing macroeconomic and fiscal uncertainty.

Figure 9: Budget reserve spending as a share of budget size



Source: Calculation based on numbers retrieved from Official Gazette.

3. Expenditure arrears:

This indicator assesses the extent to which the government's public finances are constrained by a stock of arrears and whether they are systematically monitored. Arrears include overdue financial obligations, notably debt and transfers to state institutions with administrative and/or financial autonomy, and are an indication of transparent budgeting and commitment controls. Through central bank financing, foreign assistance, and expenditure arrears, Lebanon ran a fiscal deficit every year in the post-war era. The failure, or intentional ignorance, to monitor the growing financial obligations has sunk public finances into a debt trap and crowded-out investments in the country's social services and fixed infrastructure, ranking Lebanon's quality of infrastructure in the bottom 40th percentile in 2019.[21]

More so, Lebanon's public finances were obscure even before the crisis, as fiscal reporting is fragmented between the central government, local governments, state-owned enterprises, and extra-budgetary funds. The state's total expenditure arrears are not reflected in national budgets, but a recent study on off-budget spending estimates that it reached 12% of GDP in 2018 and that 43 out of 60 state-owned enterprises effectively spent LBP 9.1 trillion (10.7% of GDP).[22] With most of these enterprises failing to comply with existing regulations of sending annual accounts to the Ministry of Finance, the country's public financial management system is considered structurally leaky and exposed to unidentifiable risks.

Perhaps the institution that had to suffer the most from the state's accumulating financial arrears is the National Social Security Fund—Lebanon's main social security provider to the public sector. The fund, established in 1965, suffered from a chronic shortage in coverage, largely due to the lack of liquidity. In fact, the state owed the NSSF between as much as LBP 96.6 billion between 2005 and 2013, which amounts to $639 million at the official exchange rate at the time.[23] By 2018, total arrears reached LBP 2.4 trillion ($1.6 billion).[24]

4. Internal controls and payroll audit:

This indicator assesses the management of public sector payrolls. It is assessed through the degree of integration between personnel records and payroll data, the regularity in the changes of payroll and personnel records, and the existence of internal controls and a payroll audit. The public sector payroll has historically been the largest budget item in Lebanon. The state of payroll management, however, has sharply weakened since the onset of the crisis, whereby the extent of digitization has stagnated and the volume of human resources in key state functions, notably in IT departments and oversight institutions, has shrank or was historically low.

Prior to the crisis, the government already had IT-based systems in place at the Ministry of Finance that streamlined and tracked the transfers of cash or cheque payments to civil servants. The computerized information system at the ministry has allowed the integration of payroll and personnel data, whereby audit trails were made available.[25] A financial accountability document by the World Bank even concluded in 2005 that Lebanon's system for payroll audit is strong and is able to identify "ghost workers".[26] However, the control system was weak, evidenced by the lack of routine compliance with existing rules, the pervasiveness of corruption within the government, and the shortage of staff in the Central Inspection and Court of Accounts.

During the crisis, payment controls and reporting became increasingly weak due to shortages in staff and working hours. The crisis period saw a large exodus of high-skilled labor, some of whom are former civil servants who worked in IT departments, and pervasive absenteeism and strikes across public administrations, which manifested in the reduction of working hours and productivity. Presently, there is a noticeable lag in the capacity of existing civil servants vis-à-vis modernized information and communication technologies that are deployed for payroll systems. In this vein, audits of payroll and personnel records are not held systematically.

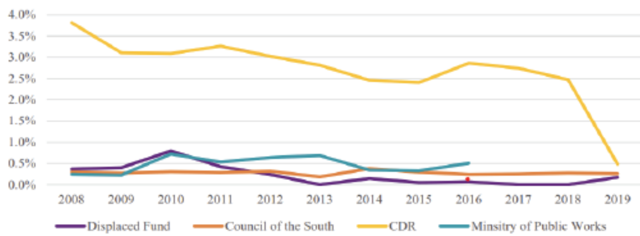
5. Procurement:

