The Collapse of Lebanon: An Analysis Into Lebanon's Political Economy

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Abstract:

This paper studies the trends of the Lebanese economy shortly following its independence in 1943 until the present day, taking into account all the historical, political, and social elements that have shaped the country as a whole and subsequently the trajectory of its growth. The Lebanese economy, once a vibrant powerhouse unmatched in the Middle East, has weakened over the course of more than seven decades to become one of the world's most inflated economies with a rigid sectarian structure and a government incapable and unwilling to enforce any form of change for fear that it may disturb the functioning system of corruptive self-enrichment that has been festering since the end of the civil war in 1990. The comprehensive dysfunction of the Lebanese political and economic institutions has classified the nation as a quasi-failed state. This paper provides a comprehensive analysis of the chronology of Lebanon's principal events that have brought forth the economic failure witnessed today.

1. Introduction:

The weakened Lebanese economy of today, plagued with record-breaking inflation rates, soaring public debt, trade deficits, low production, and high unemployment can all be attributed to the hallmarks of the Lebanese confessionalist political system, one built from the ashes of the civil war, with sectarianism at its center, and all other fractions revolving around it. The institutionalism of power politics through sectarianism has metastasized across all aspects of Lebanese citizens' life. The civil war has brought about political parties with an inherent sectarian identity where citizens of that sect can be automatically attributed to said parties regardless of their affiliation and has produced a decisive division of the country through regionalism, which had become one of the defining features of the post-war reconstruction failures.

Lebanon's history did not begin with this extreme case of sectarian identity that ravaged all forms of life. It began with a rather circumstantially successful economy that seized the opportunities provided by free market liberalism, characterized in Lebanon by its iconic banking sector. Dubbed the "Golden Age" prior to the civil war, the serenity of the economy was masked with the obscure festering of a corrupted system that failed to build Lebanon a solid footing in the face of plausible economic hardships amid a turbulent and volatile region, where conflict and war is no stranger; especially when the entirety of the economy was upheld by a banking sector dependent on foreign capital and investments.

Therefore, in order to understand Lebanon's economy today, it is of utmost importance to look into what preceded the crisis and what allowed it or even paved the path for its existence. The reader may find it important to look into the wider political and historical perspectives that this paper may not explicitly mention or extensively elaborate upon; however, there remain numerous events in Lebanon's history that play an elemental role in molding the crisis as we see it today.

2. Lebanon's Post-independence Economic Aspiration

Lebanon's most potent political class, its merchants, desired their country to represent a free market economy characterized by a noninterventionist government, attracting the free flow of foreign capital and establishing itself as a prominent regional hub that economically connects the West to the Arab world. They sought for Lebanon to become a politically neutral state where investors, corporations, and individuals were able to find and administer all their commercial, financial, and other needs through the Lebanese services sector.

Those laissez-faire advocators sought to mold Lebanon into a nation that thrived by its place as an attractive economic sanctuary where tariffs were low and global manufactured products were unrestricted and available throughout the market at competitive prices for Beirut to manifest its position as the model economy where all organizations desired to establish their businesses, supply bases, headquarters, offices, and all sorts of other services. As far as they were concerned, advocators of such an economy desired a government that only interested itself in maintaining internal security and political neutrality (to maintain confidence in the economy; more on that later), stabilizing the currency, as well as preserving and improving infrastructure and facilities such as roads, airports, electricity, and so on.

Lebanon was by no means a large-scale industrial nation (as we will observe later); nonetheless, its merchants believed that it was capable of balancing its unfavorable trading status through the development of non-commodity services that thrived in a socially, economically, and politically stable country that incentivized, remarkably, the flow of foreign capital and investors into its welcoming economy.

The environment that characterized Lebanon and the Arab region in the 1950s was ideally suited for a laissez-faire economic system to take root. Numerous domestic, regional, and international elements supplemented and reinforced Lebanon's growth, granting it an ideal and unprecedented opportunity to rise as an economic powerhouse in a region plagued with political uncertainty and insecurity. Nonetheless, Lebanon was moving towards an economic and political model far more different than its Syrian neighbor and, more widely, some of its fellow Arab countries in the region at large. Those differences created some friction between the politically divergent nations of Lebanon and Syria, despite their sharing of extremely closely-knit historical and cultural realities.

Culturally, Lebanon was suitable for the job. Lebanon represented the Arab world's leading assimilator of Western culture and lifestyle, with an abundance of religious diversity where over 18 sects of different religions coexist. Through its liberal economy and versatile society, it had become a blending point joining the West and the Arab East. Further, Lebanon's temperate climate, mountainous landscape, and famous beaches cemented its reputation as an excellent tourist destination, continuously fostering its transnational character. The development of housing, hotels, entertainment facilities, and tourist attractions was an integral element of its newfound economy, especially since Lebanon sought to prove itself as a charming place to live and work.

2.1 Lebanese-Syrian Economic Proximity & Divergence

During the French Mandate of Lebanon and Syria[1], both countries shared complete economic unity through all aspects of economic relations: joint customs, a shared currency and tax structure, unfettered labor freedom in both countries, and unrestricted movement of people and capital. However, soon after the independence of both countries—Lebanon in 1943 and Syria in 1946—uneasiness in relations began to emerge due to diverging political and economic perceptions surrounding the restructuring of the newly emerging states, and immediate strains on the customs union commenced. Many Syrian leaders expressed, with evident regret, that the price of France's withdrawal was Syria's resignation of four *qada'a* (districts) to Lebanese territory. Syria had felt that following the loss of Alexandretta to the Turkish army in 1939, the country became reliant on the ports of Beirut and Tripoli after the loss of Alexandretta. Accordingly, Syria had essentially become reduced to a mere customs zone dependent on Beirut. The Syrian-Lebanese customs union was viewed as a Syrian concession to Lebanon (54). [2]

"No member state of the League of Arab States has sacrificed as much as Syria. We hope that they will be satisfied with mentioning, in future independence celebrations, what an exorbitant price Syria has paid for Lebanon's independence." [3]

Such Syrian sentiment encountered firm opposition among the growing group of Lebanese nationalists. Consequently, the Lebanese people and government

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[1] The League of Nations mandate for Syria and Lebanon was established in the aftermath of World War I and the partitioning of the Ottoman Empire, and it comprised Syria and Lebanon. The mandate system was supposed to be different from colonialism in that the ruling nation was expected to operate as a trustee until the people were deemed eligible for self-government.

[2] Alexandretta was an important port along the eastern Mediterranean coast that the French controlled following the First World War, incorporating the city into French-controlled Syria under the League of Nations French Mandate of Syria and the Lebanon

[3] Al-Qabass, 3 January 1947. Editorial by Najib al-Raiyyes

refused to conform to the Syrian territorial claim or inherent influence, and both countries began to pursue dramatically different economic policies. This was especially exacerbated by the continuously unproductive monetary and trade union established between the two nations.

Pressures were mounting on the Lebanese government over public outcries over the high price of bread, a necessary commodity and economic indicator characterized as the benchmark of Lebanon's price index. The Syrian Prime Minister stated in parliament that he intended to introduce legislation that would continue restricting grain trade to the Mira. However, a majority of Members of Parliament and Mira's director lobbied to ensure that the government continued to purchase grain directly from farmers, although the free market price of grain was 20% lower than the Mira price. As public opposition grew, Jamil Mardam Bey reconsidered and announced in parliament that grain transportation and trade would be free and unrestrained beginning in January 1947.

However, the Syrians were reluctant to lift trade restrictions on wheat in Lebanon or allow them to import grain from other countries selling them for far cheaper rates. Syrian grain prices were 50% higher than Egypt's, 40% higher than Turkey's, and 60% higher than Iraq's. Syrian wheat was even rejected by Europe, who were able to get them from Egypt, Turkey, and Syria at a 30% markdown. Syria's best bet was to maintain Lebanon's exclusive trade that only allowed her to purchase her grain needs from Syria. However, Syria's exploit did not go unnoticed by the Lebanese government. Through their shared economic union and the political desire to maintain it, preserving friendly relations with Syria compelled Lebanon to pay a higher price for low-quality wheat imported from Syria (45 piastres per kilogram) while claiming that the Lebanese government had offers for higher-quality, cheaper wheat (20 piastres per kilogram) that lay outside that trade and customs union. [4]

Nonetheless, the grain issue was a significant indicator signifying the withering relationship between the two states. Mounting strains on trade imbalances and the dramatic differences in political and economic policies

[4] Beirut to Foreign Office, 6 February 1947, FO 371/621710 and Le Commerce du Levant, 1 January 1947.

brought about a growing rift concerning the relationship between the Syrians and the Lebanese.

