

Who needs austerity if there's an alternative?

Published: January 13, 2026, 1:18 pm

This article by me was published in the [Lebanese publication Al Akhbar](#) this weekend. This version is translated back into English:

Moody's downgraded Lebanon's debt rating last week. Today, the debt classification in Lebanon has become Caa1, just junk, which means that the debt is much lower than the investment grade. The move comes in response to Moody's growing concerns over Lebanon's default, probably linked to the restructuring of debt by the Lebanese government.

The result is the continuing uncomfortable situation of the Lebanese economy. According to Moody's, debt in Lebanon now accounts for 141 percent of GDP, and debt service costs account for half of government revenues. The practical result of these two indicators is the continuing government deficit.

No one claims that this case is not serious. They are. It may be appropriate to predict Lebanon's ability to service its debts. But in parallel, there are questions to be asked about the appropriate local response to address this problem. The traditional response is similar to the recipe for the Washington Consensus: the government's pursuit of more liberalization policies, the privatization of all that can be privatized, supply-side reforms, and lower taxes and fees, which is believed to boost trade. After all these actions have been taken, we must all assume that growth will be achieved.

I am not saying that growth will not follow the application of these policies. However, in its previous experience, the problem proved to be chronic and its chances of success were very small, while other solutions were worth considering.

I was in Lebanon last November to speak at a conference organized by ESCWA on financing sustainable development goals. In my presentation, I discussed two issues: one on the tax gap, the difference between the tax owed to the State if the tax system worked as assumed and the amount actually collected. The second was the indirect tax implications of tax revenues that arise from and between tax systems, either because of poor tax design or because of the effects of tax competition. Both issues seem to be

of particular importance to Lebanon at present.

The tax gap can best be estimated by estimating the size of the shadow economy, that is, the part of the country's economy that is not declared for regulatory purposes, whether the regulations being evaded are taxable or make little difference, especially since each income is produced in a shadow economy Do not pay it any tax.

It is known that it is difficult to estimate the size of shadow economies. This is due, of course, to the fact that activists in this part of the economy do not wish to register their activities. As a result, all estimates of this part of the economy are based on the effects of its activities within the registered economy.

The best known estimates about the shadow economy, those prepared by Austrian academic Friedrich Schneider with his colleagues. Recent estimates published by the International Monetary Fund in 2018 show that Lebanon's shadow economy averaged 31.58% of GDP between 1991 and 2015, and may be just under 30% now. However, Schneider adds a note about his work on Lebanon as home to many refugees, pointing out that the real shadow economy may be larger than this figure because the refugees living there are not integrated into the declared economy.

The World Bank notes that Lebanon collects 14% of gross domestic product (GDP) from taxes. However, since this ratio is only the amount paid to 70% of the declared GDP of the tax authorities, the rate of the actual amounts declared may be up to 20%. If the same rate applies to the shadow economy estimated at 30%, 6% of the additional GDP will be raised through taxes. Since the cost of servicing public debt accounts for half of the government's expenditure, which accounts for 7% of GDP, it is clear that the problem Lebanon faces in servicing its debts can be largely completed if it can bridge the tax gap.

It is easier said than done, of course. But until recently, there was no established methodology to help any government find a way to achieve this goal on a regular basis. For this reason, Oxfam asked me and Professor Andrew Baker of the University of Sheffield to discuss this issue.

In fact, we have addressed the approach proposed by the International Monetary Fund (IMF) on tax effects and their indirect implications, which they sought to use to measure tax losses resulting from international tax competition on corporate tax. We were impressed with what the International Monetary Fund did, but we found some problems, from its very limited scope, to local and international tax effects that affect all taxes, and in many cases the available data is insufficient to allow this approach. As a result, we proposed a different approach, which I propose to be used by Lebanon.

Our method is qualitative and not quantitative. They can be used by tax experts both within and outside the country, having developed special knowledge about the functioning of their tax system. This method assumes that, in design, taxation should

not cause damage to other taxes. In addition, no country should harm the tax system of another country.

This approach measures tax risks between major taxes (notably income taxes, corporate profits taxes, capital gains tax and capital gains, noting that local and local conditions may impose other appropriate taxes) and the risks they have received. We also propose assessing tax and corporate governance systems, as well as the position of the political system on tax collection and the impact of international conventions on the country.

To give some simple examples, it is clear that any country that provides corporate secrecy encourages a shadow economy, because no one will know who is behind these companies and who uses them. Thus, it undermines the tax collection mechanism by circulating the failure to deduct tax from the source. In addition, weak investment in the empowerment of tax authorities undermines tax collection. At the international level, tax havens are a constant threat to tax systems and, therefore, data security is essential, and even necessary, for the provision of resources and the use of data.

From here, we see that the state, which assesses the indirect tax implications, contributes to solving all its economic problems. But of course, that would be just an unrealistic expectation. However, in the absence of any other systematic approach to tax risk assessment and treatment, we believe that our proposed methodology could be an option for Lebanon.

In fact, the austerity measures proposed by the Washington Consensus for a country in danger of default are unlikely to be effective in Lebanon. There is a need for other ways to rebalance government finances. Addressing the tax gap is one way, while an assessment of indirect tax implications shows how to do so.

The question is then, does Lebanon need at least to try this alternative in light of the issues it faces?