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Abstract

This paper provides an account of the 2019 financial crisis in Lebanon. It then analyzes a series of related questions. First, it considers the historical background and asks how the crisis could have been averted. Second, it reviews post-crises economic developments and attempts to explore the reasons behind their severity. Third, it reviews the policy recommendations suggested to exit the crisis and examines whether they need to be updated in view of recent developments. Fourth, it offers a vision of a new growth path for Lebanon and examines the implications of a recovery strategy. Finally, it discusses a revised donors' strategy better adapted to the current circumstances.

Keywords: Lebanon, financial and banking crisis, balance of payment crisis, debt crisis, growth potential, stabilization and recovery, donor strategy.

JEL Classifications: G2, N2

ملخص

تقدم هذه الورقة سردًا للأزمة المالية لعام 2019 في لبنان. ثم تقوم بتحليل سلسلة من الأسئلة ذات الصلة. أولاً، تأخذ في الاعتبار الخلفية التاريخية وتتسأل كيف كان من الممكن تجنب الأزمة. وثانيا، تستعرض التطورات الاقتصادية التي تلت الأزمات وتحاول استكشاف الأسباب الكامنة وراء خطورتها. وثالثا، تستعرض التوصيات المتعلقة بالسياسات والمقترحة للخروج من الأزمة وتبحث ما إذا كان يلزم تحديثها في ضوء التطورات الأخيرة. رابعًا، تقدم رؤية لمسار نمو جديد للبنان وتبحث الآثار المترتبة على استراتيجية الإنعاش. وأخيرا، تناقش استراتيجية منقحة للمانحين تتكيف بشكل أفضل مع الظروف الحالية.

1. Introduction

Lebanon's economy, mined with structural faults for decades, has been collapsing since 2019. The GDP per capita has fallen from USD 11,320 in 2018 to less than USD 4,000 in 2022, and income inequality has shot up to Latin levels. By early 2023, the country was mired in a debt crisis, with debt to GDP exceeding 180 percent; a currency crisis with the LBP depreciated by 98 percent; a banking crisis with depositors unable to withdraw their funds; and an economic crisis with the main pillars of the economy (tourism, education, and healthcare) experiencing massive business closures and brain-drain. Three successive governments have done little to stabilize the situation. The descent continues, now at a slower pace. More delays make it harder for the economy to rise again at some point. The middle class is disappearing, corporate, human, and financial capital are evaporating, and the infrastructure is decaying. The country is at risk of being stuck in a poverty trap despite its rich potential.

More than three years after the financial blow-out, this paper seeks to advance five main theses. First, it offers a synthetic description of the run-up to the crisis. This part makes it clear that the crisis is largely derived from a longstanding overvaluation of the national currency, which has discouraged investment and production. In the face of low economic growth, the large external capital flows that have characterized the country for the past two decades had to stop sooner or later. When they did, after 2018, the balance sheets of the state, its central bank, and the financial sector were decimated, producing a severe economic depression.

The second goal of the paper is to examine the reasons behind the severity of the current crisis. Seldom does GDP fall by this much (between 40 and 60 percent) during peace times. The freeze of the financial system is a key reason; production was unable to shift from domestic demand to export. The political leadership was unable to even start cleaning up the financial system, stymied by the gargantuan task of distributing losses evaluated at multiples of the GDP. Instead, policymaking became dominated by rent-seeking interests. Banks' equity holders have, so far, been spared. The central bank spent most of its reserves on capital flight and import subsidies, and much of the banks' loan portfolios were repaid on the cheap, benefiting borrowers at the expense of depositors.

The third aspect of the paper is to shift the policy focus from exclusive attention to the banking crisis, to the other two ongoing crises that also require critical attention: the acute social crisis, with poverty rising to affect 50 percent of the population; and the state collapse, with its budget down tenfold and basic services no longer delivered. While there can be no dynamic economy without a banking sector, there can be no country without a state. Each of these three crises makes the other harder to resolve. However, without progress on the three fronts, recovery would be impossible.

The fourth aspect of the paper is to discuss how to resolve the crisis in the context of rebuilding a sustainable economic model for the future, now that the post-civil war model has died. Ideally, a rapid initial economic recovery would get the state, the market, and the society to simultaneously start moving away from their deeply wounded conditions. This would require

a boost in confidence about the future. Future growth does not require massive state investments or complicated regulation. Lebanon has many comparative advantages, from a skilled population to a connected diaspora and a brand name that is still valuable globally. At minima, it can function as a middle-class dormitory economy living off expat remittances, with recovering education, health, and tourism sectors. Additional opportunities can bubble up through SME innovations across the territory, especially in the export of services. The needed shift in expectations can only follow sufficient political progress to deliver improved cooperation among the diverse political parties in ways that ensure that vigorous policy would be implemented as needed, infrastructure remains functional (especially electronic), and external aid is available.

Finally, the paper proposes a rethink of the role of donors. Since 2018, the donor strategy has been to dangle the promise of a big push in exchange for ambitious political and economic reforms. So far, this strategy has failed to elicit any progress. We believe, however, that external pressure should continue and remains the best hope for reform to take place. However, the risk with "nuclear conditionality" is to allow the social and economic wounds to grow so deep that recovery becomes impossible in the future. In recent years, humanitarian aid has acted as a "second leg" replacing developmental support, but this remains fragmented and ineffective. We propose to consolidate this second leg into organized support for a basic services package to limit the decay in the country's potential and preserve its future.

The goal of the paper is not to offer an elaborate political economy reading of the Lebanese situation. More than elsewhere, Lebanon suffers from "political dominance" in the sense that the evolution of the economic situation is conditioned on the evolution of relations between the main Lebanese political parties. After its civil war, Lebanese political forces have been deeply divided, especially after the end of Pax Syriana in 2005, reflecting the rising tensions between Saudi Arabia and Iran.[1] How does one deal with economic rationality in such a situation? While we try to disentangle some of the political economy reasons that pushed for particular decisions in the past, we take a more normative approach when discussing the future. By focusing on how to maximize the size of the economic pie, we hope that political interactions could become more cooperative for the interest of all.

This is clearly not a convincing way to *predict* the future. However, we think that it is a useful contribution for three reasons. First, Lebanon's economic problems are complex and not well understood, and a necessary condition to solving them is to understand them better. Second, now that it has become clear how costly non-cooperative behavior can be, it becomes even more necessary to aspire to and advocate for more cooperative solutions, even while recognizing that they are difficult to enforce. Third, if better solutions are not found within the system, the knowledge that better economic outcomes are possible can only encourage citizens to redouble efforts to change the system itself.

[1] These divisions are rooted in the inherited communitarian system (see Salloukh, 2023 for a review of a huge literature). There were many external shocks that have put more stress on the system – particularly Israel's wars on Lebanon, the Syrian civil war of 2011, and Saudi Arabia's disengagement in 2016.

While we leave it for others to study the "logic" of a political system that seems to encourage the emergence of zero-sum and even negative-sum situations, it is useful to clarify the political economy approach underpinning our analysis. Broadly, we believe that uncooperative behavior among the main political actors has been dominant, leading to large "agency costs" that undermine good governance. Within this broad frame, the recent deterioration of the power-sharing system was due to three factors.

The first reason why agency costs rose originates with the formation of a large power-sharing coalition after 2008, which came to include all major political actors (Salam, 2021; Bahout, 2015; Salloukh, 2017). This helped ensure civil peace, a valuable achievement given the high level of insecurity that characterizes the region. However, the coalition of parties with different political agendas and often conflictual external alliances also made it hard to reach agreements on economic policies.[2]

Second, the private sector has also been divided and unable to push for rational policies with a unified voice. Historical tensions between bankers and importers on the one hand, and industrialists on the other, favored the first group in Hariri's post-war economy, a dominance which remained after the financial blowout of 2019. The expansion of monopolistic crony capitalism also divided the private sector.

Third, the system's dysfunctions are exacerbated by the predominance of waiting tactics, where actors try to shift the cost of adjustment to others. This phenomenon is closely connected to the high levels of geopolitical uncertainty in the region, which encourage players to wait for better regional conditions before settling. Negotiating the distribution of losses is difficult given their immensity and the uncertainty about the staying of the various political forces.[3] There are several types of "waiting games" taking place now; political parties are trying to ensure a better position relative to each other;[4] the regime is negotiating with the street, inflicting pain so that a financial settlement becomes more accepted; and the state is negotiating with the world for more support while threatening an influx of refugees.

The rest of the paper is organized as follows. Section 2 provides a historical background to the 2019 crisis and explores how the crisis could have been averted. Section 3 reviews the

[2] A political equilibrium is defined by Douglas North (2007) as satisfying two conditions: a governing coalition large enough to ensure security, but not so large as to be too costly for the economy to sustain. In this view, Lebanon had to give up on the second goal in order to be able to satisfy the first – especially with the Doha agreement of 2008, which effectively imposed a two-thirds majority rule for all important decisions.

[3] This argument follows Alesina and Drazen's (1989) argument on why stabilization gets delayed. More generally, the non-cooperative behavior of the other hypotheses belongs to the type of breakdowns that lead to war (see Fearon, 1995 for a review of "rational" wars).

[4] The choice of president is a case in point; the election of President Aoun (2016-22) took more than two years. Traditionally, this involves negotiating a range of issues that would define the new regime. Currently, according to news reports, there are ongoing negotiations over the names of the next prime minister and head of the central bank; a possible IMF program; the future electoral law; potential decentralization reforms; and a defense strategy to integrate Hizbollah into the army.

economic development post-crisis and examines why it has been so severe. Section 4 offers a vision of a new growth path, while section 5 reviews policy recommendations considering recent changes. Section 6 discusses the donors' strategy, and section 7 concludes.

2. Structural faults and missed opportunities

The Lebanese crisis emerged in the confluence of two factors: a country increasingly "living on the capital account," and an economy unable to grow for more than a decade. The post-civil war political-economic-financial model was initially driven by an expansionary state, rebuilding infrastructure lavishly by borrowing on the promise of future prosperity to get growth going. Over time, large capital inflows, coming to an unstable country with an atrophied political system, contributed to the failure to build a productive economy and led instead to over-consumption (i.e., more than that could be afforded on a sustainable basis). This section argues that, contrary to popular belief, the source of the crisis was not a profligate state, but a broader problem of a whole society living beyond its means for far too long.

Capital flows averaged 20 percent of GDP a year in the 2000s, which is probably a global record (at their height in 2016, about USD 17 billion). Attracting large flows was state policy. After the civil war, Lebanon's financial doctrine became to peg the LBP and adjust interest rates as necessary to keep flows coming. In the end, the peg became so costly to maintain that it brought the house down. While they lasted, these large inflows allowed the state to run fiscal deficits, and the private sector to consume more than it produced. Such huge inflows could only be sustained in a fast-growing economy, and for a short period of time, but economic growth was not impressive over the period. While real GDP growth approached 10 percent early in the reconstruction phase during the 1990s, it fell in the 2000s and was close to zero after the start of the Syrian war in 2011. The series of political and security shocks that continued to hit the country over the period certainly weakened the economic outlook – this included political violence and assassinations, conflict with Israel, and the still ongoing Syrian refugee crisis (Figure 1). In addition, after its initial reconstruction boom, Lebanon did not find a new growth engine. The ultimate cause of the economic collapse of 2019 was the accumulation of liabilities without a commensurate increase in assets.

Two factors are striking when looking at capital flows: how long they continued to come for over two decades despite the increased accumulation of worrisome clouds; and how the imbalance they financed was increasingly not connected to a public sector deficit but to spending by the private sector. The external imbalance, measured by the current account deficit, can be divided into a public and a private component, according to the national account identity:

$$\text{Current account deficit} = \text{Private (savings – investment)} + \text{Government deficit.}$$

For example, in 2018, the current account deficit stood at 25.5 percent of GDP, and it was divided almost equally between a public sector deficit (11.1 percent of GDP) and a private sector deficit (14.3 percent of GDP). The private sector deficit itself is made of the difference

between a modest investment rate (20.4 percent) and a dismally low private saving rate of 6.1 percent of GDP.[5] Figure 2 shows the evolution of the current account and the public deficit over time. It is striking that until around 2007, the fiscal deficit absorbed most of the inflows, but afterward, capital flows started financing mainly a private deficit. It should also be noted that the debt service was mainly remitted to the domestic private sector, boosting its expenditures even more.

