

Lebanon: From Post War Reconstruction Hype to Economic Collapse

Carole Alsharabati and Nour Gerges¹

Beirut, November 2022

Introduction

Following the devastation caused by the 15-year civil war, the Ta'if National Accord, signed on October 24th 1989, established the fundamentals of a new Lebanese state, where Rafic Hariri was appointed prime minister in 1992 to supervise the reconstruction program with support from Saudi Arabia and the West. The International Community also backed Lebanon's efforts to rebuild its wrecked economy following the civil war.²

Since then, the Lebanese Economy passed by **Four very distinctive phases³**:

- **First Phase (1993-1997):** The phase directly following the Civil War, mainly marked with optimism and reconstruction. It included increased spending, which meant increased capital expenditures, debt, and spending on capital projects in addition to hiring more people for the civil and security bodies.
- **Second Phase (1998-2002):** The primary deficit was reduced to almost balance throughout this phase, marking the start of an unofficial/informal austerity era. Notably, capital expenditures were drastically cut, and taxes were raised.
- **Third Phase (2003-2011):** A period of respite characterized by a glaring primary surplus and the accumulation of capital inflows propelled by improved attitude following the Paris II Conference in addition to rising oil prices, and favorable fallout from the 2008 global financial crisis. The latter saw money leaving international financial institutions and moving to Lebanon's bank-deposit system, which provided appealing returns.
- **Fourth Phase (2012-2019):** A period of unrest prior to the current crisis that was significantly impacted by the start of the Syrian conflict, the massive influx of Syrian refugees (which made Lebanon the country hosting the largest per-capita refugee population in the world), the economic consequences (such as the closure of trade routes, sharp fluctuations in the price of oil, and declines in tourism), and political/security unrest.

¹ Carole Alsharabati is a Professor of Political Science at Saint Joseph University in Beirut and Research Director at Siren Associates. Nour Gerges is Researcher and Consultant at Siren Associates.

² Nizameddin, T. (2006). The Political Economy of Lebanon under Rafiq Hariri: An Interpretation Middle East Journal, 60(1), 95–114. <http://www.jstor.org/stable/4330218>

³ World Bank. 2022. Lebanon Public Finance Review. © World Bank. Chap 2/B

In the 1990s, the economic rehabilitation of post-war Lebanon—which was intimately correlated with Rafic Hariri—became the challenge with the formation of a new political formula. The shortcomings of the post-Ta'if political order in Lebanon would eventually be highlighted by Hariri's liberal economic policies and long-term objectives of modernizing and overhauling the corrupt state sector.

The Growth Cycle via Rafic Hariri

On October 31st, 1992, Hariri took over as Prime Minister with the responsibility for rebuilding the physical and economic infrastructure of Lebanon. Like many other Lebanese, Hariri was hopeful that the continuing Israeli-Palestinian peace process, which in 1993 yielded the Oslo Accords, would result in a positive outcome, as peace in the region was deemed necessary to promote investment. In order to restore a state economy, since a divided Lebanon threatened regional stability, Hariri received support from the international community as well as, more significantly, Syria. But the core of the Ta'if agreement mandated that each party that participated in the 1975 Civil War have their fair share of representation, which evolved to encompass not just political but also economic and financial shares.

The "Horizon 2000" program, launched by the Hariri administration in 1993, allotted \$20 billion for the country's rehabilitation. The real GDP growth rate in Lebanon was 8% in 1994, but it steadily fell to 4% by 1997, giving the country's economy the impression that it was doing well at first.⁴ Moreover, the national stock exchange was reopened by *Solidere*⁵ in January 1996 after a relatively quick reconstruction of Lebanon's major business center.

Hariri's performance while in government, particularly in the area of economic policy, drew both high praise and scathing condemnation. **At least five significant accomplishments were attributed to Hariri⁶:**

- 1) Increasing the LBP's dollar worth after years of steadily declining value, and fixing it on 1500 LBP/\$.
- 2) Reducing inflation rates each year to single digit levels.
- 3) Beginning a highly ambitious investment project to modernize Lebanon's fundamental infrastructure and rebuild the commercial sector in downtown Beirut.
- 4) Reducing the maximum tax rate to 10%, offering tax holidays to new investors, and streamlining the tax code (all of these actions were intended to increase incentives for domestic and foreign investors).
- 5) Regaining regional and global confidence in the Lebanese economy.

