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INTRODUCTION

Its capital was once feted as the “Paris of the Middle East,” but today the economic collapse of Lebanon has driven much of the country’s population into poverty. The components of Lebanon’s economic crisis include a foreign debt default, a currency devaluation and banking sector bankruptcy, in what is being described by the World Bank as a “perfect storm,” unseen in the world since the 19th century.

This paper examines the extent of Lebanon’s economic woes, and looks at future scenarios and policy solutions that could end the crisis and bring a sense of normalcy and hope back to the country. It is a cliche to say that a country is “at a crossroads” or “close to collapse,” but Lebanon’s rapid economic downward spiral has arguably taken it far beyond these waypoints. Lebanon’s financial meltdown has stripped away layer after layer from what a modern body politic should look like.

The post-civil war era of plenty in the 1990s was exposed and the perfect storm of which the World Bank had warned was exposed and the perfect storm of which the World Bank had warned. Riad Salameh, the Governor of Lebanon’s Central Bank, has denied accusations of fraud and money laundering, claiming that he is being unjustly scapegoated for the financial crisis that rocked Lebanon in 2019. "I saw the crisis coming, and I told the commercial banks in 2007 that they needed to get out of all international investments related to the international markets,” Riad Salameh, the governor of Lebanon’s Central Bank, explained to the BBC at the time.

Zoom forward 15 years, however, and Salameh’s name being chanted by angry protesters, is at the center of this economic storm. A travel ban on him, imposed by a Lebanese judge in early 2022, was lifted only in April, to allow him to attend a hearing in Paris related to a cross-border graft probe. While Lebanon’s economy endured the 2007-2008 financial crisis, this was followed in 2011 by the war in Syria and the arrival of hundreds of thousands of refugees, a burden compounded by the collapse of investments and trade relations with Lebanon’s eastern neighbor. What’s more, a regional realignment of alliances meant that levels of traditional Gulf support plummeted - between 2003 and 2006 Lebanon had received more than $12 billion from Gulf nations.

Then, alongside the crippling economic effects of the COVID-19 pandemic, what has been described as Lebanon’s economic “Ponzi scheme” was exposed and the perfect storm of which the World Bank had warned broke with a vengeance. The country’s descent into the mire was accelerated when an ammonium nitrate explosion ripped through Beirut in 2020, causing an estimated $15 billion in damage and claiming 218 lives.

The components of Lebanon’s economic crisis include a foreign debt default, a currency devaluation and banking sector bankruptcy, in what is being described by the World Bank as a “perfect storm,” unseen in the world since the 19th century. More than 30 percent of Lebanon’s GDP is reportedly in the “shadow economy.” Turkey’s economic crisis, provided some $6 billion in annual subsidies of fuel, food and medicine. Yet Lebanon is a country with both official and unofficial sources of power. Armed actors inside the country are more powerful than its national military and many of the most influential Lebanese politicians do not need to be elected. The breakdown between the formal and the informal is reflected in its economy. More than 30 percent of Lebanon’s GDP is reportedly in the “shadow economy.”

The symptoms of this collapse are myriad, from power outages plunging cities into darkness, uncleared rubbish piling up in the streets, banks terrified of being robbed by their own depositors shuttering up, leaving millions locked out of their accounts, and a currency that has lost almost its entire value, forcing shops to change their prices by the hour. Monthly food inflation recently hit 40.4 percent, leading to the emergence of a hunger crisis. In January, Lebanon’s first ever Integrated Food Security Phase Classification (IPC) Acute Food Insecurity Analysis - a system comprised of governments, UN economic crisis, provided some $6 billion in annual subsidies of fuel, food and medicine. Yet Lebanon is a country with both official and unofficial sources of power. Armed actors inside the country are more powerful than its national military and many of the most influential Lebanese politicians do not need to be elected. The breakdown between the formal and the informal is reflected in its economy. More than 30 percent of Lebanon’s GDP is reportedly in the “shadow economy.”

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The Lebanese currency has lost more than 98 percent of its value against the dollar since the start of the country’s financial collapse and transfer agencies are filling the gap in a country where the banking sector has largely crumbled. AFP

The economic situation has caused a growing diaspora of Lebanese citizens leaving the country, while those who remain demand inflation adjustments as the prospect of living in poverty looms. AFP

agencies, NGOs, civil society and other relevant actors that was originally developed in Somalia - predicted that the situation would deteriorate this year, with 2.26 million people - 1.46 million Lebanese residents and about 800,000 refugees - expected to be in the “crisis” phase or worse, and needing urgent assistance. A Human Rights Watch survey at the end of 2022 revealed that nearly 70 percent of households said that they had difficulty making ends meet or had always been behind on basic expenses in the previous year. Inflation has hit the country particularly hard, as 85 percent of commodities are imported. Annual inflation in February jumped 190 percent from a year earlier. Healthcare expenses grew by 315 percent, clothing and footwear by 274 percent, and the cost of water, electricity, gas and other fuels rose by 207 percent.

Other parts of society are under pressure. Serious crime is spiking with an 18 percent increase in murders and an almost 8 percent rise in suicides in 2022. Narco-trafficking has been exacerbated by Syria’s conflict and Lebanese authorities claim to have arrested some 15,000 people in recent years in the battle against the extremely lucrative Captagon trade. The country’s public health sector is creaking, with 2022 seeing the first cholera outbreak in some 30 years. More children are being forced to work, enter into early marriages or leave education as teachers strike in response to their salaries vanishing into the black hole of economic chaos. The crisis does not, of course, impact uniformly across the population. The rich experience it differently to those already struggling to make ends meet. The young may increasingly look for futures out of the country while the old have seen pensions vanish and face the prospect of living their final years in poverty.