The other factor is how long this state of financial disequilibrium lasted. One of its main supporting pillars was an implicit "Saudi guarantee," which weakened over time but was clearly removed when Prime Minister Saad Hariri was involuntarily retained in Saudi Arabia in November 2017. Over the longer period, monetary stability rested on a strong homegrown bias by bank depositors, including a large base of expats, the occasional donor's bailouts, and the collective interest of Lebanese banks to avoid shaking the system.

Public debt

Since public debt is an essential part of the problem, it is useful to understand its dynamics. Public debt has been "too high" in Lebanon since the early 2000s, a result of the big infrastructure push of Rafik Hariri. By the time of his assassination in February 2005, public debt to GDP stood at 200 percent. The political bet done in 1993 was to fuel a recovery through a massive reconstruction program financed by debt, gaging on a regional peace that would inundate Lebanon with a generous peace dividend. The bet was lost by the end of 1995 with the assassination of Israel's Prime Minister Yitzhak Rabin. From that point on, the economic strategy has remained on autopilot.

The following five years saw rapid GDP growth rates.[6] Tight budgets and rising fiscal revenues led to several years with primary surpluses.[7] This led to improvements in the debt ratio, which fell to a low of 130 percent of GDP in 2012 – still a dangerously high level by international standards. Figure 3 illustrates the dynamics of the public debt ratio. After 2011, the continuous rise of the debt ratio, reaching 170 percent of GDP in 2018, was entirely driven by a combination of rising interest rates and low GDP growth. This occurred even as the primary deficit had a (small) surplus in the 2010s (+1 percent of GDP on average). The overall deficit kept growing; debt grew endogenously, so to speak, because of the rising refinancing cost.

Real economy effects

This policy stance (high interest rates and an overvalued exchange rate) had negative effects on competitiveness. Capital flows acted akin to Dutch disease, leading to a rising appreciation

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[5] This term also implicitly includes imports destined for Syria but not included in re-export data – a recurring problem in Lebanese statistics given a long and porous border.

[6] The rise in growth rates in the late 2000s came on the heels of significant deposit inflow to Lebanon. The diaspora, impressed by the fact that the Lebanese banks survived the global financial crisis unscathed, increased its inflows significantly (and its investments in real estate as well).

[7] More generally though, fiscal expenditures were badly unbalanced, focused on the payment of interest on debt, overstaffing in the public sector, and a large subsidy to the power sector, at the expense of public investment in human capital and infrastructure.

of the real (effective) exchange rate (REER). As real wages and the price of non-tradables rose, an inflation differential grew relative to trading partners. The real appreciation in the decade 2008-18 is estimated at somewhere between 30 percent (Mora, 2020) and 45 percent (IMF, 2019).

There was no renewal of the economic model, which increasingly operated as that of a rentier economy, but one without a sustainable rent. Citizens behaved as if they were rich, with the wealth effect operating through both the appreciation of asset prices (the national currency, land, and real estate), and the growth of bank deposits boosted by high interest rates (these reached 200 percent of GDP, levels only observed in very rich countries). This pushed up domestic spending, especially consumption and imports, and led to a fall in domestic saving rates. At the same time, domestic production suffered.

The fall in economic dynamism can be seen in key aggregates. Private investment declined over time, from 20 to 12 percent of GDP between 2010 and 2019 (see Figure 4). Moreover, most investments went into real estate, an area that does not generate much foreign exchange (although it did attract some foreign direct investment). There was also a secular decline in manufacturing value-added, which fell from 24 to 14 percent of GDP during the period. Exports of goods and services also fell as they became less competitive. The fall of exports was exacerbated after 2011 by the Syrian war, as land access to the GCC market closed. The private sector, already more mercantile than productivist, suffered from an increased monopolization of the economy to the benefit of the politically connected (Diwan and Haidar, 2021). Contrary to its reputation, the Lebanese economy was not a thriving marketplace with a dynamic private sector in the 2010s, as the business climate became increasingly politicized and costly to navigate.

Benefits and costs of the exchange rate peg

The need to attract sufficient funding to finance a large current account deficit was a constant challenge for the government, which led to an out-of-the-ordinary level of activism by the central bank, Banque du Liban (BdL). Its goal evolved over time from a focus on financing reconstruction, to financing fiscal deficits, to helping service a large public debt, and, finally, to prevent deposits from fleeing the country. The currency peg was seen as essential to this strategy, guaranteeing that foreign funds could exit at par. The defense of the peg, however, came at an increasingly high cost. In the end, it was the currency mismatch at the BdL, rather than fiscal deficits, that generated much of the national losses. Seeing this requires clarifying the imbrication of its balance sheets with that of the banks and the state.

In the 1990s, public sector deficits were financed in local currency by the banking sector, which over time increased its exposure to public debt. To get the banks to buy Treasury Bills, two factors came into play: high interest rates, which reached 40 percent in the mid-1990s; and a stable exchange rate. In time, Lebanon also started raising debt in international markets to borrow at lower interest rates. Risks to the system changed from mainly devaluation risks reflected in risk premia on LBP deposits over USD deposits, and default risks started to rise

showing as risk premia on dollar deposits over global dollar rates (Figure 5). As Lebanon's credit rating declined further in the 2000s, banks became more wary of sovereign risk, and BdL increased its exposure to state debt. To maintain the fixed exchange rate, however, it needed to have access to hard currency. A systemic crisis was averted several times. In 2001-02, a financial collapse was averted thanks to the Paris I and II conferences, where significant external financial aid came to the rescue. In 2007, the Paris III conference generated much-needed relief after the 2006 Israeli war. Aid was promised again in 2018 to avert a looming collapse (CEDRE), but this was made contingent on reforms.

To attract foreign exchange, BdL increasingly sought to get dollar deposits from commercial banks (Figure 6). Between 2006 and 2019, the share of the banks' assets invested in BdL rose from 35 percent to 70 percent.[8] This was a risky strategy for the banks compared to investing their dollar deposits abroad, especially since they were highly dependent on non-residents deposits.[9] If non-residents started to withdraw their deposits, the assets of commercial banks would have to be liquidated at fire-sale prices.

However, this was highly profitable. The IMF (2019) estimates that bank profits averaged four percent of GDP over the decade.[10] Their profits allowed banks to increase their capital from USD 250 million in 1993 to USD 18.9 billion in 2018.

The balance sheet of BdL grew immensely, but a dangerous currency mismatch also grew alongside it. Bank deposits, largely in dollars, rose from 40 percent to nearly 80 percent of total liabilities between 2000 and 2019. At the same time, BdL's assets became more invested in LBP denominated public debt (going from five percent to 32 percent of assets between 2000 and 2019), and less invested in foreign currency denominated assets (going from 62 to 22 percent of assets over the same period).[11] This strategy led to a loss of reserves, visible in Figure 7 (in that banks' deposits grew while reserves remained flat) due to the heavy cost of carry; placements abroad carried interest rates much lower to that paid to banks. More reserves were lost to occasional FX interventions to stabilize the peg in the face of weakening external flows. These financial choices meant to the BdL balance sheet became highly exposed to exchange rate risk. In the end, most of its losses would originate from this imbalance. The main reason why losses turned out to be so high is that unlike other countries, where defending the peg ends when the central bank runs out of reserves, BdL kept defending the peg on credit using commercial banks' funds. As seen in Figure 7, 2016 marks the first year where BdL's net

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[8] At the same time, their liquidity was reduced to a mere seven percent of assets, down from an average of around 90 percent during the 1975-90 wartime average, which allowed them to survive despite a highly unstable political situation.

[9] Since 2011, the net position of banks in non-resident assets has been negative, reaching USD -17 billion in 2017.

[10] The profit rate of the banking sector is about twice that in the US (two percent of GDP). Gaspard (2019) calculates that banks' profits were around USD 30 billion between 2009-19, with distributed dividends at around USD 7.8 billion during the period.

[11] By 2015, capital flows had weakened so much that BdL began to offer very high interest rates in what got termed financial engineering operations. To sweep as many dollars as possible off the banks' balance sheets, BdL offered banks real interest rates of up to 17 percent on dollar deposits to attract nearly USD 13 billion (25 percent of GDP) which had resided so far safely with their correspondent banks (IMF, 2016).

reserves turned negative, meaning that it started using banks' deposits to shore up the exchange rate. Its deficit grew in time to reach USD 60 billion in 2022.

When did the problem become apparent?

The financial dashboard of Lebanon had lights flashing red on several occasions: at the end of the 1990s, in 2005, and by the early 2010s. At several junctures, the financial structure became highly unstable and, barring a foreign bailout, was on a lifeline. These repeated episodes of living on the edge must have neutralized the sense of urgency that should have arisen after 2016. By then, not only were external imbalances still requiring a significant inflow of hard currency to prevent further reserve depletion; the public debt trajectory was still unsustainable, the financial sector was more than ever exposed to the sovereign. BdL's net reserves had turned negative and growing, and, unlike the past, a possible external bailout was no longer in sight.

None of this was hidden from all to see. The country's credit ratings faithfully reflected the reality of high and rising riskiness. Lebanon was rated as speculative since 1997 and constantly downgraded afterward (except for two brief periods, after Paris III and in 2009, on the heels of the injection of capital by the international community). For example, S&P had a speculative rating for Lebanon since the inception of its sovereign debt; it moved to a "high credit risk" in September 2000 and to a "very high credit risk" in January 2008. Further, international investors started shunning Lebanon's Eurobond issues starting mid-2017, and subsequent issues were only subscribed locally.

Several economists, financial investigative journalists, and pundits have been warning of an impending financial sector crisis as early as 2016. Though IMF reports tend to be written in diplomatic language as they are subject to review by local authorities, by 2018, its Article IV raised alarm bells. The clearest warning that the financial situation was getting out of control came in August 2017, from Toufic Gaspard, a respected local economist. Gaspard concludes that: "Lebanon is very likely heading towards a serious financial crisis, which would take the form of a depreciation of the currency and a destabilization of the banking sector. The consequences of a financial crisis include a drastic fall in the incomes and wealth of most households in the country, and a sharp increase in bankruptcies and unemployment."[12]

Should the peg have been abandoned earlier?

The peg was set in 1997, even as the *de jure* regime remained a free-float. Over time, holding the peg became state doctrine, and the mention of devaluation came to be seen as close to

[12] The risk factors are also listed very clearly in the documentation attached to the Republic's Eurobonds. The 2017 Note made it clear that the finances of banks and those of the public sector were closely interlinked, and therefore that any problems facing the banking sector would lead to a probable default by the Republic. The March 2017 Note states: "The Lebanese banks' ability to continue purchasing Eurobonds issued by the Republic is tied, in large part, to the continued growth of their deposits. The pace of deposit growth has slowed in recent years, in particular, between 2013 and 2015 and the growth in 2016 was due, in part, to the financial engineering operation conducted by BdL in the summer of 2016. Any significant net deposit outflows or a slowdown in the rate of deposit growth would adversely affect the Lebanese banks' ability to purchase securities issued by the Government, which could, in turn, limit the ability of the Republic to refinance its debt."

national treason. This was believed earlier to be an essential element to refinance public debt, and later as a condition for the stability of the financial sector, as the credibility of the exchange rate, public debt, and banks' profitability became entangled. The fear was that a devaluation would trigger outflows, making it impossible for the government to avoid default, which would in turn bankrupt the banking system. There was also the additional problem that private sector borrowers would have struggled to repay their loans post-devaluation – either because they borrowed in LBP, or because they would hurt financially.

An earlier controlled devaluation would have allowed for a soft landing. The goal of a real devaluation would have reduced the external deficit by reducing imports and improving competitiveness and the expansion of exports. This is certainly not a simple goal, but it should have been a national priority aimed at building a sustainable economic model post-civil war. That necessity was part of the policy debate since the 1990s. Earlier, capital control would have sufficed to stabilize the financial ripple effects of a devaluation. Indeed, a mega devaluation at the end of the civil war in 1989-90 was a prelude to the subsequent take-off and ended up barely hurting the financial system. The number of lost opportunities for a devaluation and a debt restructuring were numerous. In particular, there were two political moments where pro-industry forces were at the helm: in 1998-2000, during the Hoss cabinet (with George Corm as Minister of Finance), and in 2004-05, with the Karami cabinet (with Elias Saba Minister of Finance). On both occasions, opposition and external political events precluded plans to pop the bubble. On this and other occasions, and especially after 2011, the country's governance framework was not robust enough to bear the short-term instability associated with a deliberate move to a different growth path. The effects of a devaluation became more costly as the currency mismatch in BdL's balance sheet became more pronounced, especially after 2016.