On the other hand, **Hariri's got some charges against him, as he was accused of:**

⁴ CIA World Fact Book, Lebanon, <https://www.cia.gov/the-world-factbook/countries/lebanon/>

⁵ French acronym for Lebanese Development and Reconstruction Company

⁶ Arab Studies Quarterly, Vol. 24, No. 1 (Winter 2002), pp. 63-90

- 1) Betting on the quick success of the Middle East process, and subsequently spending billions of US Dollars (of largely borrowed money) to develop Lebanon's infrastructure, in the hope that borrowed funds can be easily repaid once peace arrives.⁷
- 2) Allowing Lebanon's public debt rapidly to mount until it reached dangerous levels towards the end of his term (in 1998).
- 3) Causing real interest rates on deposits in Lebanese Pounds to raise owing to excessive government borrowing.
- 4) Overspending on infrastructure development, while under spending on productive projects in agriculture and industry and on social projects (i.e., health care and education...).
- 5) Lowering direct taxes which helped the rich, while raising indirect taxes (such as the gasoline tax) whose impacts were mostly felt by the poor and middle classes.

And most Importantly

- 6) Turning a blind eye to rampant corruption among ministers, bureaucrats, local and foreign businessmen bidding on state contracts, as well as among his closest aides.⁸

This era would end in a deficit as the expenditures of these initiatives increased and successive Hariri administrations failed to address other economic and social issues (such as unemployment, low wages, poverty, especially in the outlying areas of the Biqa' valley and 'Akkar).

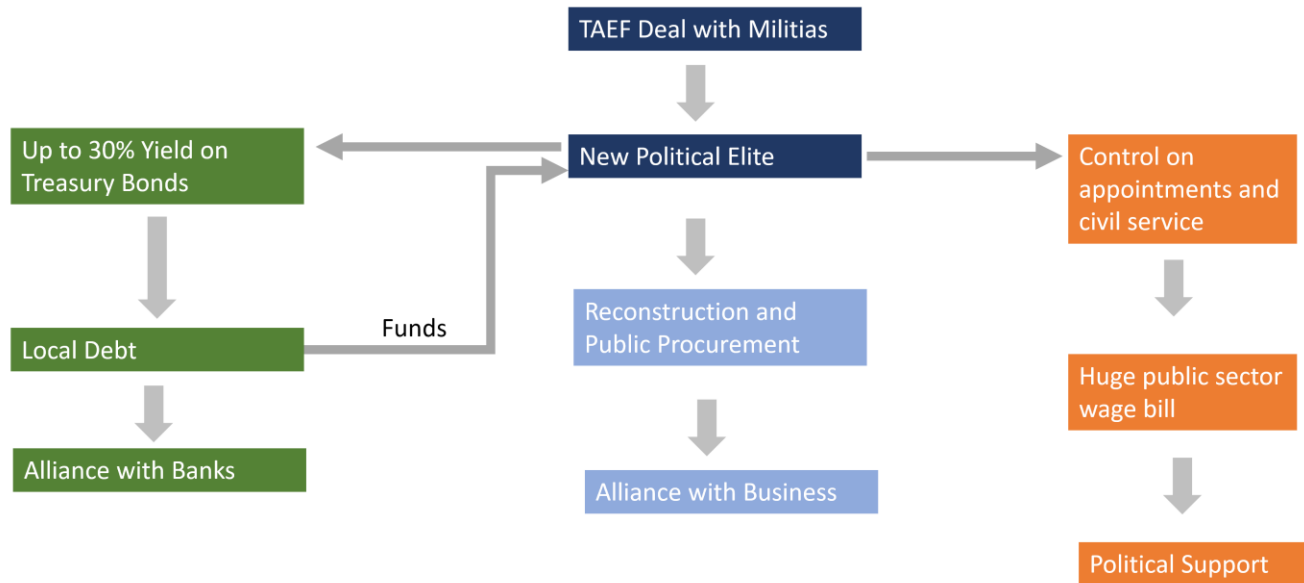
This era witnessed the development of a political economy of post-war recovery whereby militia leaders reintegrated into the State found new alliances and new “business”. After they sold their arms, they got into key public positions and in close alliance with the local commercial and financial sector. The new political elite in power managed to overspend to buy their constituency’s clientelist support through civil service jobs making the State the biggest employer, while coopting the big business through arbitrary public procurement to implement big reconstruction projects. They also paid the price of their alliance with the bankers through an increasing debt drawn on internal banking with treasury bonds yields as high as 30%.⁹ All this was done at the expense of the potential productive economy as no industry or agriculture was developed internally and at the expense of the middle class which lived off external remittances from expats which were sending remittances back redressing the balance of payment and thereby providing resilience to a twisted economy and bringing