The Syrian public also desired to leave the union. They perceived their economy to favor Lebanon by stating that *"the French have made Syria an exploitation farm and a milk cow to fatten Lebanon; and our government, after having assumed the economic affairs of the country, has continued to follow the same policies. It reveals itself soft and conciliatory before the demands and whims of the Lebanese, giving them everything at the expense of the impoverished Syrian taxpayer."* [5]

The Lebanese public did not see eye-to-eye with that form of reasoning since it had long been historically prevalent that Lebanon, a non-producing state, consumed, at high prices, what Syria produced, bearing the weight of economic hindrances. Moreover, Lebanese nationalists saw that the economic policies pursued and implemented by the French, which ultimately resulted in the establishment of the Syro-Lebanese economic union, was primarily created to serve French and Syrian interests. Accordingly, the union is artificial and has no underlying foundation; they suggested breaking off the partnership and allowing Lebanon to trade freely without fear of retribution or consequence. Furthermore, they predicted that the economic union would be destroyed by Syrian greed and envy for Lebanon's resources and Syria's desire to subjugate Lebanon to her loaf of bread.

Soon enough, there had been talks of Syria's wishes to develop their independent port, one utterly separate from Lebanese ports, marking a tremendous step in tearing down the customs union and moving toward economic independence. As a result, calls on the Lebanese government to rapidly prepare for what seemed like an inevitable break-up were growing. By 1948, the two states had separated their currencies, semi-officially partitioning what once was complete unity.
After numerous back-and-forth memorandums, statements, meetings, and speeches, the nations' growing dissatisfaction with one another's policies reached a breaking point. The Syrians had given an ultimatum to the Lebanese government, pressuring it to either completely and fully comply and integrate with Syria on economic union and policies, monetary and customs regulations,

[5] Le Commerce du Levant, 15 January 1947.

and import/export, or to impose total separation lacking any form of economic partnership. The Lebanese government was given until the 20th of March 1950 to respond officially, the date being strategically chosen to be one day ahead of the Arab League summit, wishing for no further delay or influence through Arab mediation. Riad Al-Solh, Prime Minister of Lebanon (who had survived an assassination attempt that same month by the Syrian Socialist Nationalist Party due to political reasons unrelated to the customs union), expressed his deepest regrets at the Syrian ultimatum, which the Lebanese government viewed as a threat unfamiliar to the spirit of friendliness and brotherhood the two states were supposed to share.

The Lebanese government officially responded by publishing a memorandum listing all their grievances with the behavior the Syrian government has been demonstrating. It was especially notable that the memo was made public and was not kept secret or confidential. The memorandum highlighted the Lebanese government's regret that its efforts to maintain friendship elicited no acknowledgement from its Syrian counterpart. Furthermore, the sudden limitation of grain shipments to Lebanon, while Syria allowed grain exports to international countries, was emphasized. Lebanese nationalists, particularly Michel Chiha (considered one of the founders of the Lebanese constitution), made it clear that they were not interested in following Syria blindly, particularly when they were experiencing political trouble—in reference to Syria's 1949 coup d'état. They held that philosophical, political, and ideological differences the Lebanese and Syrian governments shared made them incompatible in the 1950s. [6]

Khalid al-Azm (Prime Minister of Syria at the time) called a cabinet meeting at 10 PM on March 13, 1950. The meeting produced the final communiqué announcing the dissolution of the Syro-Lebanese customs union.

2.2 Investment in Lebanon

Some fears arose regarding Lebanon's stability as an economy outside of the customs union with Syria. Some were apprehensive that Lebanon would not be able to support itself independently of Syria and worried that should Lebanon

[6] (Chaitani 2007, 157-158)

fail economically, terms for rejoining the customs union would be far too drastic to accept. Moreover, there were some significant concerns regarding Syrian expansionist aims that Lebanon was seen as subject to. Due to political, cultural, and historical contexts, many Syrians thought of Lebanon as a historical extension of its broader former presence in the region— an issue that sparked fears that, at any moment, the Syrian army would find a pretext for marching into Beirut [7]. Further, Lebanon's southern border shared with the newly founded state of Israel was viewed as problematic since a protracted conflict that cemented regional instability and obstructed growth, marking the lasting development of Lebanon's economy as unlikely.

Despite those fears, both Arab and foreign investors, especially ones from western capitalist nations, scurried to invest in the small Lebanese economy. Although the small Mediterranean country had its disadvantages, there remained many factors that lured the assets of foreign capital:

1) Strategically, Lebanon is located favorably along the eastern coast of the Mediterranean. Its location and proximity to both Arab and European countries marked Beirut as the only consequential port of the Arab world, especially since the closure of Haifa to Arab goods in 1948 (following the establishment of the state of Israel)[8]. Beirut, therefore, became the natural entry port of foreign goods into the Arab world, creating a tremendous opportunity for the flow of goods and capital into Lebanon and the Arab world at large.

2) Lebanon's closer cultural and historical ties to Europe, especially considering its then Maronite Catholic Christian majority and its comparatively high literacy rates (illiteracy was down to 20% according to a 1957 US Operation Mission Report), Lebanon produced much of the Arab world's intellectual and entrepreneurial class, laying exceptionally solid foundations for the implementation of Western capitalist concepts.

3) Lebanon was not burdened by the question of land distribution that plagued many newly independent states. Most of Lebanon's land was cultivator-owned, and the few absentee landlords that lived in the city

[7] (Persen 1958, 277)
[8] All points expressed above can be referenced to data found in (Persen 1958, 279)

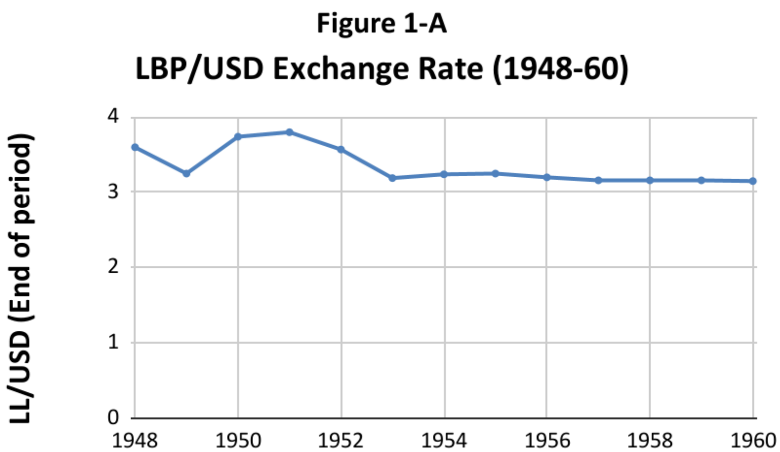
were capable of properly managing their properties due to Beirut's relative proximity to cultivated lands in Lebanon.

4) Income inequality was substantially low during the early 1950s, especially in comparison to other Arab states, such as Iraq, Egypt, or Syria. Unlike the rest of the region and most underdeveloped countries, Lebanon's income distribution was similar to that of the United States during the 1920s, relieving it from the sociopolitical challenges of land reform.

5) The diversity of the Lebanese commercial sector and the large inflow of foreign capital granted its economy a balanced quality. Lebanon's heterogeneous output of *invisible exports* ranges from banking, tourism, international trade, and the transit of goods such as gold and oil. In contrast to many Arab states that depended on a singular commodity to uplift the entirety of their economy (cotton in Egypt and oil in Saudi Arabia), Lebanon's economy was upheld by several sectors that held their proportion and stabilized the country's economy. Thus, if a crisis were to occur and affect an important sector, the entirety of the Lebanese economy would not collapse due to its dependency on that one commodity but would rather maintain some form of functionality, owing its survival to that diversity. Moreover, Lebanon also retains a significant amount of remittances from the country's dispersed immigrants.

Those factors motivated investors and instilled a sense of confidence in the potential of the Lebanese economy. The low price and high return, coupled with reasonable political stability, brought investors rushing in. Lebanon's free market economy, backed by a stable currency, was unique among the Arab world at the time. Lebanon enjoyed a sense of stability that the Middle East had been deprived of at the time. Countries affected by political, economic, and security instability all transferred their money into Beirut's banks. Simply, when confidence in the governments of Egypt, Syria, Jordan, or others waned, private flight money poured into Beirut, a safe haven of foreign capital—and once it arrived, it usually stayed.