3. A disastrous crisis

Since late 2019, there has been massive inflation and currency devaluation. The economy has collapsed, there is an enormous decline in standards of living, and poverty is estimated to have shot up to over 50 percent of the population.[13] The same governance failures that led successive governments to be unable to muster the discipline to avoid a financial crisis also made then unable to craft a stabilization plan when the crisis hit. This section examines why the collapse has been so deep.

The timing and extent of the collapse

Looking at the development in the capital account is instructive in understanding the timing of the crisis (Table 1). Capital flows slowed down from USD 17.2 billion in 2016 to USD 12 billion in 2017 and collapsed in 2018 to USD 3.2 billion, one year before the crisis erupted. During 2017-18, it was left to unrecorded capital inflows to finance most of the current account deficit, probably attracted by the extremely high interest rates offered by the BdL and the banks. However, such high rates also announce problems to come. The sudden stop was not due to

[13] Statistics vary widely. The UN Special Rapporteur on poverty and human rights states that multi-dimensional poverty almost doubled from 42 percent in 2019 to 82 percent in 2021, with extreme poverty estimated at half that number.

banks trying to massively withdraw their deposits from the BdL; they knew that such actions would lead to their own collapse. Instead, the run was triggered by depositors losing confidence in the banking system. Table 2, on the structure of bank deposits, shows that the run took place mainly among the very large depositors, with more than USD 10 billion withdrawn during 2019. It was the financial crisis that led to the default on public debt, not the other way around.

On 18 October 2019, massive demonstrations asking for a change in the political regime started to occupy the public squares of major towns all over the country. On that day, banks closed their doors, only to re-open them on 1 November. By then, a bank run was ongoing, which led banks to immediately institute unofficial capital controls, rationing the payments of deposits. The decision to default by the government of Hassan Diab came only in March 2020, five months later. It was by then unavoidable: the Eurobond market had closed down on Lebanon since 2017 (only domestic subscriptions took place afterward), capital inflows had stopped flowing in (capital flight was, by now, massive), and reserves were falling fast (by USD six billion between October 2019 and February 2020). Moreover, there were steep repayments due in the short term. Despite the "hard" character of the default, the government promptly hired financial and legal advisors to assist with debt restructuring and IMF negotiations. What made the default harder were the internal conflicts among Lebanese factions that blocked any meaningful treatment of the crisis afterward.

Since then, Lebanon has been facing a three-pronged crisis. First, a sudden stop in the inflow of capital led to a balance of payments crisis that resulted in imports collapsing and a massive and accelerating devaluation of the LBP. Second, a fiscal crisis has seen government revenues imploding, its spending collapsing, and basic service provisioning crumbling. Finally, a banking system crisis has rendered the sector both illiquid and insolvent. Citizens have lost access to their hard-earned wealth, and the private sector has lost access to funding and liquidity. These developments were made worse by COVID-19, the Beirut port explosion in 2020, and the continued political instability.

As a result, the economy has been shrinking at a rapid pace; this is already the worst economic crisis in the country's history since WWI. In such an environment, it is even more difficult than usual to estimate the main elements of the national accounts. In this paper, we rely on the World Bank's estimates. The World Bank Group has been extremely involved in analyzing the multiple aspects of the crisis in regular hard-hitting reports (World Bank 2020, 2021, 2022). It bases its estimates on a set of real indicators (such as cement consumption and port activity) as well as government reports (from the Ministry of Finance and BdL). Still, one needs to take the figures, and especially the estimates for 2021-22, with a grain of salt, as early estimates tend to be heavily revised afterward.

Part of the difficulty stems from hyperinflation, which makes the computation of real values difficult: if inflation is underestimated, which is likely given estimation lags in the face of its acceleration, real values will be overestimated. Further, the cash economy has grown a lot, and official data may not capture some elements of it. Moreover, the massive devaluation of the

LBP must have largely overshot, so measuring economic aggregate in real (market-based) dollars is likely to exaggerate the estimates of the fall. As evident in Table 3, between 2018 and 2022, prices have gone up by 10.4 times – close to the rise in money supply over the period (10.2 times). The average exchange rate has, however, devalued by more – 17.7 times when measured at mid-year (and 29.8 times when measured at the end of the year). Because the market-based real exchange rate declined by around one-half, there is a large divergence between changes in "real values" and in dollar values.

To capture the fast-changing structure of the economy in such an environment, the evolution of key macro-variables is presented in 3 different ways: (i) as a share of yearly GDP; (ii) as a share of their level in 2018 computed in real terms (accounting for inflation); and (iii) as a share of their level in 2018 computed in market dollar terms (to account for the effect of the real devaluation). Table 3 presents the trend in GDP from 2018 to 2022. The GDP is estimated to have contracted by somewhere between 36 and 62 percent since 2018 (in real terms, and in market dollars, respectively), with the decline not yet stabilizing, going down by a further 6.5 percent in 2022 (in real terms, and more in dollar terms). This is an incredibly high decline, only comparable to what is observed elsewhere during wartime. The economic collapse has caused catastrophic income and wealth destruction. A large share of the population is unable to afford basic items, and the middle class is being wiped out. During 2020-21, consumer goods, fuel, and drugs were subsidized by the BdL, and subsidies were largely eliminated by the end of 2021. Scores of firms have closed. Thousands of children have dropped out of school. With hope lost, big waves of Lebanese, including professionals and youth, are fleeing the country.

Why has the crisis been so deep?

The crisis simmered for a long time, erupted suddenly, and then turned out to be durable and deep. The fact that this is not a passing recession is attested by the fact that the old model is clearly dead: the brand of Lebanon as a bank has been so badly tarnished that other means need to be sought to earn foreign exchange – in other words, a new development model is needed. The main reason for the depth of the crisis is that much of the accumulated debts – by the banking sector, BdL, and the government – were internal. Initially, there was a popular belief that, being a national affair, the debt problem would be easy to resolve. This turned out not to be the case at all (Diwan, 2020). A larger external debt would have allowed to push a larger part of the burden to external actors. Instead, faced with the challenge of determining how to distribute huge losses domestically, the political process froze. Moreover, there was an additional layer of difficulties related to the debt crisis metastasizing into a banking crisis.[14] The collapse in production was closely related to the loss of access to credit. Finally, the loss of confidence in policymaking precipitated massive capital flight, which led to the over-shooting of the exchange rate.

[14] Comparing all external debt crises, Reinhart, Reinhart, and Rogoff compute the cost of *debt overhang* in terms of lost output at 24 percent of GDP on average over history. Looking at all recent *banking* crises, Lavens and Valencia find an average loss of 34 percent of GDP. Double or triple crises, while being rare events, experience even larger losses.

The direct impact of the sudden stop is that, initially, domestic production falls. Lower capital flows impoverish people, firms, and the state, and this lowers domestic demand. Ideally, firms shift their production toward exports to protect their business, but this transition, at best, takes time. It also takes credit lines to adjust production to the requirements of the export markets, a good business climate to be willing to invest at all, and access to infrastructure to produce and export (such as energy and logistics). These crucial inputs were all sorely missing. Misguided policies made things worse. Three main mechanisms usually initiate a rebound: a devaluation of the exchange rate, which makes exports more attractive; an effective credit market that allows firms to adjust their production structure; and counter-cyclical monetary and fiscal policies, supported by foreign funding, that ease the pain and re-establish macro stability. Despite a huge devaluation, the utter destruction brought to the banking, fiscal, and monetary institutions ended up deepening the crisis. Instead of rising, exports of goods and services were cut in half in 2020 (Table 6). When measured in real terms, production fell mainly in 2020 (by over 21 percent), when domestic demand fell sharply and firms lost access to credit. In 2021, subsidies were removed, leading to higher energy prices, and there was a further fall in demand as real wages collapsed. The various additional shocks – from COVID-19 and the explosion of the Beirut port to the food and fuel price rise associated with the Ukraine war – only made a bad situation worse.

These developments exacerbated the collapse of domestic demand (see Figure 8). Households were unemployed, with no access to their savings, and facing rising prices and falling real wages. The state had lost its revenues and was unable to borrow. Further, businesses operated in an environment of enormous uncertainty. It is not surprising that the demand for consumption, investment, and the supply of public services all collapsed. According to World Bank data, national expenditures in real terms in 2022 were merely 62 percent of their 2018 levels, with investment at 24 percent and government spending at only 16 percent, all in real terms (Table 4, last column on the right). Private consumption too fell sharply and stood in 2022 at 82 percent of its 2018 level in real terms. Inadequate policies reduced demand further by pushing the burden of adjustment onto the middle class. Runaway inflation taxed people's real incomes and pensions. The creeping expropriation of deposits ate into people’s savings. While the value of LBP deposits has been wiped out, even USD deposits have been cut by banks “allowing” limited withdrawals in LBP at a massively overvalued exchange rate.[15]

The exodus of the youth and professionals has been bleeding the country's human capital. Equally, capital has also been finding ways to leave. The influential rich with political connections and access to BdL reserves have sent their deposits abroad to avoid future haircuts, leading to undue pressures on imports, but also an excessive fall in the real exchange rate. The external accounts (Table 1) reveal the enormity of capital flight, another specificity of the crisis. Paradoxically, more dollars were pumped into the economy by BdL in 2020 than flowed voluntarily in before the crisis. Of the USD 13.2 billion of official reserves it spent in 2020,

[15] The danger of this was recognized very early in the crisis, see: “The trouble with the creeping expropriation of depositors,” *Annahar*, 24 January 2020.

nearly USD nine billion are now either in banks abroad or hidden under mattresses – recorded in the BoP under "errors and omissions."

Size of the losses

Balance sheet effects are at work in all economies but tend to be of secondary order: consumers spend less when they feel poorer; firms can borrow less when the value of their real estate holdings falls; and states need to pay higher interest costs when borrowing excessively due to rising sovereign risk. These effects exacerbate the economic cycle – for example, a recession reduces the demand for and prices of real estate, leading to lower value of collateral and thus to less lending (Bernanke et al., 1991). In Lebanon, however, balance sheet imbalances are so large that they have become first order. The public sector cannot borrow and needs to print money to finance its deficit; the central bank cannot engage in normal practices of monetary policy; banks cannot attract deposits and make loans; and firms and households operate with cash. To get financial institutions to work again, their balance sheets need to be restored by erasing unfunded liabilities – this requires painful reductions of public debt and in banks' deposits at BdL, and haircuts in deposits in the banking sector. This process of loss distribution has considerable political and economic ramifications, and it is, in the absence of leadership, an impossible task to execute.

By mid-2023, how large were the total losses of the financial system? After the crisis and hyperinflation, all domestically denominated assets and liabilities were debased, and thus, looking at the FX denominated balance sheets gives a close enough description of reality. In a recent paper, Zouein (2023) offers an estimate of the consolidated balance sheet of Lebanon Inc – i.e., a merged balance sheet of the state, BdL, and the banking system. On the asset side, there is gold and the FX reserves held by the BdL, the banks' (remaining) private sector loan portfolio, and their holding of FX, and state assets. There is so much controversy about the value of state assets that Zouein leaves the entry blank. We assume that public debt is reduced to USD 20 billion. On the liability side, there are the deposits and other loans to the banking system, and the government's external debt (which we estimate is settled at a discount of 80 percent). We reach a (lower bound) estimate for a total loss of around USD 50 billion (see Table 7). Losses have been increasing over time. This has happened despite the much-criticized process of "Lirafication," which has reduced these losses by pushing them to small depositors. Banks have both limited the amount that can be withdrawn and provided these at below-market exchange rates, causing capital losses to depositors reaching up to 80 percent. However, a back-of-the-envelope estimate of the amounts withdrawn by small depositors indicates a maximum of USD three billion.[16] The real action was elsewhere. Around USD 30 billion of bank loans were repaid at discounted dollar rates, and at least USD 30 billion of BdL reserves were spent on subsidizing imports or in capital flight.[17] These massive leakages, which continue unabated,

[16] Table 2 indicates that that accounts of less than USD 1.5 million rose by about USD four billion between the end of 2019 and the end of 2021. A minimal amount of interest was paid during this period. Banking sources suggest that around USD three billion of "fresh" funds came into the small accounts. At most, all the USD 3.8 billion reduction in the USD 1.5/3 million category could have moved down to that group.