This indicator reviews the quality of the procurement system, focusing on its transparency, competitiveness, complaint management, and access to information. Procurement entails the process through which government institutions acquire goods, services, and public works, and constitutes around 14% of GDP in upper-middle-income economies. A well-functioning procurement system ultimately yields an optimal return on every dollar spent from public funds. Up until 2021, Lebanon's public procurement system was deemed archaic, fragmented, and mired with capacity and technological gaps, falling significantly off from international standards.[27] Legal frameworks that regulated public procurement suffered from structural gaps, increasing the risk of corrupt practices and undermining accountability and transparency efforts. The procurement system was particularly cluttered as its decentralized nature meant that more than 190 public administrations were mandated to purchase goods and services, 44 of which procured public contracts worth around $13.46 billion between 2001 and 2020.[28]
Among these, Lebanon's Council for Development and Reconstruction (CDR) is undoubtedly the largest public procurement agency (Figure 10). Excluding central governments, public procurement represented 4% of Lebanon's GDP in 2015, of which CDR was responsible for

more than one-quarter.[29] Established in 1977, the council enjoyed wide prerogatives to fast-track reconstruction efforts, such as being exempt from audit by the Court of Accounts. This characteristic, coupled with CDR's institutional set-up that endowed the board—who is appointed by the cabinet—with absolute authority, allowed for corrupt practices to flourish. Indeed, a recent study found that politically well-connected firms were awarded contracts that were inflated by 34% compared to the average contract between 2008 and 2018.[30]

Figure 10: Share of infrastructure procurement expenditure to total public expenditure, by institution

Source: Mahmalat, M., S. Atallah, and W. Maktabi. 2021. "Public infrastructure procurement in post-conflict power-sharing arrangements: Evidence from Lebanon's Council for Development and Reconstruction."



In June 2021, nearly two decades after first pledging it, Lebanese politicians passed a modernized public procurement law. The law is considered a structural reform of its predecessor, as it paves the way for an open and competitive tendering process, providing equal opportunities to participants in public procurement. The law also establishes a centralized institution—the Public Procurement Authority (PPA)—to supervise the sound implementation of development projects, in coordination with relevant public administrations. The regulatory body is additionally tasked with consolidating tenders on an electronic procurement platform, which it has started to do.[31] As of 2023, the comprehensive implementation of the law is still lagging, as some administrations are still resorting to direct contracting prior to the issuance of an open call for bids, which is a violation of the new law.[32]

19. Authors' calculation based on data from International Monetary Fund and World Bank on tax-to-GDP.
20. As per Lebanon's Public Accounting Law, public spending happens on the basis of the one-twelfth rule when a fiscal year lacks a budget law.
21. World Economic Forum. 2019. "Global Competitiveness Index."
22. Financially Wise. 2022. "Off-budget spending: A risky business for Lebanon."
23. Merhej, K. and K. Chehayeb. March 2022. "The Full Story Behind the Looming Collapse of the National Social Security Fund". The Public Source.
24. Ibid.
25. World Bank. May 2005. "Country Financial Accountability Assessment."
26. Ibid.
27. World Bank Group and Ministry of Finance. 2021. January 2021. "Assessment of the Public Procurement System." Methodology for Assessing Procurement Systems.
28. Gherbal Initiative. 2022. "Public Procurement Analysis: Contracts Conducted by the Lebanese Public Administrations, Institutions, Commissions, Councils, and Funds with Contractors (2001-2020)."
29. Ministry of Finance. 2015. "How can Sustainable Public Procurement pave the way to Sustainable Development."
30. Mahmalat, M., S. Atallah, and W. Maktabi. 2021. "Public infrastructure procurement in post-conflict power-sharing arrangements: Evidence from Lebanon's Council for Development and Reconstruction." International Growth Centre.
31. See https://www.ppa.gov.lb/
32. مجلس الوزراء. شباط ٢٠٢٣. "من محضر جلسة مجلس الوزراء." رقم المحضر ٣٥، رقم القرار ٢٨

Dimension 5: Accounting and reporting

This dimension assesses the timeliness, maintenance, and reliability of financial records to support fiscal management and budgetary decision-making. Based on latest available information, there is no legal framework in Lebanon that regulates the use of international standards for accounting and auditing of public finances.[33] This hinders the ability to perform comprehensive auditing and reporting via annual financial reports that compile budgetary and off-budget spending. In this vein, the only widely adopted framework that Lebanon follows in its reporting is the Government Finance Statistics Manual.