With the desire to maintain the prosperous streamlining of foreign capital and in hopes of further increasing it, Lebanon established Law No. 1/1956 that effectively instituted a banking secrecy law that prohibits, with some restricted circumstances, bank managers and staff from disclosing customer identities or information about client assets and holdings to any person or public administration, law enforcement, or judicial entity [9]. Passing the Bank Secrecy Law dramatically increased banking deposits and advances, doubling the deposits from LBP 215 million in 1950 to over LBP 564 million by the end of 1956. Time deposits increased around eightfold during that time period, from LBP 5.5 million to LBP 42.2 million, with a significant portion of them likely being of foreign origin [10]. To put Lebanon's exceptionally rapid growth into perspective, the Lebanese economy doubled the growth rate experienced by the United States between 1950-1956, years that are generally considered to be particularly prosperous for the U.S. economy.



The value of the Lebanese pound in relation to the U.S. dollar was stable (hovering slightly above LBP 3 to USD 1), and the Lebanese market saw an increase in demand for the Pound, a sign reflecting the increased number of tourists, increased payment for commercial, transportation, or financial services, and increased inflow of capital. It represents confidence in the Lebanese economy. The chart below shows the average stability of the LBP/USD exchange rates between 1948 and 1960, visualizing the consistency and reliability of the Lebanese Pound during that time period,

2.3 Trade Deficit

[9] (Tohme Law Firm, n.d.)
[10] (Persen 1958, 285)

Since the early 1950s, Lebanon produced an unfavorable trade imbalance begrudged with a ratio of 5 to 1. That chronic deficit did not recover with the sharp increase of foreign capital; Lebanon rather plummeted deeper into its imbalance as time persisted, with the imbalance starting at around $58 million in 1951, $314 million in 1960, to $489 million in 1970 [11]. Lebanon was not a producing country, yet with the growth of its economy through the successful commercial and banking sectors, the increased demands and consumption of the Lebanese population prompted the government to increase imports amidst a continuously weakening commodity-producing sector (more information on that later). By 1973, imported products made upwards of 47.5% of the total amount of agricultural and industrial commodities consumed annually. The trade deficit was maintained only by the high inflow of foreign capital and the success of the Lebanese banks in maintaining and growing them.

3. Wider Politics of the Region

Politically, Lebanon was surrounded by challenges that threatened its growth and laid solid foundations for many of the future domestic and international conflicts the country will encounter near its post-independence future. Most prominently, the growing influence of Arab-nationalist and Pan-Arabist movements across the middle east were growing with exceptional prominence, particularly with the increasing popularity and power of a charismatic general from Egypt, Gamal Abdel-Nasser. Leading the Egyptian Revolution of 1952 that toppled the reign of Egypt's monarchy under King Farouk, Gamal Abdel-Nasser assumed power over Egypt and officially became president of Egypt in June of 1956. His favorability among Egyptians throughout that turbulent period was tremendous; However, Nasser captivated the entirety of the Arab world following the nationalization of the Suez Canal Company, popularizing Pan-Arabism and Arab-nationalism across the Middle East. His views matched closely with that of Syria, who has been experiencing a period of tremendous political instability, yet the growing influences of Arab-nationalist sympathizing parties, such as the Syrian Communist Party and the newfound Ba'ath party, gained enough power to culminate in the establishment of the United Arab Republic (UAR) in 1958. The UAR was a

[11] (Nasr 1978, 3) *All figures adjusted to inflation*

short-lived union between Egypt and Syria, a materialized political manifestation of the growing influence of secular Arab-nationalism.

3.1 Lebanon 1958 Conflict

The UAR presented a major conflict within Lebanon. Nasser's calling for Arab Unity, sparked a division within the population. At the time, Lebanon's Maronites, the poplar majority and most politically influential sect, had opposed the unification of Lebanon into the UAR, in contrast to the majority of Muslims and Druze that had advocated for Lebanon's integration as part of its Arab identity and political independence from Western influence. The United States' support for Camille Chamoun, Lebanon's president at the time, was steadfast. Seeing Chamoun as the only openly anti-communist leader, the United States saw it in its best interest to preserve that sentiment among the Lebanese leadership, especially at the height of the Cold War and considering the United States pledge to combat international communism under the Eisenhower Doctrine.

Following domestic pressure, and fearing possible sectarian unrest and Lebanon's subversion and coercion by the UAR, the Lebanese government issued a formal complaint to the United Nations 22 May 1958, accusing the UAR of meddling in the nation's affairs [12]. On 15 July 1958, Eisenhower responded by launching Operation Blue Bat, the first implementation of the Eisenhower Doctrine since the US declared that it would interfere to support regimes deemed endangered by international communism. The operation involved over 14,000 men whose mission was to bolster the Chamoun regime and protect strategic Lebanese locations, namely the naval and air ports from any internal or external compromise that may arise [13]. Tensions were gradually lowered, and U.S. troops withdrew from Lebanon on October 25, 1958.

Following the conclusion of the 1958 crisis, the Lebanese government, led by Prime Minister Rashid Karami, formed a national reconciliation government.

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[12] (Brewer 1958, 4)
[13] (Bryson 1980, 126-40)
For more information Eisenhower and the UN speech see this video: https://en.wikipedia.org/wiki/File:1958-08-14_Ike_Tells_UN.ogv

3.2 Impact on the Economy:

Lebanon's entanglement in external crises, and the tough political stance it played within the early periods of its economic growth proved to be harmful in some way to the economy, and to the politically "neutral" portrayal it attempted to showcase to the world in hopes of luring additional foreign capital. The British, French, and Israeli invasion of Egypt following the Suez Canal's nationalizations contributed directly to the 13% decline of foreign deposits into Lebanese banks [14]. Fearing a spillover into the wider region, that decline highlights the importance of domestic as well as regional stability into the economic model that Lebanon desired to maintain. The non-guarantee of Lebanon's freedom and stability, regional tensions led to the capital flight from the banks of Lebanon to Swiss and American banks.

Despite that setback, Lebanese banks retained their role as the most reliable and familiar safe haven for foreign capital, particularly for the booming Arab oil economy. Further, Lebanese banks tapped into an important demographic segment of wealthy Egyptian, Iraqi, and Syrian bourgeoisie whose government's drastic and sweeping implementations of socialist policies, agrarian reforms, and economic intervention frightened their wealthy economic class into transferring their assets to Lebanon.

Consequently, the number of banks increased dramatically from 10 in the mid-1950s to 55 in 1965. To which the proportion of total deposits to the national income concurrently increased from 28% in 1950 to 122% in 1974 and was the highest globally [15].

3.3 Banking System in Lebanon and the 1966 Crisis

Lebanon's banking system was exceptionally Western-oriented. As previously mentioned, Lebanon's free market economy was unique among the Arab world, a region dominated by either socialist economies, or economies kept afloat by the booming oil industry. The Lebanese example, however, was presented differently, with a strong banking system and a special emphasis on

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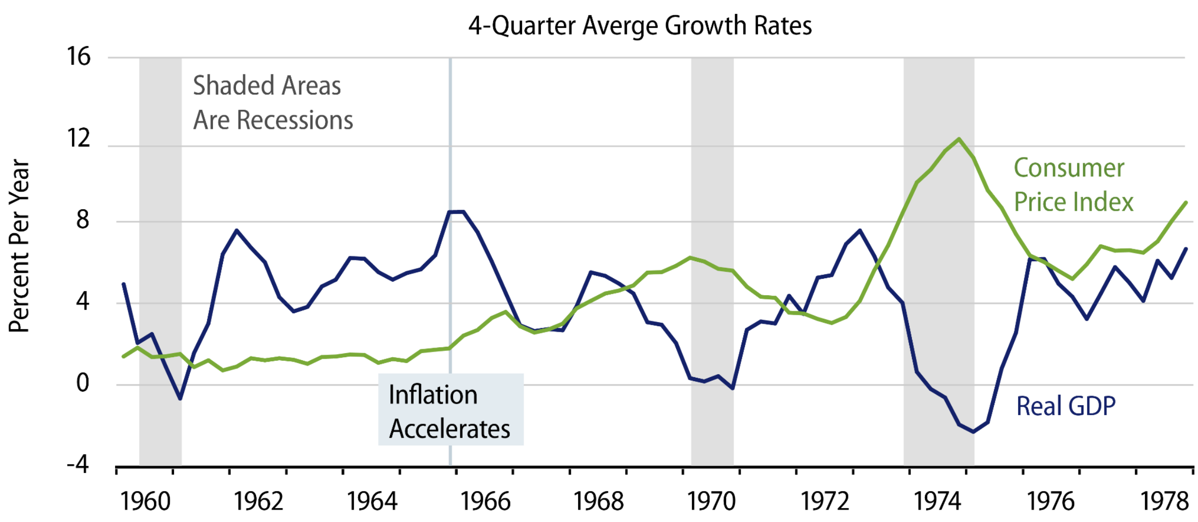
[14] (Persen 1958, 286)
[15] (Nasr 1978, 4)

the commercial and service sectors, Western industries found in Lebanon an opportunity to introduce their industries to the Middle East by establishing a base of operations in Lebanon. Lebanon's banking system, however, similarly swayed by the massive influence of Western economies in the Middle East, was tested by the looming financial crisis in 1966.