[17] The size and composition of the BdL losses are difficult to ascertain in the absence of a detailed audit. The Diab 2020 plan estimates the losses of the BdL are close to USD 50 billion, of which around USD 20 billion on account

have continued to reduce rapidly what depositors will ultimately be able to recover from their frozen bank accounts.

Has the economy hit rock bottom?

After three years of crisis, the rebuilding of the economy has barely begun. However, the silver lining of the needed adjustment to the lesser availability of foreign currency is that the country now has broadly balanced external and internal accounts again, albeit at a much lower level of income and expenditure. It would be an exaggeration to say that there is an absence of a working banking sector. What is left of the economy now operates largely outside that system in cash and in dollar bills. There is even a rebuilding of banking relations in “fresh” money, separated from “Lollar” accounts by Chinese walls created and managed by individual banks themselves, with no legal basis.

On the external side, the current account deficit stood in 2020 at around USD three billion/year, but it is thought to have grown again as donor inflows have risen. Gross remittances have doubled since 2018 to at least USD six billion. This means that a large share of domestic consumption is now financed from external flows (more than 50 percent). Even though part of the external deficit continues to be financed by the BdL, drawing on its remaining reserves (Table 6), it is unlikely that expenditures will fall much further. Imports have already collapsed, as households cannot afford expensive consumption goods anymore, and because the process of import substitution has started to show some results. Exports have started to recover and even grow in some sectors, such as agriculture and tech services.

While the budget deficit has been broadly brought into balance, the fiscal situation is far from stabilized. The size of expenditures has collapsed, together with revenues, to six percent and five percent, respectively, of a much smaller GDP. The fiscal balances have become the more fragile element of the macro picture given the huge demands on the state and its pitiful level of revenues. Public expenditures in 2022 were around 11 percent of their 2018 real levels (and revenues 20 percent) (see the last column of Table 5). The big change in composition is that debt service and public investment are both close to zero. This extraordinary collapse in expenditures is reflected in ridiculously low real wages for civil servants. With average wages in the range of USD 50 per month at the time of writing, these represent more than the cost of transport for public servants to get to work. Recently, the government has started promising wage increases, and it has started to make efforts to increase tax revenues (initially by applying a more favorable exchange rate on border taxes). Unable to tax or borrow, the state has expanded the money supply enormously, and the BdL has done the same to finance depositors’ (limited) withdrawals. It is estimated that money supply has risen by 198 percent, 109 percent, and 75 percent in 2020, 2021, and 2022, respectively, which can be compared to inflation figures of 84 percent, 150 percent, and 120 percent in these years (Table 3).

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of public debt, USD 20 billion in cost of carry (famously classified as “Net other assets at BdL”), and USD 10 billion in FX losses. The 2022 Mikati plan has different figures, reflecting the passage of time - total losses are estimated at USD 60 billion, with nearly USD 50 billion in FX losses.

4. The potential for future growth

The collapse of production amidst capital and skills flight illuminates the deep causes of the crisis: the death of a rentier economic model; and deeper down, a political system that has been unable to advance the public good. The crisis offers an opportunity to rebuild better. There are at least two reasons why it is useful to discuss the prospects for long-term growth before plunging into a discussion of short-term stabilization and recovery. First, it is an attempt to describe the road not taken in the 1990s, and to reaffirm that there can be light at the end of the tunnel. Second, to examine the essential ingredients that should be in place to move onto a new growth path once the political situation improves.

It has now become clear that future prosperity can only be achieved in the future through the efficient production of goods and services (Nahas, 2020). This is a major challenge. If Lebanon does not find a productive growth path, it will continue to export its youth and live on remittances and some tourism. This may stabilize incomes at around USD 4,000 per capita. To get back to the 2018 level of income and double that number, the Lebanese economy will have to triple in size and undergo structural change. Given how small the country is, incomes cannot grow without expanding exports. Before the blowout, the country had a modest export base of goods and services of around 40 percent of GDP. To bring Lebanon's GDP back to its 2018 level and raise the export-to-GDP ratio to 60 percent, exports need to rise by a factor of five. This will demand efforts for several generations. Igniting growth will not be sufficient; it will need to be sustained over a long period.

Contrary to popular belief, Lebanon can be productive. The two most formative phases of growth through production are those of the 19th-century silk boom (Salibi, 1988) and the rapid growth of manufacturing during the 1960-70s. The latter phase is also that of the Chehabist institutional development, which saw the creation of the BdL, social security, a meritocratic civil service, and more balanced regional development. However, finding a new productive path requires innovation. The "Merchant Republic" model, which had its heyday in the 1950s (Salibi, 1988; Traboulsi, 2007), led to the development of a strong banking lobby, which was developmental in the 1960s (Safieddine, 2019). However, the crony capitalism of the 1990s (Leenders, 2017) has seriously dented entrepreneurship. The entrepôt model is no longer a workable fallback since the consolidation of Dubai and Turkey in that space. Equally, a return to the pre-war productive model based on agriculture and industry, when services were limited to tourism and finance, will not do either. Even then, it was difficult to compete with the rising East. Today, a labor-intensive model is even less palatable. Workers are increasingly being replaced by robots, reducing the potential of manufacturing-led exports (Rodrik, 2016).

Comparative advantages

The distinct comparative advantages that have (and could again) made Lebanon an attractive site for productive economic activity include a dynamic entrepreneurial culture, a rich intellectual capital (driven by a strong and trilingual educational system), closeness to the GCC market, and a large and connected diaspora (Shiraa, 2021). The "Lebanon Brand" is seen as a valuable asset and one that can combine cultural heritage and innovation to speed up export

growth by upgrading traditional sectors, including in areas as diverse as skilled e-services of various kinds (health, education, finance, engineering, law, advertising, media..etc.) and tourism, all leveraged through e-commerce.[18] Many of these sectors offer new opportunities that did not exist as recently as a decade ago; eco-tourism, organic food, high-value crafts, clean energy, or water management are relatively new areas of consumer interest which can become competitive with the application of technology.

While high costs limited productive opportunities in the past, the future can be different if costs that have come down with the real devaluation can remain under control. With suitable infrastructure, especially digital, islands of specialized skills can promote innovation, attract investment, engage the diaspora, and become thriving growth centers (Dibeh, 2021). Cultural inputs as embodied in language, design, and music are especially needed to support the expansion of Internet-based services and AI into Arab markets.[19] Promising areas for growth rely heavily on Lebanon's diaspora as consumers of its products; contributors to production with their links to global value-chains; financiers connected to regional and global financial networks; and providers of technology and knowhow. High-skilled Lebanese workers tend to be mobile and emigrate as soon as conditions deteriorate, but incentivizing them to come back is also possible, as witnessed during the 1990s. This requires not just security (so far mined by the presence of weapons outside the control of the state), but also “quality of life” factors that appeal to them, including environmental and cultural, as well as a functioning basic infrastructure.

The domestic political backdrop will likely remain a constraint on growth, and Lebanon will continue to live in a chaotic neighborhood.[20] While this does not rule out growth, the model should incorporate resilience. The basis for resilience involves equal citizenship, solidarity, and justice. Currently, Lebanon is one of the most unequal countries in the world (Assouad, 2023; Traboulsi, 2014). A productive economy offers a historic opportunity for inclusive growth and social mobility, as promising growth sectors and products involve a diversified set of skills. Active labor market policies will also be crucial, including the management of in-migration to keep the labor market tight and unskilled wages elevated.

Implications for short-term policies

The highest risk until a take-off can be engendered is that Lebanon's comparative advantages deplete beforehand. The current crisis is already leaving deep scars: the country's brand is getting wounded, skills (and capital) are leaving, accumulated capacity is disintegrating with companies that embody them shuttering; and the quality of education is precipitously falling. The requirement to move onto a sustainable production-based growth path requires the usual

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[18] In the 2000s, Lebanon already had high levels of relative comparative advantage in over 200 products (Atallah and Srour, 2014).

[19] While the Arabic-speaking world constitutes about five percent of the global population, Arabic website content is currently at less than one percent of global content, presenting a unique opportunity for a mix of scientific and cultural value-added for the next decade (Mahroun, 2021).

[20] On the deeper roots of instability in Lebanon, as endowed by geography and history, see El-Khazen (2000) and Salibi (1988).

ingredients: a macro framework that fosters pro-growth incentives, a competitive and flexible exchange rate, access to capital and infrastructure services, and the rule of law.

Besides these standard recommendations, others are more connected to Lebanon's comparative advantages. First, decentralization can support the deployment of the country's advantages over the whole territory. Regionalism (and even localism) can offer creative workers better lifestyles by enabling municipalities across the land to compete to attract firms. A rich cultural and environmental work setup is needed to convince entrepreneurs to locate their firm near a well-kept and managed Lebanese small town, rather than in, say, Dubai, the same way Italian high-value entrepreneurs prefer to work in Piedmont rather than in Torino. The second specific requirement is environmental. Protecting nature is not a luxury but is at the core of Lebanon's competitive advantages. The promotion of decentralized renewables can solve the energy crisis, create jobs, and lower the air pollution crisis plaguing the country. Third, gas and oil discoveries, if they end up large enough to be exploited commercially, will be transformative. Unless properly regulated, however, those discoveries risk exacerbating corruption. Finally, in the short to medium terms, rebuilding Syria will offer profitable opportunities for many sectors in Lebanon, contributing to a quick recovery if the political and financial conditions are right.

5. The politics of stabilization and recovery

This section describes the early consensus on reforms, and how this has been evolving. Some adjustment to the initial shock has taken place, albeit in the worse possible manner, but still reduces the urgency to move on some measures, such as capital controls, and puts more emphasis on others, such as fiscal adjustment. Our main message is that while fixing the financial sector remains a priority, two other challenges have become as pressing: helping society cope and restoring government capacity. In the short term, these are competing, financially and politically, but they are also complementary; a lack of progress on any one of them would preclude progress on the recovery goal. As such, the risk of falling into a poverty trap is high.

In fact, it is hard to imagine how to deal decisively with the three constraints in the absence of an initial big push (for example, 10 percent per year for three years) that would be able to sufficiently release the three constraints at once to give rise to a virtuous rising path of progress. Such a boost might be created by the initiation of the reform of the financial sector, together with sizable external support, allowing inflation to come under control, and social tensions to be minimized. Such a plan might generate a confidence push that leads to a large appreciation of the national currency – the billions of dollars circulating in the economy being used for investment and imports rather than as a precautionary store of value. Such a scenario may sound fanciful in the current depressed environment, but it would not be impossible to craft if the conditions are ripe. Rafik Hariri managed to rebuild downtown Beirut under much more difficult circumstances, when militias were still roaming the streets and the country was utterly divided. Ambitious reforms were also implemented in Lebanon the post-1958 civil war presidency of Fouad Chehab, and the post-1975 civil war of Amine Gemayel. In each of these

episodes, the cabinet managed to obtain broad legislative power from the Parliament to implement the needed reforms. This itself required, at minima, a new political dispensation, if not a new political settlement, willing to bet on development.

Whether a big push can be organized or not, the three basic agendas remain. The policy stance by succeeding governments after the eruption of the crisis (Hariri who resigned within 10 days, Diab, and Mikati) has so far been disastrous. At the risk of repetition, the list of mismanaged policies includes an absence of capital controls to prevent capital flight; banks allowed to manage their insolvency by themselves, rationing deposit withdrawals at their whims; FX reserves splurged on leaky subsidies and capital flight; and an enormous expansion in money supply to finance fiscal deficits and bank withdrawals.