⁷ A report issued by the Council for Development and Reconstruction (CDR) estimates expenditures on reconstruction and infrastructure development between December 1992 and the end of 1997 at US\$ 4.2 billion, of which close to US\$ 2 billion (US 1,986.5 million) came from foreign loans. See Al-Nahar, 14 March 1998, p. 10

⁸ Democracy (Again) derailed: Lebanon's Ta'if Paradox" in Bahgat Kourany, Rex Brynen and Paul Nobel (eds.), Political Liberalization and Democratization in the Arab World, Vol. 2, Comparative Experiences (Boulder, Colorado: Lynne Rienner Publishers, 1998), pp. 144-145.

⁹ <https://www.bdl.gov.lb/webroot/statistics/table.php?name=t5271-3>

temporary viability into a dreadful political economic model. On the surface, things were working for all, but the ground was set for a distorted regime where economic and political systems were interconnected to enrich a ruling mafia ahead of the biggest bankruptcy and Ponzi scheme in modern history.



Services Are Not Serving Us

On February 14th 2005, a big explosion hit Beirut, which resulted in the killing of Rafic Hariri, alongside it his era of fiscal policies. This led to big protests in the country objecting the Syrian presence in Lebanon. Hereinafter, the Syrian regime withdrew from Lebanon and with it, came successive Lebanese national governments who pursued similar types of policies as the late Rafic Hariri. With such policies in place, and by 2019, the services sector accounted for 78.85% of the GDP, followed by the manufacturing sector at 5.6% and agriculture one at 3%.¹⁰ Moreover, the dependence on foreign capital inflows and remittances from the Lebanese diaspora was also a reflection of this weakness in the productive sectors. For the past 20 years, most foreign direct investments have been made in real estate and tourism-related industries, with an annual average

¹⁰ World Bank Data, “Lebanon”, <https://bit.ly/3G5mrwf>

of \$2 to \$3 billion since 2010. Additionally, Lebanese expatriates were a major source of foreign capital, contributing between 15% and 20% of GDP on average through the 2010s.

This meant, Lebanon has one of the most unequal wealth distributions in the world, and one of the highest concentrations of billionaires per capita. In 2019, the top 10% of adults owned 70.6% of the country's wealth¹¹

Additionally, the banking sector took on the patron role over all of the sectors in the country as everything was interconnected and funneled back to the banks, whether it came to fuel subsidies, wheat import or local transactions.

Politicians + Banks = 1+1 = 1

With a focus on greater integration into the global economy, the Ta'if Agreement also significantly deepened the nation's economic liberal system. Neoliberalism in Lebanon was highlighted in this context as opening up the economy to international investment flows. These were primarily directed at the banking, finance, and real estate industries, deepening the economy's already heavily financialized structure and lessening its weight in the agricultural and industrial industries.¹²

It can be said that **as much as 18 out of the 20 banks have major shareholders linked to political elites, and 43% of assets in the sector could be attributed to political control.**¹³

Additionally, the Lebanese politicians did not stop at owning the financial sector, but deepened their control of the public sector, where civil service positions were filled through political appointments that do not even go through the Civil Service Council and merit-based processes anymore. Over the past 15 years, this process has ramped up as competing political forces have fought over appointments to the civil service

¹¹ UNESCWA (2020), "Poverty in Lebanon: Solidarity is Vital to Address the Impact of Multiple Overlapping Shocks", <https://bit.ly/32r9qhP>

¹² Joseph Daher, Lebanon: How the Post War's Political Economy Led to the Current Economic and Social Crisis, doi:10.2870/824020 // ISBN:978-92-9466-179-1, © European University Institute, https://south.euneighbours.eu/wp-content/uploads/2022/07/QM0122031ENN.en_-1.pdf, Parag 1.2

¹³ Jad Chaaban, "I've got the power: mapping connections between Lebanon's banking sector and the ruling class", Economic Research Forum, October 2016, <https://erf.org.eg/app/uploads/2016/10/1059.pdf> Abstract

throughout the state apparatus, including the Port of Beirut that ended up exploding on August 4th 2020. The process of politization is evident not only in hiring but also in management practices like firing, promoting, and changing jobs.¹⁴

Moreover, one of the main ways that public money is wasted is through public procurement. Malpractices have been made possible by the weak oversight institutions and the shaky, outdated legal system. Which makes procurement a huge source of corruption and public funds squandering contributing to the biggest financial and economic crisis in the country's history.¹⁵