The U.S. dollar (as well as the British sterling) was experiencing periods of tumultuous instability, rising inflation and unemployment, and the substantial devaluation of the dollar. Dubbed as 'The Great Inflation' in the United States, the period was characterized by what renowned economist Jeremy Siegel called "the greatest failure of American macroeconomic policy in the postwar period". Prompted by increase in the price of oil and President Johnson's Great Society programs resulted in substantial expenditure projects across a wide range of social projects amid a difficult US fiscal situation that was already stretched thin due to the strains and burdens of the Vietnam War [16]. The cost of living for Americans thus increased significantly, as shown by the Consumer Price Index (CPI) in Figure 3-A .

Figure 3-A



Source: Bureau of Economic Analysis, Bureau of Labor Statistics. As of March 31, 2022

[16] (Bryan and Federal Reserve Bank of Atlanta, n.d.)

It was only natural for Lebanon, whose strong ties and economic integration to Western financial markets, to experience immediate impact of 'The Great Inflation' for many reasons which this paper cares to briefly outline:

1) The International liquidity squeeze effect was inevitably reaching Lebanon, in view of the open channels that connect the Lebanese money market to those of Western Europe and the United States. That connection was especially emphasized when considering the free exchange system that existed at the time, which Lebanese banks benefited from by shifting funds heavily from local to external markets in order to benefit from higher interest rates and yields found abroad. The reversal of which—meaning the increasing inflation, and spiraling devaluation of the dollar—would undoubtedly harm the Lebanese banking sector [17].

2) The Lebanese banking system heavily favored foreign currency deposits by attracting them with higher interest rates. Considering the difficulty of individual banks to distinguish between resident and non-resident accounts (despite the Central Bank's efforts to organize them), and the Lebanese resident depositors' attraction to the higher interest rates placed on foreign currency deposits, heavy conversions of local currency to foreign currency occurred, further contributing to the shifting of funds to foreign markets. Local banks, therefore, now have an increased liability in foreign currency which they need to supply by purchasing that foreign currency with the local pound, contributing to increased inflation [18].

3) Lebanese banks' total cash assets fell significantly, from LBP 1354 million in December of 1965 to LBP 838 million in September of 1966, a decrease of 42% [19]. Concurrently, demand deposits increased from LBP 922 million in the first quarter of 1965, to LBP 1026 million by September 1966, and time deposits also increased from LBP 1390 in Q1 of 1965 to LBP 2175 million in September 1966. Meaning numerous local

[17] (Ghattas 1971, 32)
[18] (Ghattas 1971, 34)
[19] (Ghattas 1971, 36) Table II

banks witnessed a dramatic drain in their liquidity and therefore were unable to maintain their cash assets, and were soon declared bankrupt.

> *"In the absence of measures to prevent runs [20], such as was the case in Lebanon, the degree of exposure of the average bank to liquidity problems or the chances of liquidity casualties in the whole system, mark a significant measure of the system's safety."*

Subsequently, the number of Lebanese banks fell from 55 in 1966 to 38 in 1969 and 25 in 1974 [21]. The 1966 crisis revealed the fragility and ill-preparedness of the banking sector, and exposed the low level of concentration within Beirut's banks, given that 33 or the 55 banks had deposits of less than LBP 10 million. Further, the Western multinational advanced and quickened the collapse of local Lebanese banks—multinational banks began buying up Lebanese banks and consequently establishing affiliates in Beirut to accrue profits and continuously attract the increase of Arab petromoney capital.

Most of all, the people felt the brunt of the collapse. Lebanon's inflation rate skyrocketed during that time period, increasing 46 between 1964 and 1974. The public, despite the growth in GDP, was beginning to face serious challenges resulting from the banking system that had been put in place, one that proved to be weak and unable to support its weight in the face of fiscal challenges. The determinant factor as to why this crisis afflicted Lebanon was due to the exposure of the underlying yet massive underdevelopment that lay bare beneath a seemingly successful banking business flooded with foreign capital. Yet all that success was profitable to the banks and their foreign beneficiaries, and not the public and its institutions.

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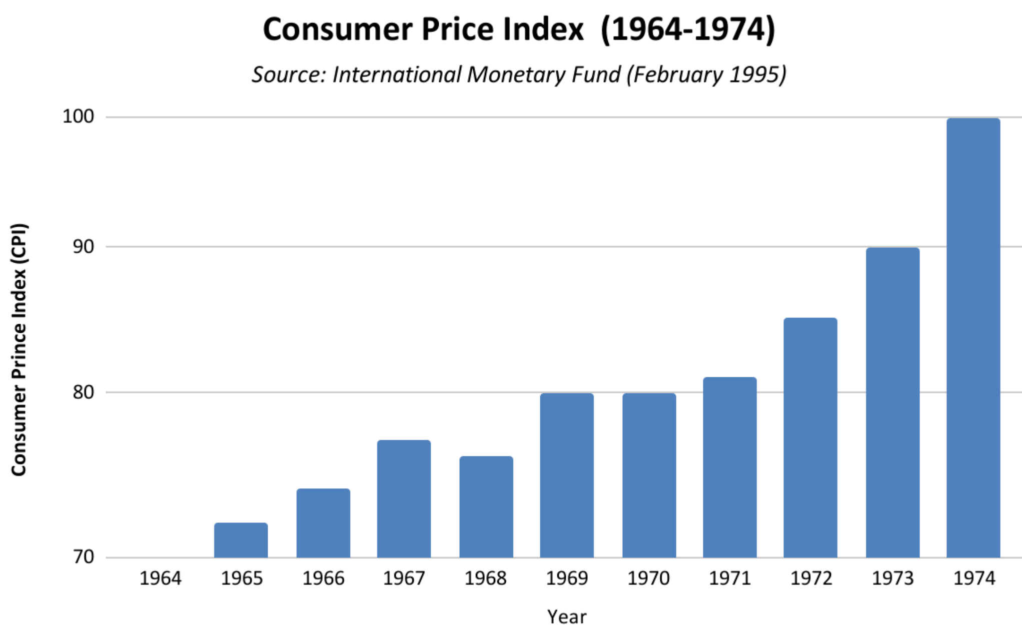
[20] Bank runs is a phenomenon where people rush to withdraw their money from their accounts since they believe that the bank will collapse in the near future.
[21] (Nasr 1978, 4)

Figure 3-B



During the 1970-1974 era, the foreign-dominated banking industry diverted credits and resources that could have contributed to national economic growth by investing 40 to 50 percent of its resources outside Lebanon. More than half of the savings accumulated by foreign-dominated banks have been moved to their central offices or to international financial markets, rather than being invested in strengthening the Lebanese economy. Moreover, what was left to be invested domestically was strategically placed to the advantage of local commercial sectors with direct ties to their Western counterparts.

Additionally, credit distribution was tailored to the interest of foreign financial institutions, where the commercial sector received twice as many credits as all productive sectors combined. Trade (53.6 %); Industry (16%); Construction (10.3 %); Financial institutions (5%); Agriculture (4.3%); Other (10.5). Additionally, only particular industrial firms with assets connected to western capital received financing from the dominant banks of Beiut, and thus, by and large, the vital sectors of the Lebanese economy such as irrigation, housing, and education were ultimately left underfunded and underdeveloped [22].