1. In-year budget reports:

This indicator identifies the comprehensiveness and timeliness in the issuance of budget execution reports throughout the fiscal year. An orderly budget report should follow a classification that mirrors that of the budget law and be issued on a regular basis. While there is no legal text in Lebanon that outlines the format and schedule of such reports, the Ministry of Finance used to issue monthly public finance reports on a regular basis. However, as the manifestations of the financial crisis grew larger, particularly on an already feeble public administration infrastructure, the degree of regularity in the issuance of in-year reports diminished. In fact, the ministry has yet to issue any budget execution report for the 2022 fiscal year (Figure 11).

Figure 11: Screenshot of MoF's in-year reports for the 2022 fiscal year

Note: Shaded months indicate that reports are missing.
Source: Ministry of Finance website.

2. Annual financial reports:

This indicator reviews the completion and timeliness of national budgets' yearly financial statements, which are also referred to as the closing of accounts. Constitutionally, Lebanon must publish its annual closing of accounts before the issuance of a budget law for the succeeding year.[34] These reports are issued via law by parliament, and represent an important tool by which the legislative branch monitors and holds the executive accountable. However, after failing to issue either budget laws or financial reports for 12 consecutive years between 2006 and 2016, Lebanese parliaments passed five budget laws without the closing of accounts of previous fiscal years—making them unconstitutional.

33. World Bank. May 2005. "Country Financial Accountability Assessment."
34. Lebanese Constitution. Article 87.

Dimension 6: External scrutiny and audit

This dimension assesses the impartiality of public finance auditing, focusing on independent external reviews and improvements by the executive.

1. External audit:

This indicator assesses the execution, reliability, and impartiality of external audits. The Court of Accounts (CoA), which is Lebanon's main judicial institution tasked with supervising all public spending, assumes the role of external auditor and enjoys ex-ante and ex-post mandate. The court is administratively under the auspices of the prime minister, with some of its jurisdictions overlapping/conflicting with that of the Ministry of Finance. Based on international best practices, this undermines the CoA's independence and contributes to an increase in fiduciary risk.

Concluding Remarks

Despite gaps in fiscal information, this document provided Lebanon's first mapping and assessment of public financial management using the PEFA 2016 framework. The findings echo the paramount importance of reforming the state's public financial management system, which has been suffering from detrimental capacity shortages during the crisis that could leave public finances in ruins for a protracted period. Future studies on this topic should focus on investigating missing data in an attempt to deliver a comprehensive assessment and scoring of Lebanon's public financial management pillars.

Before outlining policy recommendations, this section synthesizes the key weaknesses in Lebanon's PFM.

1. Lebanon's ability to reach aggregate fiscal discipline is a function of the distribution of political power. In the post-war era, public finances served as a vital instrument in the institutionalization of an "allotment policy" across social groups that is dictated by dominant political factions. In this vein, policy recommendations for reforming PFM ought to consider the guiding ideologies of the ruling political class.

2. For the past 18 years, Lebanon either failed to issue a budget law (2006-2016; 2021; 2023) or ratified it well into the fiscal year. This, in turn, undermined budgetary institutions and the role of a national budget in shaping a coherent medium-term fiscal policy.

3. Even when Lebanon issues a budget law, it is void of programmatic policy objectives. As it sta- nds during the crisis, the national budget is detached from a macroeconomic recovery framework and resembles an accounting exercise whose function is to finance the public sector payroll.

4. Budgetary controls and disciplined accountability measures are severely lacking due to structural political constraints over oversight agencies, which aggravated capacity shortages during the crisis.

Recommendations

Aware of the political resistance over reforms, this section proposes more feasible measures that have a high return on PFM reform outcomes.

1. Refilling capacity shortages in public administrations, particularly in the Ministry of Finance’s budget, tax, and IT departments. This entails staffing relevant departments that faced significant reductions in human resources during the crisis, including tax collection officers and IT personnel, as well as investing in technologies and infrastructure necessary to enable robust and reliable communication and data management within the ministry.

2. Unifying financial reporting across extra-budgetary funds and local governments with the Ministry of Finance’s annual financial reports. This merging exercise can be done in a phased approach to gradually reach comprehensive financial reporting.

3. Enforcing a disciplined budget preparation process across ministerial departments, as a significant delay in the budget preparation stems before the budget reaches the Council of Ministers and parliament—where progress is based on political choices.

4. Binding the budget’s preparation and execution to documentation that promotes citizens' financial literacy and public access to fiscal information. This includes building on the work of Institut des Finances to provide macroeconomic assumptions based upon which expenditure and revenue figures are calculated and policy reasoning behind which tax burdens are allocated in a user-friendly way to taxpayers.

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