Early consensus

Among Lebanese economists and finance experts, versed in similar crises elsewhere and long sensitized to Lebanon's financial fragility, the broad agenda for action was clear from day one. Meeting on an emergency basis in December 2019, just a month into the crisis, a group of prominent Lebanese experts recognized that the old economic model was dead and that enormous challenges lurked ahead.[21] The group issued a ten-point program to stabilize the economy and move rapidly toward recovery. The proposed stabilization plan issued in December 2019 and updated in March 2020 included:

- Establishing capital controls and restructuring the financial sector to restore banks' viability.
- Restructuring public debt to ensure sustainability.
- Implementing fiscal reforms to create space for social spending and infrastructure.
- Reforming the state-owned energy sector.
- Modernizing the central bank's legal and PFM systems and eliminating banking secrecy.
- Establishing a credible and transparent monetary and exchange rate system.

The government plan, supported by Lazard as an advisor, came six months later in April 2020 and presented a detailed strategy organized around a similar package (Government of Lebanon, 2020). The plan was to move quickly into an IMF-supported program. The plan proposed a bail-in to restructure the banking system, a steep reduction of public debt, and a recapitalization of the central bank. The plan was comprehensive, if overly optimistic, and included fiscal and monetary policy reforms as well as growth-supporting measures. It was the first time that the government issued a report exposing the true challenges and losses facing the financial sector.

Lebanese experts were generally supportive of the Diab plan and of seeking IMF support (for example, Bisat et al., 2020; Chaoul, 2020). The BdL, the powerful finance committee of Parliament, and the banking community, however, obstructed any attempt at reform. The economic elite, particularly the banks' shareholders, resisted losing their massive equity base, preferring to wait for other options to open up. The bankers' association rejected all guilt for the meltdown on the state and offered a counter-proposal built around a bailout financed by a

[21] Lebanon's Economic Crisis: A Ten Point Action Plan for Avoiding a Lost Decade. *Annahar*, 6 January 2020

massive sale of public assets – estimated improbably at USD 50 billion. Most top political leaders also obstructed the plan; some had direct interests in banks, others wanted to "protect" their rich supporters, and all needed to avoid recognizing their inability to prevent such a calamity from happening in the first place.[22] These views were propagated through a captured media.

With its reform plans resisted, PM Diab resigned soon after the August 2020 Beirut port explosion. It was only in April 2022, under the Mikati cabinet, that the government and the IMF agreed on the terms of a staff-level agreement, which included a list of the prior actions that would need to be completed before a financing package could be considered at the Fund's Board. This included the following measures:

- Parliament approval of a reformed bank secrecy law, and a formal capital controls law.
- Agreement on a bank restructuring strategy and a connected Bank Resolution legislation.
- Audit of the BdL's foreign asset position and bank-by-bank evaluation for the largest banks.
- A medium-term fiscal and debt restructuring strategy that restores debt sustainability.
- Unification of the exchange rates for authorized current account transactions.

By the time of writing, none of the conditions have been satisfied. Paradoxically, Lebanon was having symptoms worse than during the harshest IMF program, but not enjoying any of the actual benefits of a program, i.e., the financing and the reforms. Multiple exchange rates continue to cause major distortions to economic activity, creating opportunities for corruption and rent-seeking. Several drafts of a Capital Controls Law were submitted to Parliament and then discarded. The most current focused on protecting banks from legal action, as the number of court cases against banks' illegal behavior multiplied, in Lebanon and abroad, in addition to repeated hold-ups by citizens withdrawing their deposits by force. A Banking Secrecy Law was approved by the Parliament but in a watered-down version so as not to allow progress on fighting corruption, supervising banks effectively, collecting taxes, investigating financial crimes, or recovering stolen assets. On banking, no law was submitted to the Parliament.

Fiscal challenges

Currently, the size of the state has been reduced by more than 10 times compared to 2018 to a minuscule budget of less than USD one billion in 2023 at the market exchange rate. Essentially, the state has ceased functioning, and civil servants work intermittently at best.

The collapse is so profound that the minimal basic services needed to keep society from imploding cannot be delivered at this stage. Unless urgent external support is provided, it would not be possible to keep the most basic services going, especially that a large part of the population that used private services in the past cannot afford to do so and is now lining up in public schools and clinics. This includes basic health, education, and a social safety net. A large

[22] Hizballah, a party that yields enormous influence, retains an ambivalent posture. On the one hand, it tends to take a progressive view on economic reforms, as reflected in its newspaper, Al Akhbar. On the other hand, it is keen to protect the existing political system, which has allowed it to thrive.

safety net will also be needed for several years to protect the most vulnerable from the worst effects of the crisis. Such a program would also allow for stopping the monetization of deficits, leading to a fall in inflation, and would create the fiscal space needed for the state to start rebuilding its core capacity.

Tax revenues need to rise in both the short and medium terms. Over time, much of this performance would depend on the speed of the economic recovery. In the short term, given the depressed economy, one needs to set realistic goals. Efforts are initially needed at the border and on large incomes. Over time, the structure of taxation will have to change, given that imports, bank deposits, and interest rates will be smaller in the future. To increase revenues (up to around 20 percent of GDP in the medium term), the tax base needs to grow while tax rates should become more progressive at the same time. An expansion of the VAT would be a bad idea (IMF, 2023), as the current tax incidence is already heavily regressive (VAT, customs).[23] Ultimately, an ambitious tax reform that institutes a system of progressive taxation on the whole of income will be needed (Bifani et al., 2020).

On the expenditure side, the crisis is a golden opportunity to rebuild better. In the past, calls for reform focused on the need to close corrupt institutions that served no purpose other than clientelism, and eliminating subsidies to EDL. At this stage, these expenditures have all shrunk massively. Ideally, the state would be rebuilt on principles of efficiency and transparency, with e-government at its core, and with a clear anti-corruption agenda. As the GDP starts to recover, these reforms (in conjunction with the savings accruing from lower debt servicing) should allow real civil servants' wages to recover, and to increase spending on social and infrastructure sectors, and on defense.

On the macro front, public debt must be reduced to 60-75 percent of GDP so the state can regain creditworthiness. Cleaning up BdL's balance sheet is also needed, although its recapitalization can be more gradual with part of the losses absorbed by future profits. Beyond this, debates continue on whether state assets need to be used in part to bail out the banking system (or as some would say, to repay parts of the public debt). The state owns several state-owned enterprises (EDL, telecom, ports, and the airport), as well as real estate property. It is imperative that those assets are managed more efficiently and transparently. Moreover, they must be regulated in a way that maximizes consumers' welfare and economic competitiveness rather than profit maximization. There is nothing wrong with an eventual divestiture of state assets so long as the sales and/or management contracts are done transparently, with safeguards against corrupt capture, and certainly not at fire-sale valuations, and private management can improve efficiency (Kostanian, 2021). However, pledging part of the state's asset revenues to the repayment of public debt service does not in itself help the overall cause of fiscal consolidation because this reduces state revenues.

[23] In 2018, only 11 percent of tax revenue was collected in a progressive manner, as interest earnings, capital gains, dividends, and corporate profits are all taxed at flat and low rates, and separately.

Reviving the financial sector

The old banking system is agonizing, and the priorities in that domain are to first salvage what can be salvaged of household savings, especially among the middle class, and to reinvent a new banking system to finance the recovery and a growing economy. Capital and banking controls must be part of a transitional plan. To clean up the balance sheets of banks, the main approach will have to be a bail-in. Even though banks' stakeholders have been the main roadblock to a resolution of the crisis, there is a legal obligation for them to be the first in line to absorb the losses. Banks' equity still won't be enough, by any measure. Large losses by depositors ("haircuts") will be inevitable. Even if the Eurobonds are largely wiped out, haircuts will be necessary. What has changed over time is that the estimated overall haircut has constantly risen – from 20 percent early in the crisis to more than half today (see Table 7).

Public pronouncements have consistently stated that depositors' losses will be distributed in a way that is socially fair. To do so, in the context of a reorganization of the sector, small accounts would be left out of the "tax base." The main challenge is to settle the large accounts, which represent 40 percent of total deposits now, down from 60 percent in 2018 (see Table 2). Negotiations there are likely to be long and arduous. There are various proposals to reduce the stock of deposits, such as the (partial) return of stolen assets, or the recovery of large interest and profits paid to shareholders and large depositors. The best way to deal with large deposits is to try and ring-fence them. As in other countries during a banking crisis, a "good bank/bad bank" solution can be useful.

Other proposals for reforms have emerged. It has now become clear that without repealing the banking secrecy law, it is not possible to implement a fair and efficient bank restructuring, or a workable tax system, or to be able to take to court those suspected of stealing public funds (including the governor of the BdL). Moreover, as the world is becoming more transparent, there is much less room for tax heavens. From an implementation perspective, an independent Banking Resolution Authority is needed to formulate and implement the banking sector restructuring strategy. Moreover, a debt recovery agency is needed, as bank equity holders' incentives are no longer aligned with profit maximization. The agency needs to coordinate and implement a bank-by-bank asset review, and to have the authority to impose material loss of shareholders and depositors, and to be able to reorganize the sector, including by forcing mergers for some and unwinding for others. The current banking code is not suitable for the current multi-bank crisis, and a new and modern bank restructuring code will be needed. In the end, the banking sector should be much smaller. The process will require consolidation and a reduction in the number of banks. It will also require a much better regulatory oversight: the banks that emerge should focus on lending to the productive sector, and not to government excesses or unproductive sectors like in the past.

Several complicating factors can be noted. There has been a strong popular opposition to using state assets to bail out the banks, especially since half of the population does not have bank accounts. There are other claimants in the state besides depositors, and pensioners in particular. LBP debt has nearly been eliminated by high inflation, but parts of it deserve preferential

treatment, especially those held (by law) by the National Social Security Fund and by other pension funds. As such, some of the state assets should be left aside, leaving less to the banking resolution. Similarly, many have argued that gold reserves must also be largely left out to allow for the conduct of monetary policy in the future. It is important to note that should there be any type of bailout, foreign lenders will also stand to benefit.[24] Finally, a sale of state assets can reduce future revenues and asset prices are too depressed presently to consider outright sales. Both the Diab and Mikati plans have proposed to establish an Asset Recovery Fund to offer an extra income stream in compensation for losses – derived from better managed national assets, and possibly warrants indexed on possible gas revenues. There are also considerations to "dress up" losses in attractive ways, such as in the form of a long-maturity (tradable) security (with low interest rate). These options should also give large depositors an incentive to act in ways that increase economic growth in the future.

5. Can external donors have a better influence?

This section examines the impact of external aid on policy and recommends a change of strategy. Donors have played an important role in Lebanon's recent history; their support during several delicate junctures managed to shore up confidence and avoid a financial collapse. Over time, however, repeated bailouts fostered moral hazards and allowed successive governments to avoid the needed economic reforms, ultimately making the fall larger. Despite this experience, there is an urgent need for humanitarian support, and it is hard to imagine that Lebanon could recover in the future from its current poverty trap without generous donor support. As such, the question of how to make conditionality effective is at the center.

A short history of international support

International assistance to Lebanon has fluctuated in recent years, oscillating between two and 10 percent of GDP, with peaks in the early 1990s with the post-civil war reconstruction effort, and in the 2010s with the influx of Syrian refugees (Figure 9). Since the end of the civil war, donors have disbursed close to USD 22 billion, roughly 56 percent from GCC countries and institutions and 20 percent from the World Bank, the EU, and the US, respectively.[25]

External support was packaged around highly publicized donor conferences (Paris I, II, and III, and CEDRE, held in 2001, 2002, 2008, and 2018) to maximize their signal power, as each came at a delicate time, and intended to boost confidence and encourage capital flows. The Paris I and II conferences of 2001-02 organized by President Chirac to help his friend PM Rafik Hariri came at a time of high financial fragility, with a fiscal deficit of 25 percent of GDP, a debt to GDP ratio of 145 percent, and interest payments on public debt absorbing nearly all tax revenues. In a major boost to Hariri, the ambitious first post-war reform program that he presented received a USD 4.4 billion pledge of support, the largest ever received by Lebanon

[24] An issue that is not well understood is the extent to which Eurobonds include collective action clauses that allow the supermajority to reach agreements on restructuring in ways that avoid litigation.

[25] Compared to Jordan, the donor darling in the region, Lebanon has received less official assistance as a share of government spending, or per capita, even though these amounts in Lebanon, as in most countries of the region, are well above global averages.