[22] (Nasr 1978, 4)

"On the eve of the civil war one could observe the strange co-existence of a banking sector with excess deposits, organizing international loans for the likes of Renault and the World Bank, and a public sector in deficit, trying to borrow from external sources and proclaiming its inability to finance social and economic projects"

4. Laying the Foundations for Failure: Corruption and Monopolies

The weakness of the Lebanese productive sectors was unable to provide for its population, and amid increasing demand and population, the government had to rely on imports to feed its people. Imports increased from 34.8% in 1967 to 53.6% in 1973. This increase in imports further drove Lebanon's chronic deficit, which increased from LBP 223 million (≈ $58,684,000) in 1951 to LBP 968 million (≈ $314,285,000) in 1960 to LBP 1.6 billion (≈ $489,296,000) in 1970 [23]. By 1973, imports constituted 47.5% of the total agricultural and industrial commodities consumed annually, with Western capitalist states providing 75% of that total [24]. The international domination of international capital and sectors over the Lebanese economy allowed for a small group of monopolies to succeed in seizing important economic sectors with the help of internal governmental corruption.

According to Law No. 34 (1967), foreign businesses with representatives in Lebanon are not permitted to replace their commercial agents without their consent, and punishes international companies in case of the agent's termination by no fault or "justifiable" reason by enforcing them to pay a termination indemnity equivalent to the agent's average net annual profits[25]. Meaning the law had provided the agent with powerful judicial protection and privileges vis-à-vis the major international entities, enabling them to increase the price of imported products without fearing termination or the transfer of representation to another agent.

Moreover, the Ministry of Trade had set an import quota that sets the maximum permissible quantity of products allowed to be imported. Meanwhile, the Ministry of Economy imposes import licenses on international

[23] Exchange rates calculated through period average rates provided by the International Monetary Fund. 1951: USD 1 = LBP 3.8; 1960: USD 1 = LBP 3.17; 1970: USD 1 = LBP 3.27
[24] (Nasr 1978, 5)
[25] (Nasser & Associates Law Firm, n.d.)

products that can compete with domestic products in order to protect local commodities prior to their importation. These import licenses are then sold to a small group of politically powerful businessmen who implement the most lucrative pricing and distribution strategies, knowing that there would be no competition.

Internal market weakness, selective bank lending and favoritism, limited credit, persistent rises in input costs, and a growth in imports have all culminated in the hands of a few monopolies that control the vast majority of food products, agricultural inputs, construction materials, and textile goods. The groups that control all these imports also control local production and industries of sugar, poultry, cement, and wood [26]. This massive reliance on imported products contributed to a rural crisis in Lebanon, where agricultural production, namely cereal, fell from 38% between 1948-1952 to 18% between 1968-1970. Lebanon thus had to import 60-70% of its consumption needs of cattle and dairy products, all of which contributed to the rising rate of inflation in the late 1960s and early 1970s.

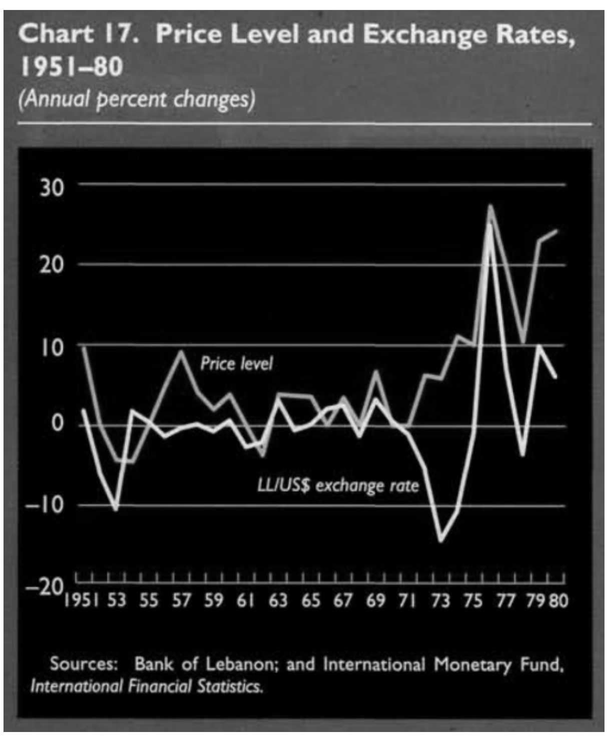


Figure 4-A

4.1 Corruption in the "Industrial" Sector

[26] (Nasr 1978, 6)

To remain competitive and ensure profits comparable to their commercial and financial counterparts, industrialists maintained heavy pressure on their workers and developed an employment policy heavily influenced by the speculative and short-run nature of the majority of Lebanon's economic activity. It was a policy characterized by exploiting and wasting a seemingly endless workforce.

The security and stability of employment are entirely up to the employer's discretion under Lebanese labor law. They only need to pay 2 months' salary as indemnity to fire a worker at any time without having to provide a reason for doing so (Article 50). This allowed businesses to hire and fire large numbers of workers each year, allowing them to respond to market fluctuations and replace workers who were becoming "old" with contingents of young workers when they could pay much less than the mature workers. Article 50 of the Lebanese labor law allows an organization to pay workers under the age of 20 less than the minimum legal wage. Unqualified adolescents, some of whom begin working at the age of ten, were frequently paid half the minimum wage. A 1974 study of 26 large businesses in Beirut's eastern suburbs, revealed that 29% of wage earners had worked for their company for less than a year, 43.6% had done so between 1 and 5 years, and only 27.4% had done so for more than five years. Additionally, the study revealed that 36% of all workers were under the age of 20. workers over the age of 40 made up about 10% of the workforce [27].

Considering the aforementioned spike in the Consumer Price Index, industrial workers' average monthly pay increased from LBP 215 to LBP 217 between 1964 and 1974, while the official cost of living index increased by at least 110%.

[27] (Nasr 1978, 11)

4.2 The Rural Crisis

The infiltration of capitalist companies into the agricultural sector impacted the population of share-croppers in rural Lebanon, whose population among the agriculturally active demographic was 25% in 1950, falling dramatically in 1970 to around 5%. After the takeover of companies, the sharecroppers were forced to relocate to the city or in some cases outside the country. On the other hand, some were permitted to stay and work the land as wage laborers at extremely low rates and harsh working conditions, threatened by their easy replaceability with Palestian and Syrian immigrant who served as capitalists' labor reserves[28].

Lebanon's success in the commercial and service sectors naturally impacted the share of agriculture in Lebanon's GDP, falling from 20% in 1948 to less than 9% in 1974. However, the neglected agricultural sector in Lebanon was completely left abandoned and underserved by the government, where the agriculture's share of the state budget was slashed reaching an abysmal 2.3% in 1973. As to agriculture's share in bank credits, that matched its negligible quantity at 3.4%. Mounting pressures on the peasantry were becoming unbearable. Up to 65% of cultivators in Lebanon during the 1960s had a second non-agricultural job they were forced to maintain if they sought to survive. Moreover, in 1973, the UN Food and Agriculture Organization (FAO) revealed that the level of indebtedness of small farmers with assets of less than 2 hectares increased from 20% to 69% over a few years, and farmers with assets less that 5 hectares constituted nearly half of all agricultural debts.

[28] (Nasr 1978, 8)

Figure 4-B: Rural to Urban Migration (1970)			
Province	**Total population of rural origin**	**% of population migrated to towns in province**	**% of population migrated to Beirut or suburbs**
Mount Lebanon	344,000	2.1%	17.4%
North Lebanon	204,435	8.6%	7.4%
South Lebanon	242,085	2.8%	29.3%
Beka'a	178,425	1.7%	16.9%
Total	**758,670**	**3.5%**	**18.1%**

This raging inequality led to the exodus of Lebanese farmers (as shown above in Figure 3-B) to the cities where their living conditions remained impoverished. The large disparity of government and bank credit funds between agricultural and service/commercial fields left non-service fields to deteriorate at colossal rates. This created a profound socio-economic crisis within the Lebanese population that lay the foundations for the coming civil war.

The prevalent characteristic of Lebanon's seemingly booming development within its center, lay the underdevelopment and unequal development of its periphery. In 1969 there were thought to be 70,000 unemployed workers (10-13% of the workforce); by 1974, it more than doubled, reaching 120,000 (15-20% of the workforce) [29]. Moreover, the income disparity between various occupational demographics in Lebanon was catastrophic. For example, in commerce, the average income per head was LL 60,000. The total tertiary sector figure is LL 8,060, industry is LL 1,100, and agriculture is LL 500. Thus,

[29] (Nasr 1978, 11)

while per capita income in the commercial sector is comparable to European standards, income in the rural sector is among the lowest in the world! [30]

Another study in 1960-61 by the Institut de Recherches et de Formation en vue de Développement (IRFED) estimated that 15% of all Lebanese families earn LBP 10,000 per month, while the middle 40% earn around LBP 1,500 per month, and the poorest 45% earn only LBP 350 [31]. Even using very conservative criteria, the authors find that 85 percent of Lebanese families earn less than what is required to provide a minimally decent standard of living.