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The German statesman Otto von Bismarck is credited with the phrase that “politics is the art of the possible.” While the history of Lebanon’s economic collapse is relatively clear, the way out of the morass is not. According to the International Crisis Group, “Lebanon is suffering economic meltdown while its politicians dither.” Some protesters on the streets push for getting rid of “the whole system,” while the Arab Reform Initiative warns that the old model for the country is simply “not redeemable.” All agree that there is no short-term fix and that things could get worse before they get better.
The scale and speed of the crisis is leading to fundamental questions being asked about what kind of political response the country needs to restore an effective social contract alongside a working economy.

The simplest solution would appear to be for international money, particularly from the IMF, to bail the country out. Yet any external support will come with strings attached and, unless the government implements the conditional sweeping reforms that would be required by the IMF and other financial bodies, Lebanon will receive nowhere near the support it needs. France, for example, has been leading international efforts to push Lebanon to tackle corruption and implement reforms demanded by donors. Yet Oxford University associate professor Adel Malik and Harvard research associate Jamil Ibrahim Hajjar argued in The Washington Post that “Lebanese politicians and elites profit from their corrupt system - and foreign donors keep propping them up to hang on to their own influence.” As contradictory as it may seem, there are vested interests relying on the current disastrous status quo continuing.

But if Lebanon’s governing structure could enact economic reforms, what should they look like in order to reflate the country’s economy? Economic consensus lands around the need for an overall financial and monetary stabilization plan. The country’s banking sector, so central to a service-oriented economy, needs to be unparalyzed. The currency needs a more flexible-exchange-rate regime, coupled with capital controls and foreign loans accompanied by conditionality. According to George Kanaan, CEO of the Arab Bankers Association, talking to Arab News, the financial crisis in Lebanon could be resolved within five to 10 years if “a well-thought-out program” is implemented that takes care of small depositors, addresses the needs of medium-sized ones and brings big depositors on board as partners in new banks.

With financial and monetary stability comes the potential to explore large-scale infrastructure projects, better leveraging the country’s diaspora and unlocking the potential of offshore energy. In late 2022 Israel and Lebanon signed a breakthrough agreement establishing a permanent maritime boundary between them in the Eastern Mediterranean Sea, and experts argue that “Lebanon’s offshore oil and gas reserves could eventually become an economic lifeline for the beleaguered country.”

A future Lebanese economy could see fiscal reform and the depoliticization of large-scale infrastructure projects. The Washington Post revealed that “recent research finds that 60 percent of total spending between 2008 and 2018 by Lebanon’s Council for Development and Reconstruction, which leads public investment efforts, flowed to only 10 companies, widely known to be politically connected.”

There is arguably no better place for a more transparent approach to investment to be adopted than the country’s airport, its main gateway to the outside world. Such is the rollercoaster nature of today’s situation in Lebanon that earlier this year officials announced that a new $322 million second terminal for the airport would be built. The incredulity that followed such a decision was tempered by the news that followed weeks later that the plans had been scrapped with Public Works Minister Ali Hamieh explaining that it had been halted after local and international actors questioned the project’s legality for bypassing public procurement regulations. Yet in a future of economic sanity a development plan could add hundreds of jobs, meet the capacity demands of the overcrowded airport and bring in new sources of critically needed revenue.

Foreign direct investment into a more diversified economy as well as large-scale projects, such as expanding the country’s international airport, could be closely linked to a reinvigorated approach to harnessing the energy of the country’s diaspora. Famously, more Lebanese live outside of the country than in it and there is a long tradition of remittances flowing back from successful Lebanese abroad. There are about 14 million Lebanese scattered across all five continents and their continuing support has been crucial in maintaining a financial lifeline to help people through the current crisis. As a result of the economic situation, the diaspora has grown with the increasing numbers of Lebanese leaving the country. According to a February 2022 Information International report, 75,134 Lebanese migrated in 2021 compared to 77,241 in 2020, the highest in five years. In 2021, money from the diaspora back into Lebanon totalled nearly $7 billion dollars, more than half the country’s GDP. A regular returning diaspora is also an important component of Lebanon’s tourism industry. The country where you can famously ski in the morning and dive in the afternoon has not disappeared into the vortex of this crisis and this remains a huge economic advantage.

WHAT NEXT?

The Arab Reform Initiative argues that Lebanon “could successfully transition from a rentier, service-based economy to a competitive, open-economy model driven by low-tariff reform, a robust exchange rate regime, and a dynamic export sector.” Yet nobody can credibly guarantee when or even if Lebanon’s economy can pull out of its downward spiral. The recent tensions on the southern border with Israel were a reminder that traditional geopolitical challenges that could escalate quickly have not gone away. On the more positive side, the agreement between Saudi Arabia and Iran to restore relations in March of this year is surely good news for Lebanon considering how influential the two states are in the country. Likewise, increasing normalization between Damascus and the states in the region has the potential to benefit Lebanon if managed correctly but as this paper has shown there is no way back to the economy of the past.

Indeed, this briefing paper has set out economic alternatives that “could” happen in Lebanon but the existential question that underpins all of them is whether the country’s politic can and will be able to embrace the required change. The “old” system had winners and losers, but its combustion has given the country the challenge to reimagine its economy through a structural transformation to becoming a high productive, sustainable economy with successful human capital at its heart. The alternative is that the country can’t change fast enough or dramatically enough and that its economy is simply beyond recovery. If so, those treading for revolution over reform will be the ones whose voices in the country may raise to the ascendency.
Lebanon declares bankruptcy, losses to be shared by State, Central Bank, depositors. [Website: https://www.middleeastobserver.org/2022/04/04/lebanon-declares-bankruptcy-loses-to-be-shared-by-state-central-bank-depositors/]