(Chedrawi, 2019). The Paris III Conference in 2008 came to stabilize the country after Hariri's assassination, Syria's withdrawal, and Israel's war. Pledges stood at USD 7.6 billion, but they were made conditional on reforms, as the international community was starting to lose trust in the willingness of the state to improve governance.

The CEDRE Conference was organized in 2018 by France amid high levels of financial and political fragility and coming on the heels of the disengagement of Saudi Arabia from Lebanon. The stakes for CEDRE were high: politically, to strengthen Saad Hariri's legitimacy on the eve of the legislative elections; economically, to prevent the collapse of the financial system; and geopolitically, to support the stability of Lebanon in the face of the intensification of the Iran-Saudi Arabia standoff, and to prevent the refugee crisis from spilling over to Europe. USD 11.6 billion were pledged to an investment plan and were made conditional on a list of fiscal and monetary reforms, and for the first time, on governance reforms meant to curb corruption.[26] In the end, CEDRE's pledges did not disburse.

With their diverse and opposing agendas, Saudi Arabia and Iran also played important financial roles. Saudi Arabia and the GCC were central to the post-civil war reconstruction effort by strongly backing PM Hariri and his post-civil war political system.[27] From 1990 to 2016, the GCC was the dominant donor to Lebanon.[28] In parallel, Iran has backed its allies with large but hard to measure resources, which continue to this day. In contrast, Saudi Arabia abruptly cut its support after 2016, and GCC donors did not participate (except for Qatar) in the CEDRE conference.[29]

After the Syrian war started in 2011, donors' interests started to shift to short-term concerns, and their support became focused on financing the Lebanese Armed Forces and the response to the refugee crisis. These trends accelerated after the 2019 crisis and the 2020 port explosion in Beirut. Donor support increasingly turned humanitarian and became channeled through UN agencies and NGOs. This shift was epitomized by the creation of the 3RF, a new organization dedicated to channeling international support for the reconstruction of the port neighborhoods, which was meant to be dominated by civil society groups.

Would future conditionality work?

A striking characteristic of donor support is its increased focus on conditionality, and the utter failure of these conditions to lead to any change on the ground, especially in the controversial

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[26] This included pledges to reduce the fiscal deficit, raise tax revenues, adopt a new procurement law, and reform the electricity sector.

[27] The post-war new political settlement was based on the Taef accords of 1998. In later phases, GCC support kept the LBP afloat at sensitive times, and later, came increasingly to support its confrontation with Iran (Kalout, 2022). Its withdrawal after 2016 reflects the failure of this effort.

[28] Saudi Arabia pledged USD two billion during Paris I and II. Together with Kuwait, it deposited USD 1.5 billion into BdL during the 2006 war to support the LBP. In addition, the remittances from Lebanese expats in the Gulf countries have accounted over the years to 10-15 percent of GDP; and most foreign direct investment into the country came from GCC investors.

[29] Moreover, a travel ban for GCC nationals has been in place since 2020, and the export of Lebanese fruits and vegetables was banned in 2021.

dossier of the EDL, with high financial losses (some have calculated that these add up to 40 percent of national debt). This was exemplified by the very largely undisbursed leftovers from the CEDRE pledges despite the current gaping needs of the public sector. Donors did become stricter in their conditions, but these were not met. As a result, ODA fell over time. After the crisis, these conditions became even tighter, and are now aligned with an IMF program, in effect forming a promise for a big economic push *if* the political situation miraculously improves. While the existence of these funds has been reaffirmed on various occasions, and one of the goals of the relatively small IMF program in the making (around USD three billion) is to allow for the start of the CEDRE disbursements, these pledges are now uncertain given the steep budget constraints in donor countries, and there is the extra challenge of shifting them from project-based to budget support.

As noted earlier, the IMF reached a staff-level agreement with Lebanon in April 2022, which includes a long list of prior actions that need to be met before a program can go to the IMF Board, and these have become enmeshed with donors' promise of a conditional big push. However, a three-year typical IMF program is too short for such a package, given the magnitude of the challenges. A longer, more structured, and more generous program, would be needed. In such a program, the focus needs to support a measured expansion of the state, ahead of the recovery of the economy. This would require much closer cooperation between the IMF and the World Bank than occurs typically.

From humanitarian support to the protection of basic services

In recent years, donors have provided humanitarian support for Syrian refugees, and this trend was extended to the local population after the financial crisis and especially after the port explosion in August 2020. This support is mostly disbursed through CSOs and not through the government. Needs have been estimated at USD three billion in the most recent Lebanon Appeal of 2022 (UNDP, 2023), but disbursements were much lower, at around USD one billion in 2022 – about as much as during 2019-21. Humanitarian support is, however, fragmented and poorly coordinated. Some progress has been made in coordination with the creation of the 3RF, which despite its teething problems, represents progress compared to the problematic governance of the Council for Development and Reconstruction, the public entity that managed donor disbursements in the past (Atallah et al., 2020).

For the social situation to stabilize, even if at a relatively low level, this support would have to become better organized. The collapse of public services is so deep that it will become impossible to fuel an economic recovery if the rapid deterioration of the health and education sectors is not stopped. Moving from the current emergency mode to a more organized effort that protects a minimal basic services package is a necessary first step in the reconstruction of Lebanon. In organizing this effort, going back to the past level of public service provision will not be sufficient. A much larger share of the population now demands public services instead of the higher-quality private services that they could afford in the past. Moreover, the basic safety net needed to prevent extreme poverty has become quite wide and thus costly.

Politically, several arguments can be made for such an approach. Besides conserving Lebanon’s future potential, such a fund should not reduce the pressure on the political system to reform. A key argument is that a poor population is easier to dominate through clientelism and repression than one whose minimal requirements are ensured. Still, if such an organized platform is put together, it would need to incorporate two core priorities: avoiding the misuse of support, and the stabilization of inflation. The main challenge will be to protect these from politicians that have always used social services for patronage and clientelism. To do so, the use of direct transfers and horizontal accountability mechanisms will be needed. These mechanisms must be thought of in ways that strengthen the will to build back better.

The cost of a basic package is likely to hover between USD one to two billion per year. The disbursement of these funds will have to pragmatically look for capacity and accountability where this remains, in the public, private, and associative sectors, with convincing horizontal oversight by third parties. Even in the best of cases, support for basic services should continue several years after stabilization given the current poverty of the state and the necessity to ensure low inflation as a necessary condition for recovery.

The seeds of such a program already exist. The current social safety net program funded by the World Bank provides direct and unconditional cash transfers, and the development of an electronic registry has done much to reduce middlemen and corruption. When key local prices were freed (including drugs, food, fuel, and electricity tariffs), and again during the depth of the COVID-19 pandemic, the program played an important role in alleviating suffering. A new World Bank/UNICEF program provides a wage supplement to public school teachers. What remains is to add a health component, and to consolidate these efforts to the medium term. Constructing and operating such a program would require major mobilization among donors and civil society organizations.

6. Concluding remarks: What are the lessons learned from Lebanon?

Lebanon's experience exemplifies well-known principles of fiscal responsibility on how to avoid and manage a crisis. To avoid a crisis, do not let the exchange rate appreciate; use capital inflows as productively as possible; and keep fiscal deficits low. To manage a crisis when it hits, find a rapid political agreement on loss distribution; avoid capital flight; avoid multiple exchange rates; protect the poor; fix the banking sector rapidly if needed; and, most importantly, have a credible growth strategy that helps in accepting short term costs in exchange for the hope of a better future.

Economists often get (fairly) accused of ignoring political realities when they come up with these kinds of statements. A more complex lesson coming from Lebanon concerns the political economy of crisis and the pathways to progress. There was some hope that a crisis would mark the end of a regime that generated it and that the time has come to build back better. The harsh reality is that, at least in the short term, the reverse seems to have happened: the ruling regime was not just resilient to a crisis in the sense that the elites were less touched by economic collapse; the crisis seems to have strengthened their durability. Clientelism became cheaper as

people became poorer and more desperate to find ways to sustain their families. Repression became cruder, including targeted assassinations, a daring push to capture the judiciary and the media in proportions that would have been unacceptable earlier in "normal times." The bending of reality into alternative accounts to justify the current order has been a constant in the past, but it has become much more pronounced now, as politicians refuse to recognize that the country is bankrupt, and act as if the current situation should be accepted as a new normal.

In other parts of the world, the tools of populist autocrats have become mainstream, such as India, Turkey, Hungary, or Israel. Lebanon, however, is part of a smaller group (Venezuela, Iran, and Syria) where populism has gone bankrupt, and it has survived its reckoning by redoubling its old methods of control. A convincing pathway to progress becomes hard to find in these situations. In a way, this is the flip side of modernization theory: if economic progress facilitates a move toward democracy, economic collapse makes elites more resistant to letting power slip away, as they can expect to be unable to retain control.

The situation remains dynamic and uncertain, and one could also afford some guarded optimism, at least for the longer term. The political/societal evolution that has been triggered by the crisis is still ongoing, and it won't be as easy for the establishment to impose its choices in the future. Independent MPs now sit in Parliament, and more can be elected in the future. What used to be accepted behavior in the past, such as state procurement with no competition, now moves public opinion. Civil society is also more mobilized and more effective. Even though it has still been unable to force an investigation of the port explosion, authorities had to back off more often, for example by being forced to drop cases of investigation with journalists or activists. If revolutions are unlikely to work, evolution remains possible.

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Figure 1. GDP growth and main political and financial events