5. Civil War

Although there are many interpretations as to why the civil war in Lebanon "truly" erupted, the undeniable fact is that Lebanon's political divisions had long been drawn through sectarian lines. Those sectarian tensions, characterized purely by their political nature, divided the country since its inception. During the French mandate, despite the division of government to accommodate the different sects of the Lebanese public—the President must be a Maronite Christian, the Prime Minister a Sunni Muslim, and the Speaker of the House of Parliament a Shiite Muslim— the Frenchfavored the Maronite and other Christian populations who had been the demographic majority during that time, enjoying the privileges of the pro-Western French alliance that brought about an all-powerful presidency and a Maronite domination of Lebanon's political and economic life.

However, splits over how the country should be represented first emerged during the 1958 crisis, which showcased many Muslim's sympathies toward Arab nationalism and their desire to join the newly-founded United Arab Republic. The United State's intervention eventually interrupted that movement, and the issue had been dissolved; nevertheless, the sectarian tensions remained. The escalation of the Israeli-Palestinian conflict and the immigration of Palestinian refugees to Lebanon created a crisis where the Palestine Liberation Organization (PLO) had been active among the over

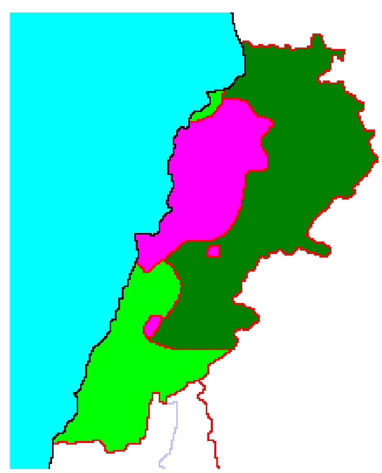
[30] (Nasr 1978, 12)
[31] (Institut de Recherches et de Formation en vue de Développement and Lebret 1960-1961, 23)

400,000 Palestinians inside the refugee camps [32]. The creation of a pseudo-state within the refugee camps consolidated tremendous power, considering the political and military autonomy of the Palestinian refugee camps relative to Lebanon's ability to maintain any form of neutrality, and political stability became extremely unlikely. This phenomenon dissatisfied a significant proportion of predominantly Christians in Lebanon, who had been politically characterized by Lebanese nationalism, while their Muslim counterparts were politically aligned with a sense of Arab nationalistic anti-imperialism; that rift and political consequences of that orientation also played a tremendous role in the eruption of the war.

Fighting erupted and its inception brought about a colossal loss in human life, infrastructure, and the economy at large. The staggering number of armed factions that fought within Lebanon and consistently changed their allies and enemies further plummeted Lebanon's security away from peace and dramatically prolonged the war. Moreover, foreign intervention from both Syria and Israel created yet another branch of the civil war that further obscured a path for Lebanon to move toward peace.

5.1 Syria's Intervention:

In 1976 a Syrian proposal to limit the presence, influence, and amount of Palestinain guerrilla forces inside Lebanon was welcomed and rejected by numerous factions. Upon the disputed request of President Suleiman Frangieh for Syrian intervention to help stop the yearlong civil war[33] In May of 1976, the intervention was later legitimized through the approval and support of the Arab League in its consultation to aid in halting the war through Arab intervention, which in this case almost entirely consisted of Syrian troops.



Map showing power balance in Lebanon, 1976:
Controlled by Syria.
Controlled by Maronite groups.
Controlled by Palestinian militias.

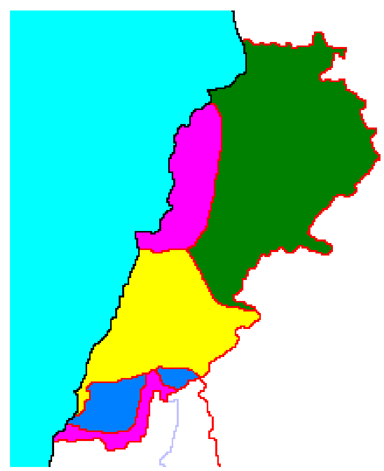
Image courtesy of the Wikimedia Foundation

[32] (Tawil 2022)
[33] As provided by the United Nations International Independent Investigation Commission through the Mehlis Report. (Mehlis and UNIIIC 2005)

This paper will not divulge in the specific alliances, factions, and conflicts that Syria was involved in. However, it is important to note Syria's heavy influence on Lebanese politics that completely delegitimize Lebanon's political sovereignty and legitimacy that endured throughout the civil war and prolonged years after its ending. Syria refused to leave Lebanese territory despite the signing of the Taif agreement on the pretexts that stability in Lebanon would only be achieved through the elimination of the sectarian identity of Lebanese politics, knowing full well the difficulty and longevity of such a strenuous task, particularly when rival factions had just been given the task of managing a confessionalist government. The Syrian Army was later expelled, resulting from the pressures mounting through a series of protests that emerged following the assassination of Lebanon's Prime Minister Rafic Al-Hariri[34].

5.2 Israeli Invasion of Lebanon:

In an effort to exert and expand its sphere of influence and push back the PLO's threat to the Israeli northern border, Israeli forces breached the Lebanese border launching an invasion into South Lebanon beginning in 1978 and maintaining a presence within Lebanese territory well into the peak of the civil war. Israel's invasion of Lebanon was colossal and calamitous to the Lebanese people, with well over 48,000 civilian casualties perpetuated by the Israeli invasion[35].



Again, this paper will not divulge in the political specificities of Israeli role and policy in Lebanon. However, it is important to note the significance of the fear, harm, torture, death, and overall instability that was created as a direct result of the Israeli invasion and military operations it conducted within Lebanon. The Israeli military was later expelled under heavy

[34] (New York Times 2005)
[35] (Ross 1982)

losses, and duress levied by Hezbollah's forces [36] and in compliance (disputed) with UN Security Council Resolution 425 in May of 2000.

Lebanon technically remains at war with Lebanon, and tensions have increased and decreased sporadically throughout the years, maintaining an enduring sense of instability within Lebanon. Tensions broke out in 2006, an event that will be later discussed in this paper.

6. Lebanon's Economy During the Civil War

Although GDP had decreased by more than a third between 1975 and 1981, net resource transfers were able to maintain national income and living standards. Wage remittances from Gulf workers during the oil boom years of 1972–1982 more than made up for whatever GDP was lost as a result of the destruction of capital stock, decreased investment, and labor migration. The local warring factions received "political money" transfers from their international backers, while a growing Palestinian sub-economy sustained an illusion and bubble of financial immunity of the Lebanese economy. Indeed, between 1974 and 1981, the national per capita income rose from $1,415 to $2,011[37].

It was obvious that it was only a matter of time before the serious consequences of the longstanding economic troubles became apparent. This developed steadily but peaked between 1982 and 1984. All the factors that had sustained the bubble collapsed; the Israeli invasion breached new levels during that period, the Palestinian sub-economy witnessed a complete collapse and a dilution of "political money", and most significantly, the widespread perception among the Lebanese of the protracted nature of their conflict and the difficulty in finding a solution to it. Not surprisingly, in addition to these unstable variables, the state witnessed a near collapse in tax revenue without a proportional decrease in spending, which led to the dependence on the banking sector for deficit financing.

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[36] Hezbollah is a political party and paramilitary force that exerts tremendous influence on contemporary Lebanese politics. They are the only organization that was permitted not to give up its arms following as per the Taif Accord's demands, under the justification of fighting off the Israeli invasion.