A large part of the reason Lebanon's national debt has exploded can be attributed to the pervasive greed of the country's political elite. Greed is the outward manifestation of corruption in Lebanon, but it is not the full picture, as a main guise of corruption in Lebanon is clientelism. The little public support that Lebanese politicians do have comes from providing jobs and services to their constituents, and from providing contracts to big business. Perhaps this is true in other nations as well, but in Lebanon the practice is openly acknowledged and seen as the norm.¹⁶ This era set the ground for impunity. The “norm” has become a totally twisted regime where very little resistance or critical review was taking place, except for a handful of intellectuals who were outside the system. This norm was disguised by a pretend-democracy, which was only procedural with elections taking place and governments being appointed, but no accountability and a strong cooptation of various oversight institutions, from the parliament to the judicial, court of accounts, central inspection, and civil service board.

Financial Engineering 101 with BdL

¹⁴ Mahroum, S. (2021, July 4). Lebanon badly needs an independent civil service. The National. Retrieved October 27, 2022, from <https://www.thenationalnews.com/opinion/comment/lebanon-badly-needs-an-independent-civil-service-1.1064825>

¹⁵ Al Sharabati, C., Ajaltouni, S., Spognalo, V., & Ghandour, T. (2020, December 9). Public Procurement in Lebanon: A Gateway to Malpractice. Siren Associates. Retrieved from <https://sirenassociates.com/wp-content/uploads/2020/12/Institutional-Mapping-Final-Report-Dec-9-2020.pdf>

¹⁶ "The Three Faces of Corruption in Lebanon" (February 2001). (2022). Retrieved 27 October 2022, from https://www.meforum.org/meib/articles/0102_12.htm

After 2011, the real economy became more and more dependent on the Lebanese Central Bank (BdL) financing. BdL's interventions became more unorthodox as balance of payments pressures increased, resulting in the "financial engineering" scheme that started in 2016, providing costly incentives for banks to increase their foreign exchange placements in BdL, whom carried it out in total secrecy. The central bank's financial burdens increased, jeopardizing its position as the last-resort stabilizer of the financial sector.

Lebanon saw a decline in its balance of payments after the start of the Syrian Civil War, along with a sharp downturn in economic growth, this included a combination of worsening exports and declining capital inflows. In response, commencing in Q2 2016, BdL launched significant swap operations, also known as “financial engineering”, totaling US\$13 billion¹⁷, to strengthen BdL's reserve position and encourage foreign exchange deposit inflows.¹⁸

This mechanism made clear the challenges BdL was having keeping up its tactic of buying time and hoping for better days.¹⁹ The operations that followed prepared for much greater losses when the crisis eventually broke out in the Q4-2019 crisis.

Conclusion

As a result of the crisis Lebanon is currently facing, life has become financially unattainable, services have become limited, and the Lebanese have come to believe that their security can be threatened at any time, many have resorted to leaving the country all together searching for a better quality of life outside the homeland. It has led to a mass Lebanese Exodus following the Covid Pandemic, The Beirut Port Explosion and the deterioration of the Lebanese currency.

For those who stayed in Lebanon, tomorrow is often unpredictable as finance, security, livelihood and anything that can come to mind has become uncertain. The Lebanese people have their money stuck in banks,

¹⁷ IMF 2016 Article IV Consultation Report

¹⁸ These operations are studied in a series of Lebanon Economic Monitors, specifically in: World Bank (2016), *The Big Swap: Dollars for Trust*, Lebanon Economic Monitor, Fall 2016

¹⁹ World Bank. 2022. Lebanon Public Finance Review. © World Bank. Parag 49/50

and resorted to storming the banks in holdups and standoffs in order to withdraw their money, which is factually illegal, but has been praised by most of the public.

But some hope remains, as Lebanon has been ranked among the top countries in the world in Math (4th/141 country), in quality of its higher education (18th/141 country), in digital skills (23rd/141 country), in ease of finding skilled employees (10th/141 countries). These skills can surely be mobilized towards the new country, the new economy, an efficient and transparent public administration, good governance, and a success story. While oil is being discovered in the Mediterranean and old mafias are rushing to cut deals and control it, a silent young generation is preparing to unleash its talent, knowledge and expertise to save the sinking ship. Oil deals can only prolong the agony, genuine and solid recovery is inevitable and it is only a matter of time.

Lebanon Ranks

4/141

Quality of its math & science education

18/141

Quality of its higher education system

23/141

Digital skills among active population

10/141

Ease of finding skilled people

World Economic Forum, Global Competitiveness Report, 2019