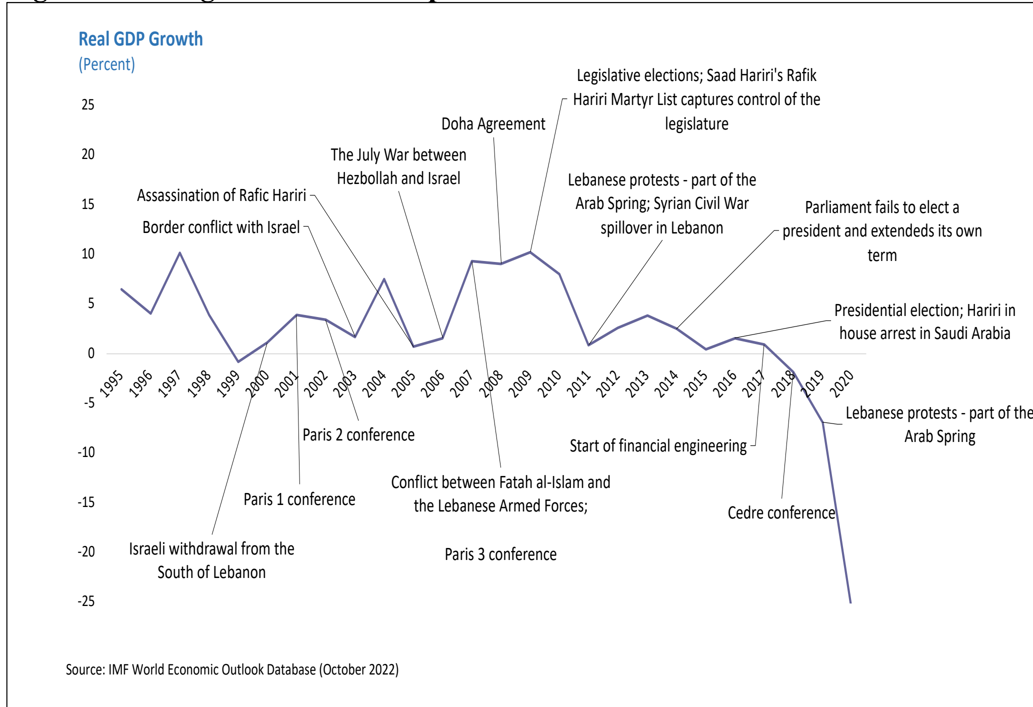
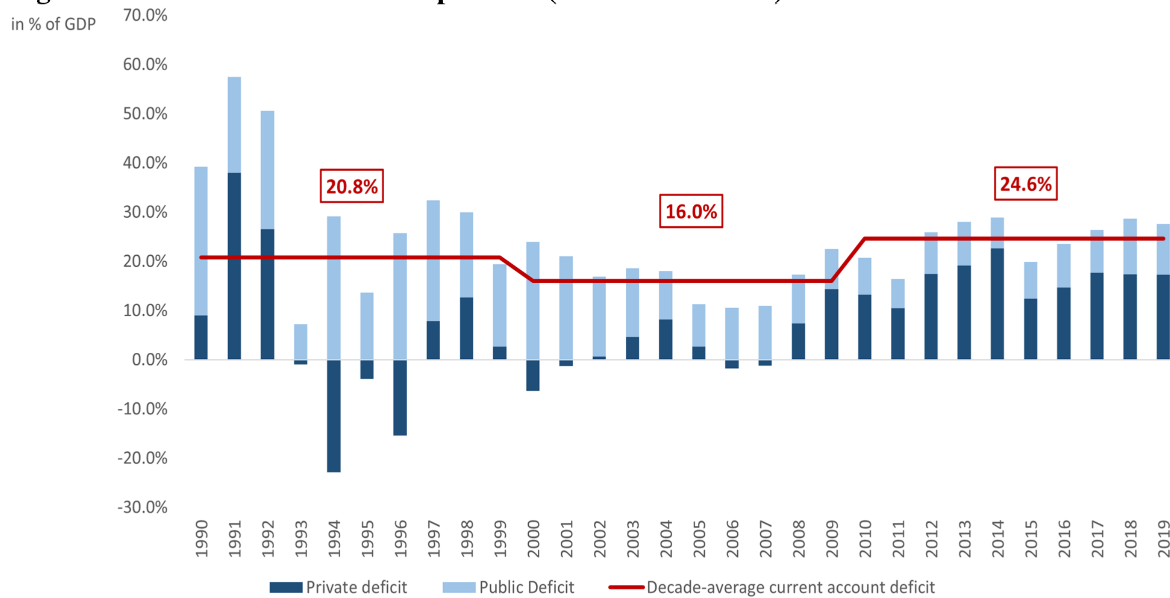
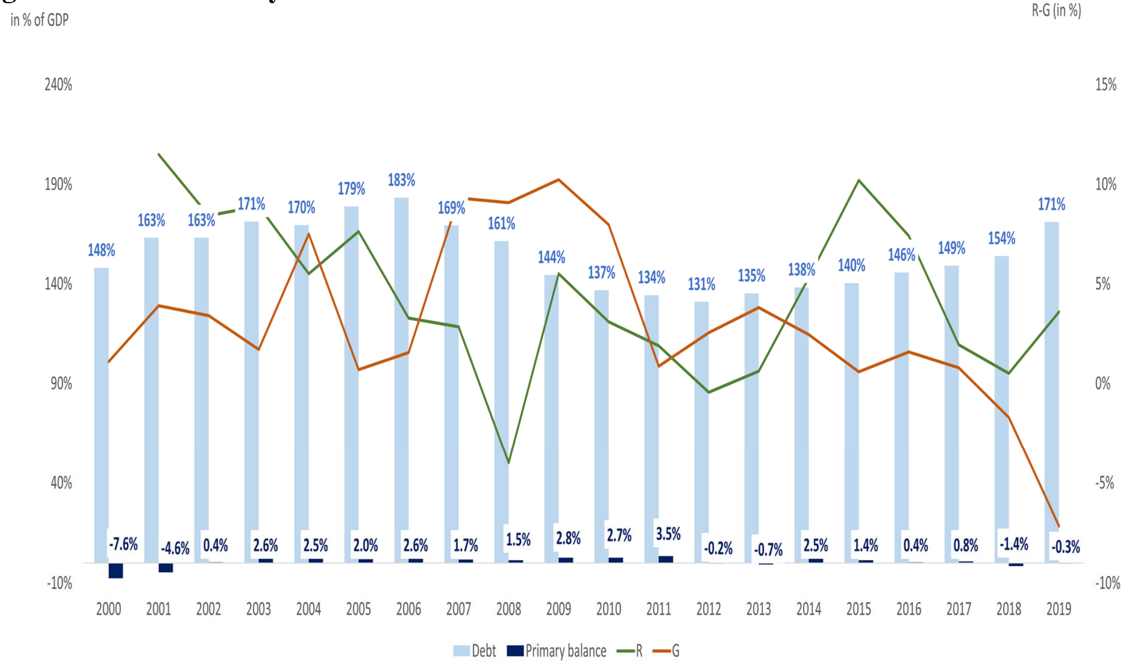


Figure 2. Current account decomposition (in shares of GDP)



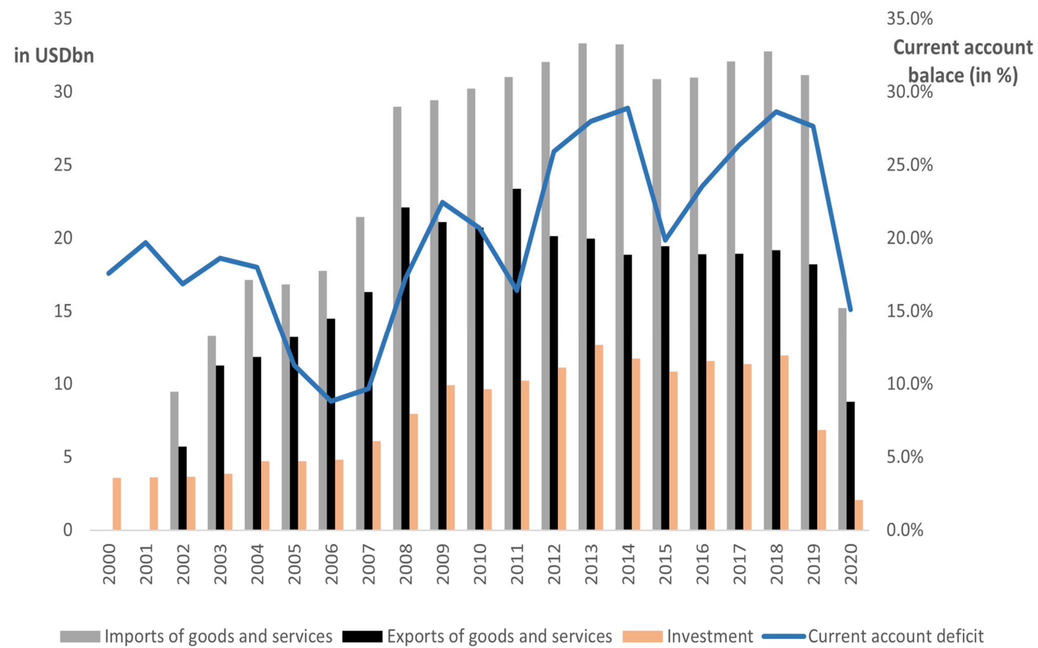
Sources: World Bank. The annual current account deficit is the sum of the public and private deficits. The red lines represent decadal averages of the current account deficits.

Figure 3. Public debt dynamics



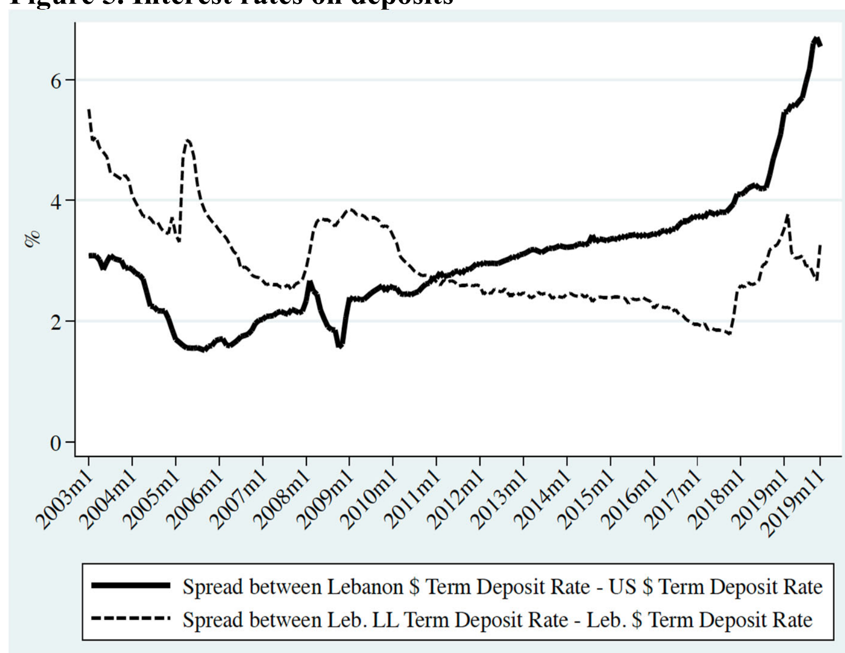
Sources: World Bank and WEO. Red line: GDP growth rate, Green line: average interest rate on public debt. Light blue bars: public debt to GDP; deep blue bar: primary deficit to GDP. The LHS measures the debt and deficit to GDP ratio, the RHS axis measures percent change for R and G.

Figure 4. Debt, investment, and economic growth



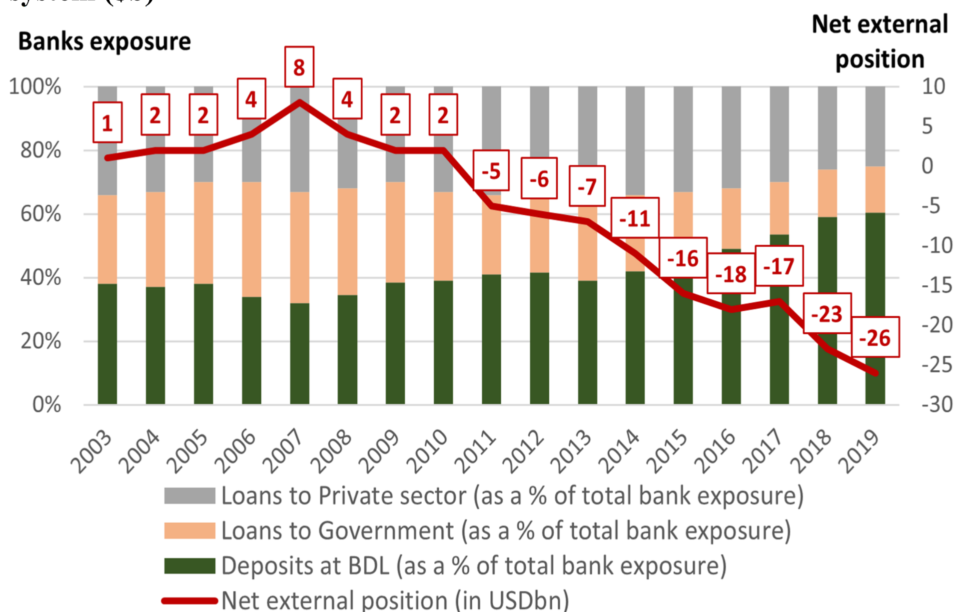
Sources: World Bank data. LHS scale: $billions. RHS scale: share of GDP.

Figure 5. Interest rates on deposits



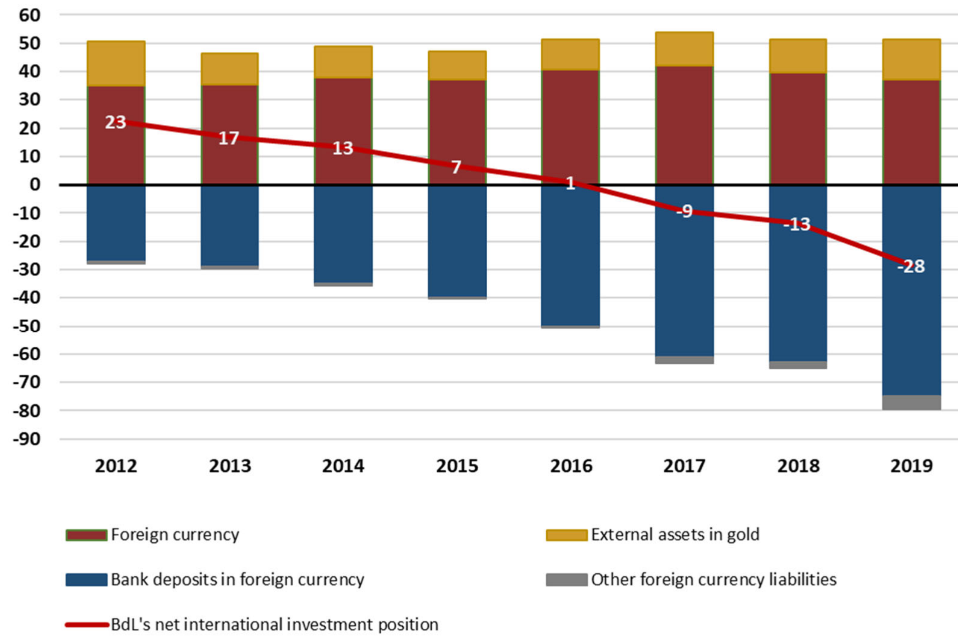
Source: Taken from Nora 2020, based on BdL data.