[37] (Bolbol 1999, 1861)

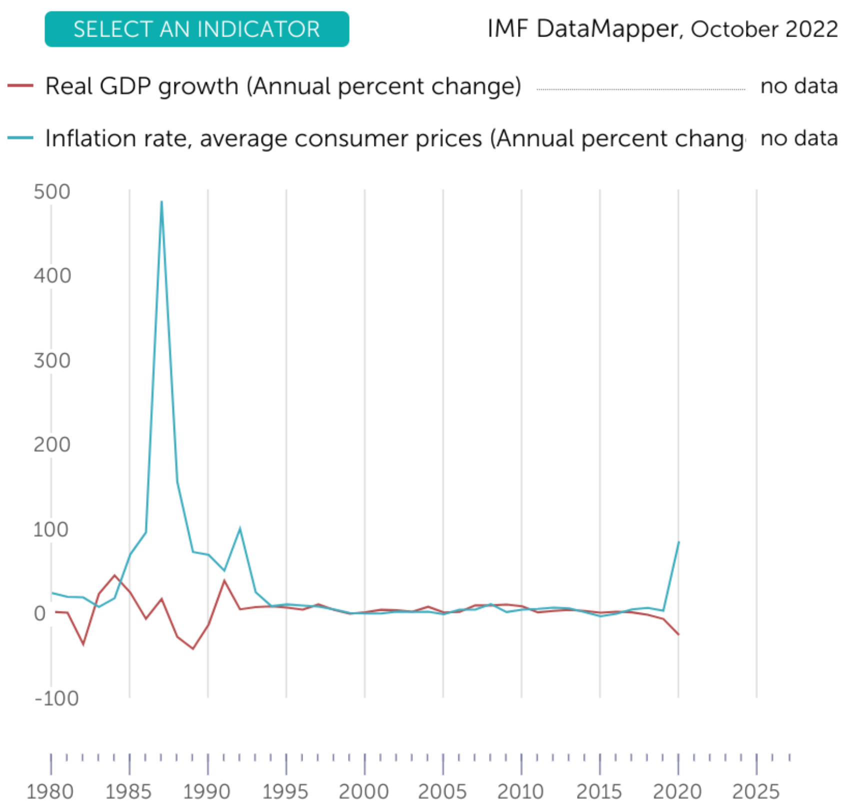
The massively deteriorating macroeconomic conditions produced the inevitable fiscal collapse: major flight from the Lebanese Pound, currency substitution and dollarization, exchange rate depreciations, and ultimately soaring inflation. By 1991, national per-capita income had plummeted to less than half of its 1981 level, and the capital stock had reached close to $25 billion, along with 200,000 professional and skilled emigrations and more than $10 billion in financial capital flight.

Further, the civil war reduced the government's revenue yield, particularly due to the inability of the government to collect taxes, owing to the complete breakdown of government authority over revenue sources. Weak tax revenues (even initially prior to the civil war) dropped from 15.6% of the GDP in 1974 to 9.7% in 1990. What kickstarted Lebanon's economic crisis during the early war years was the government's efforts to maintain a minimum level of public services and activities, while revenue losses during the war years were not matched by a similar restriction in expenditure. Total expenditure went from 15.4% of GDP in 1972 to 39% in 1989-90, keeping in mind the large surge in inflation that raised the cost of providing those services [38].

Furthermore, as the government turned to debt financing of budget deficits, domestic interest payments took a rising share of total expenditure rising from 4% in 1980 to 29% in 1989. With no fiscal revenues to finance spending, the government was forced to rely on deficit financing through seigniorage, particularly during the 1989-1991 period. To finance the budget deficit, the Banque Du Liban (BDL) resorted to printing money, spiking the rate of inflation to a historical high of 490%.

[38] (Saleh and Harvie 2005, 108)

Figure 6-A:



The money creation policy that resulted in an inflation spike owed its existence to the government's failure to respond to debt reduction. Prior to the war, from 1970-75, the average annual growth of nominal gross public debt was 3.5%, while the nominal gross public debt as a percent of GDP averaged at around 5.4%. In other words, public debt before the civil war was no major concern.

However, the mounting financial and economic crises prompted by human and capital obliteration by the war, followed by government failure, dwindling economic deceleration, and capital flight, and finally, an increase in public spending amid spiking inflation, prompted the government to borrow money and begin the process of deficit financing. The average annual growth of nominal gross public debt from 1976-83 was 66% but declined to 4.6% from 1983-90. This decline was caused by the government's resorting to printing money in order to rescue debt payments[39]. That policy led to the massive spike that is shown above in Table 4-a.

6.1 Dollarization

The inflation prompted Lebanon, still ravaged with war, to exploit the convertibility and free foreign exchange markets to replace their unstable currency with the US dollar. Lebanon's dollarization provided some advantages, for one main reason: the loss of seigniorage and the resulting monetary discipline, whereby risk-adjusted interest rates and prices would be dictated by levels in the United States. However, there are several drawbacks.

First, it denies the country's independent monetary policy and the central bank's function as a "lender of last resort." In truth, whether the country would have a central bank is a "semantic" matter. Second, in order to preserve broad liquidity, the government must create persistent balance-of-payment surpluses[40]. Third, because of the difficulties in sustaining the parity, it would be impossible to keep the exchange rate as a nominal anchor. Furthermore, exchange rate measures aimed at improving the balance of payments and economic circumstances may become ineffective. Fourth, a seigniorage fee is paid to the United States as part of the dollarization process. This only applies to dollar currency assets since bank reserves are held in interest-bearing form, and the cost represents sacrificed interest profits[41].

Nonetheless, since the civil war's inception, the United States dollar became an undetachable part of Lebanon's economy, one that persists to this very day.

6.2 Taif Agreement

[39] (Neaime 2015, 129)
[40] A balance of payments surplus means the country exports more than it imports. It provides enough capital to pay for all domestic production.
[41] Analysis on upsides and downturns: (Bolbol 1999, 1867-1868)

The beginning of peace and the end of the civil war was initially marked by the signing of the Taif agreement between all the main warring actors in Lebanon. The agreement established the principle of "mutual coexistence" among Lebanon's many sects, as well as their "proper political representation," as the primary goal of post-civil war parliamentary electoral regulations. It also reformed Lebanon's National Pact political system by redistributing some power away from the Maronite Christian community, which had been granted special status in Lebanon under the French occupation. Prior to the agreement, the Maronite President appointed and reported to the Sunni Muslim Prime Minister. Following the Taif accord, the Prime Minister was accountable to the legislature, much like in a regular parliamentary system [42]. As a result of the accord, the power-sharing formula that had benefited Christians was revised to a 50:50 ratio, and the powers of the Sunni Prime Minister were expanded over those of the Christian president. The accord also called for all national and non-national militias to be disarmed. Hezbollah was permitted to maintain its arsenal while acting as a "resistance force," as opposed to a militia, to combat Israel in the south of Lebanon.

Although the Taif Agreement acknowledged the eradication of political sectarianism as a national goal, it did not provide a deadline for its removal. The Chamber of Deputies (Parliament) was expanded to 128 members, evenly divided between Christians and Muslims, rather than being chosen by universal suffrage, which would have resulted in a Muslim majority (excluding the expatriate community, a majority of which is Christian).

7. Post-War Reconstruction

Immediately following the civil war, the government convened and decided on an economic reconstruction plan dubbed the 'Horizon 2000'. From 1993 through 2007, this vigorous plan targeted a macroeconomic revaluation objective set in conjunction with an investment expenditures program. Further, the government took on the task of macroeconomic and financial stabilization, in an attempt to control the high inflation and the recurring currency crises that ravaged the economy during the final phase of the civil

[42] (Salloukh 2006, 639)

war. Thus, the government and central bank found the exchange rate as an anchor to their policy in the postwar reconstruction period [43].

7.1 Horizon 2000 Plan, Projections, and Failure:

Horizon 2000 engineered a plan where $18 billion would be spent on public and social infrastructure reconstruction over a span of 13 years, beginning in 1995 and ending in 2007. Sectoral shares within the Horizon plan are as follows:

Table 7-A: Government Budget Allocation by Sector and Share Percentages

Sector	Share (%)
Physical infrastructure (electricity, telecoms, roads, highways)	37%
Social infrastructure (education, health, social affairs)	25%
Public Services (water, wastewater, public transport)	22%
Productive sectors (irrigation, oil, airports, ports)	8%
State apparatus (buildings, administration, information)	8%

Considering historical data trends, the project assumed that public investment would be matched on a three to one footing by private investments in equipment and building structures. The plan projected that GDP growth over the period would average 8% annually and doubling GDP per capita by the end of 2007. As it stands today, the plan is largely forgotten, surviving only four years past its inception, with its endpoint being marked by the election of Emile Lahoud in 1988 and the exit of Hariri from government.