Figure 6. Commercial banks' exposure (%) and net non-resident position of banking system ($b)



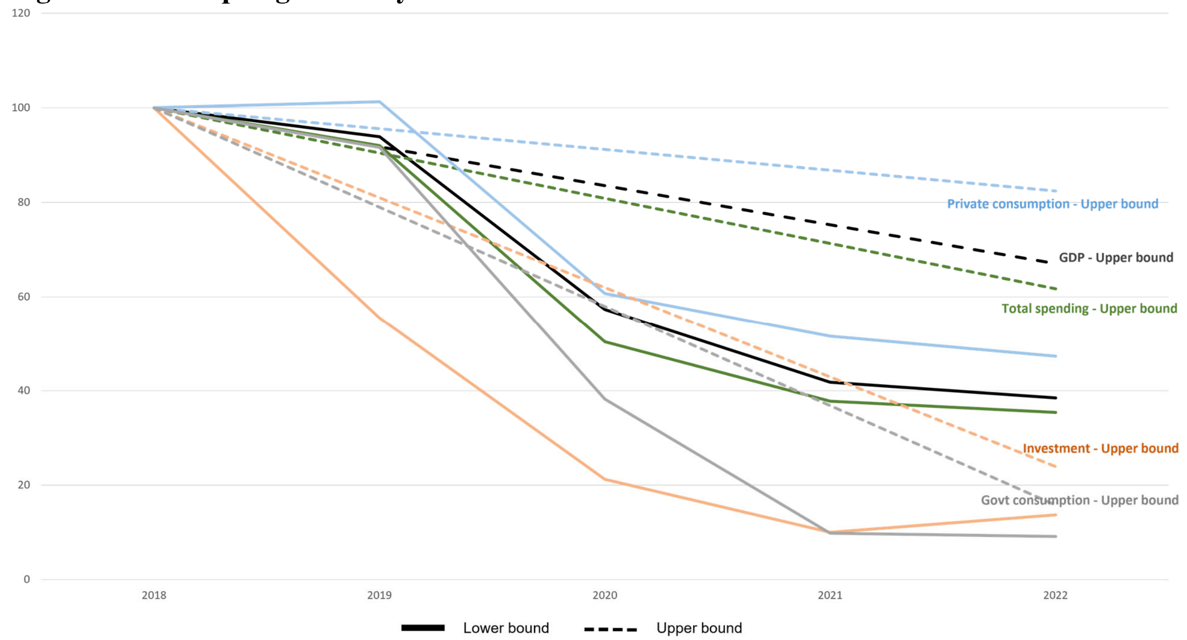
Source: BDL. LHS scale: banks' exposure. RHS scale: net external position in $ billions.

Figure 7. BdL hard currency reserves ($ billions)



Source: BdL

Figure 8. A collapsing economy



Sources: World Bank and authors computations

Figure 9. ODA total ($b), and as a share of government expenses, Lebanon vs Jordan

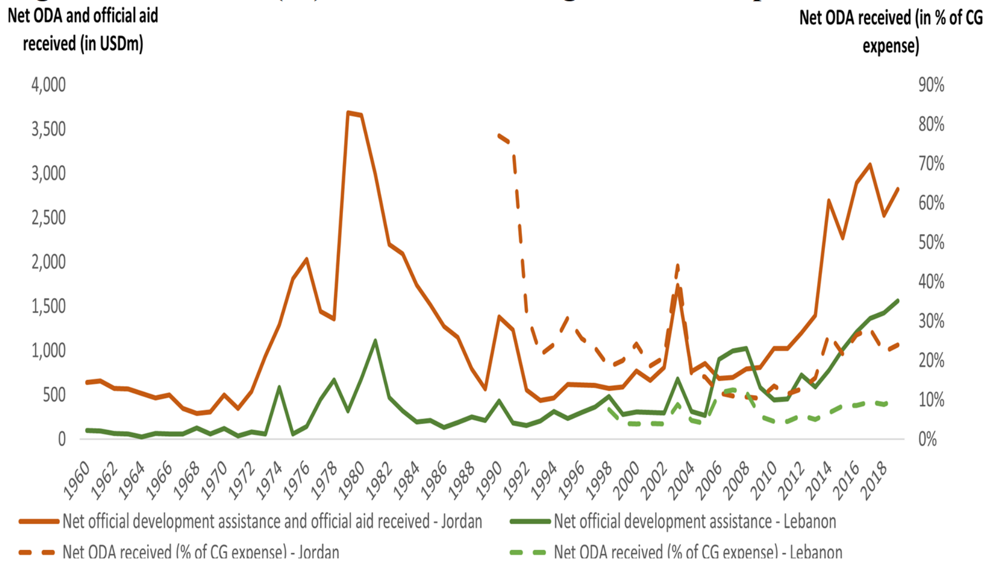


Table 1. Capital account, $ billions

	2016	2017	2018	2019	2020	2021	2022 (1/2)
Current Account	-10.47	-12.13	-13.36	-11.08	-2.78	-3.4	-3.02
o/w remittances	3.4	2.74	2.3	3.31	3.93	4.26	2.27
Capital account	17.25	12.94	3.28	4.81	-1.75	0.58	0.42
Use of reserves	-3.86	-2.37	2.31	2.39	13.18	6.53	2.48
Unrecorded inflows	-2.91	1.56	7.77	3.85	-8.65	-3.72	0.15

Source: Adapted from BdL quarterly report, 2022 Q2. The slight differences with Table 4 are due to the difference in the source, and the date of publication. Notes: Reserves: (+) = use; (-) = accumulation. Unrecorded flows: (-) = capital outflows; (+) = capital inflows.

Table 2. Distribution of dollar deposits in banks ($billions)

	Dec-18	Dec-19	Feb-20	Dec-21
< 5K	451	350	344	312
5 - 30	2,314	2,317	2,309	2,541
30-75	3,681	3,919	4,073	5,054
75-150	5,070	5,801	6,203	7,768
150-300	8,075	9,560	10,168	10,867
300-750	14,961	17,921	18,508	19,563
750-1.500	13,877	15,401	15,156	13,026
A-Total	**48,430**	**55,268**	**56,761**	**59,131**
1.500-3.000	14,500	14,414	13,801	10,113
3.000-4.500	8,006	7,615	7,404	5,094
4.500-7.500	8,663	8,144	7,649	5,509
7.500-15.000	10,694	9,399	9,026	6,423
15.000-30.000	8,786	7,608	7,194	5,131
30.000-75.000	8,209	6,679	5,962	4,342
75.000-150.000	4,103	2,172	2,208	1,505
> 150.000	8,567	5,577	4,642	2,243
B -Total	**71,528**	**61,608**	**57,887**	**40,360**
Total	**119,958**	**116,876**	**114,648**	**99,490**

Sources: Deposit Insurance Corporation

Table 3. National Accounts – 2018-2022 (share of GDP and %)

	2018	**2019**	**2020**	**2021**	**2022**	**Change 2022-2018**
GDP in market $$	55.3	51.9	31.7	23.1	21.3	
GDP $ Growth %		-6	-39	-30	-36	-61.5
GDP real growth %		-7.2	-21.4	-10.5	-6.5	-35.8
Prices and exchange rate						
Money supply change %	3.0	-6.7	198	109	75	10.2 times more
CPI change %	6.2	2.9	84.3	150	120	10.4 times higher
Av. XR change (%)		3	137	219	127	17.7 times higher
Eoy XR change (%)		3	331	151	168	29.8 times higher
XR (eoy) LBP/$	1,507	1,554	6,700	16,800	45,000	
XR (average) LBP/$	1,507	1,554	3,688	11,755	26,713	

Source: Adapted from World Bank Monitor – various years.

Table 4. Domestic spending

	2018	2019	2020	2021	2022	Change 2022-2018
As a share of yearly GDP						
Total spending	124.3	121.9	109.3	112.4	114.2	-10.1
Private consumption	83.1	89.7	88	102.6	102	18.9
Investment	20.8	12.3	7.7	5	7.4	-13.4
Government consumption	20.4	19.9	13.6	4.8	4.8	-15.6
As % shares of 2018 own levels - market exchange rate basis						**2022 in "real" terms**
GDP	100	93.9	57.3	41.8	38.5	67.1
Total spending	100	92.0	50.4	37.8	35.4	61.7
Private consumption	100	101.3	60.7	51.6	47.3	82.4
Investment	100	55.5	21.2	10.0	13.7	23.9
Government consumption	100	91.6	38.2	9.8	9.1	15.8

Source: Adapted from World Bank Monitor – various years.

Table 5. Fiscal accounts

As a share of yearly GDP						
	2018	**2019**	**2020**	**2021**	**2022**	**Change 2022-2018**
Revenue	20.9	20.7	13.1	6.3	6.6	-14.3
o/w tax revenues	15.3	15.5	9	4.7	5.3	-10.0
Total expenditures	31.8	31.2	7.4	5.9	5.5	-26.3
o/w current	30.2	29.9	16.1	5.8	5.4	-24.8
o/w int. payment	9.8	10	2.5	1.2	0.9	-8.9
Cap expenditures	1.7	1.3	0.4	0.2	0.1	-1.6
Primary balance	-1.2	-0.5	-0.8	1.7	1.1	2.3
Total balance	-10.9	-10.5	-3.3	0.7	0.5	11.4
As % shares of 2018 own levels - market exchange rate basis						**2022 in "real" terms**
Revenue	100	93.0	35.9	12.6	12.2	21.2
o/w tax revenues	100	95.1	33.7	12.8	13.3	23.3
Total expenditures	100	92.1	13.3	7.8	6.7	11.6
o/w current	100	92.9	30.6	8.0	6.9	12.0
o/w int. payment	100	95.8	14.6	5.1	3.5	6.2
Cap expenditures	100	71.8	13.5	4.9	2.3	3.9
Primary balance	100	39.1	38.2	-59.2	-35.3	-61.5
Total balance	100	90.4	17.4	-2.7	-1.8	-3.1

Source: Adapted from World Bank Monitor – various years.

Table 6. External accounts

	2018	2019	2020	2021	2022	Change 2022-2018
As a share of yearly GDP						
Current account	-24.3	-21.9	-9.3	-12.5	-14.2	10.1
Import goods & services	60.5	60.3	48.5	77	79.9	19.4
Exports goods & services	35.7	35.4	28.2	44.9	48.5	12.8
o/w Remittances	4.2	6.1	10.3	16.7	26.7	22.5
As % shares of 2018 own levels - market exchange rate basis						
Current account (def.)	100	84.6	35.9	69.9	49.4	
Import G+S	100	51.7	25.4	29.4	28.1	
Exports G+S	100	51.5	25.0	29.1	31.4	
o/w Remittances	100	75.4	77.7	91.9	146.9	
In $$ billions						
Current account	-13.4	-11.4	-3.0	-2.9	-3.1	23.1%
Import G+S	33.5	31.4	15.4	17.0	15.8	-47.2%
Exports G+S	19.6	18.4	8.9	9.0	9.8	-50.0%
o/w Remittances	2.3	3.2	3.3	3.7	3.8	162.1%

Source: Adapted from World Bank Monitor – various years.

Table 7. Lebanon Inc. consolidated balance sheet ($billion), 2022

Assets		Liabilities	
BdL: FX Reserves	10	Government Eurobond outside country	4
BDL: Gold	15	FX deposits in banks and other liabilities	111
Banks: Private sector loans	10	Total liabilities	115
Banks FX	10	LEBANON INC. EQUITY	-50
Sustainable public debt	20		
Total assets	65		

Source: Adapted from Zouein, 2022.