The plan's unstable foundation produced an inefficient take-off. Due to the sectarian nature of Lebanese politics, the plan was initially met with political

[43] (Dibeh 2005, 1)

opposition from the parliament. Being presented as part of the 1995 budget and fearing an unequal distribution of resources among the different sects, parliament ultimately decided that the project would be approved on a project-by-project basis. Despite the political problems, PM Hariri was capable of overcoming them; the problems that the plans faced were primarily fiscal.

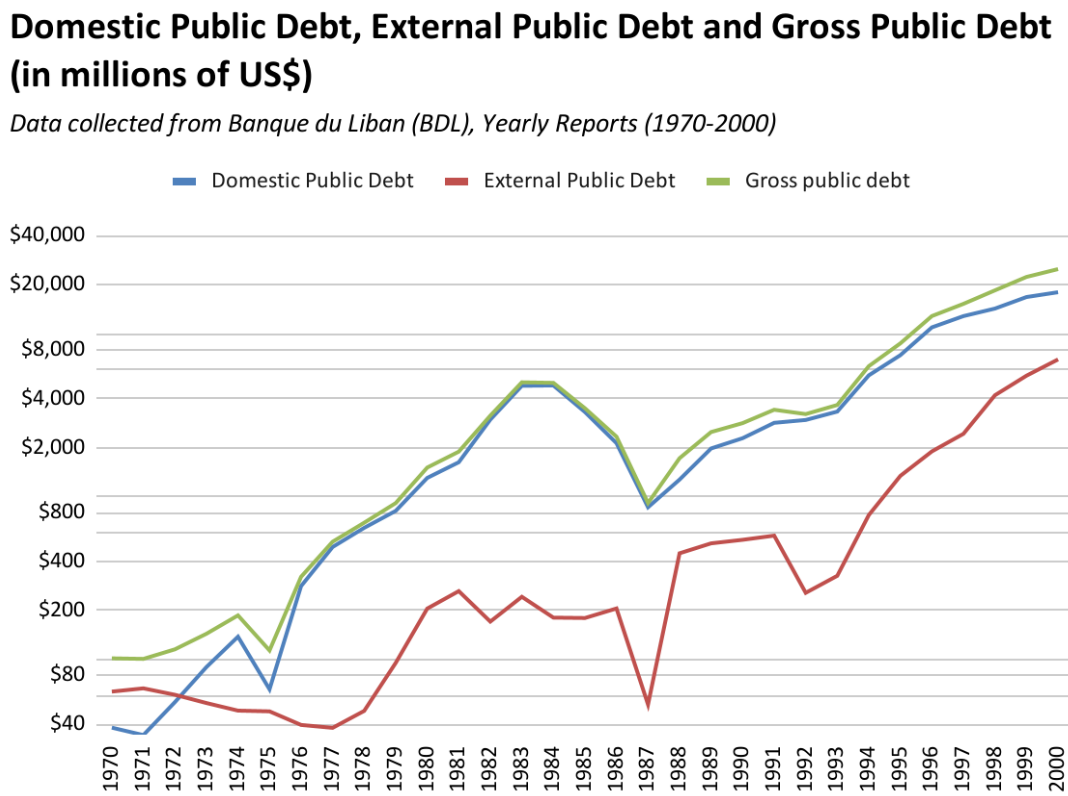
7.2 Budget Deficits and Public Debt in Postwar Lebanon:

In the first period following the war, the public deficit was reduced dramatically. From 1990 to 1992, the entire budget deficit as a proportion of GDP fell from over 30% in 1990 to 13% and 11% in 1991 and 1992, respectively. In 1991 and 1992, the ratio of gross public debt to GDP fell to 76.8 % and 58%, respectively. Debt service as a proportion of revenue fell from 168.9% to 48.9% in 1992, while debt service as a percentage of GDP fell from 10.8% in 1990 to 5.5% in 1992 [44]. The reason for such a quick turnaround was governmental reassertion and the revenue that soon followed.

In the second phase (1993-200), following the initiation of the *Horizon 2000* plan, the rebuilding of the infrastructure and the expanding sums of expenditure, and the slow recovery of the revenue-generating sectors, sizable fiscal imbalances occurred. Budget deficits grew from 9.2% of GDP in 1993 to 20.6% in 1996 and 23.7% in 2000. This resulted in a steady increase in government debt from 1993 to 2000. During this time, the average annual growth rate of public debt was 31%, and gross public debt as a percentage of GDP climbed from 48.6% in 1993 to 102.9% in 1997 and 151.8% in 2000. In 1997 and 2000, net public debt increased from 38% to 92.3% and 141.2% of GDP, respectively. Domestic public debt as a percentage of GDP went from 44.2% in 1993 to 86.5% in 1997 and 109.5% in 2000. The external public debt as a percentage of GDP rose from 4.3% in 1993 to 16.4% and 42.3% in 1997 and 2000, respectively.

Figure 7-B

[44] (Saleh and Harvie 2005, 113)


Domestic Public Debt, External Public Debt and Gross Public Debt (in millions of US$)
Data collected from Banque du Liban (BDL), Yearly Reports (1970-2000)
Domestic Public Debt
External Public Debt
Gross public debt
$40,000
$20,000
$8,000
$4,000
$2,000
$800
$400
$200
$80
$40
1970
1971
1972
1973
1974
1975
1976
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1981
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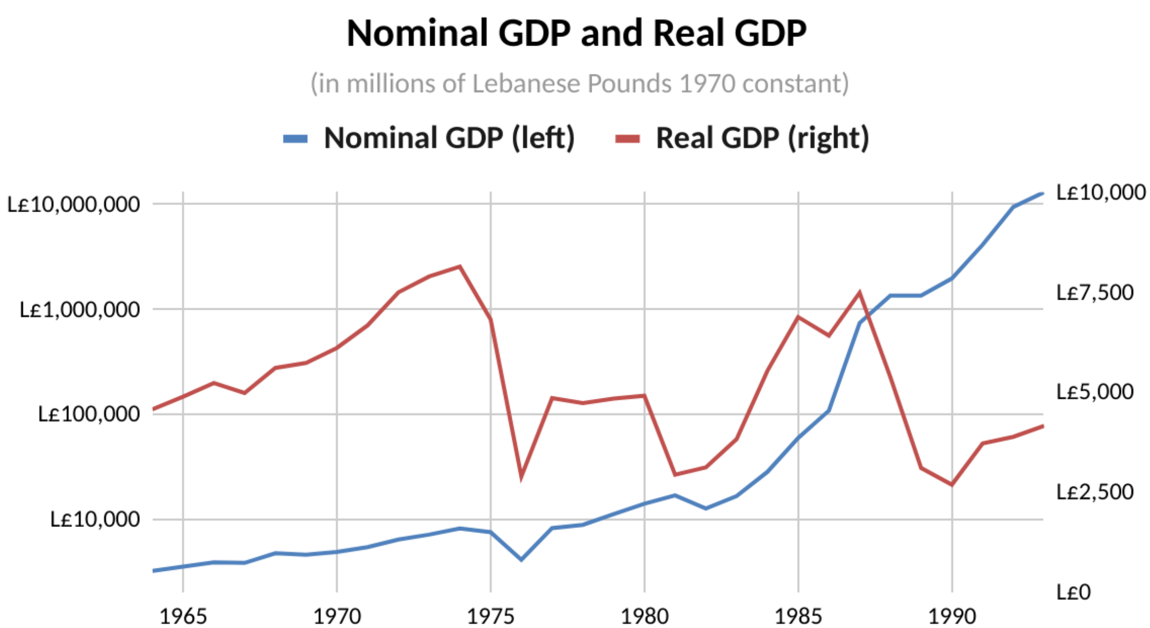
Figure 7-C


Nominal GDP and Real GDP
(in millions of Lebanese Pounds 1970 constant)
Nominal GDP (left)
Real GDP (right)
L£10,000,000
L£1,000,000
L£100,000
L£10,000
L£10,000
L£7,500
L£5,000
L£2,500
L£0
1965
1970
1975
1980
1985
1990

8. Postwar Growth in Lebanon

Lebanon was incapable of reaching the GDP per capita levels of 1970 in 2003. Poor governmental planning in regards to both fiscal and economic policies yielded extremely underwhelming results. In 2003, GDP per capita was $US 1,715 (constant 1990) in comparison to the $US 3,308 at the eve of war in 1974[45].

The reason for that failure is multifaceted, some of which will be elaborated upon. First, Lebanon's rebuilding program attempted a type of redistribution focused on regional redistribution. The Horizon 2000 plan mirrored the regional redistribution inscribed in the Taif Accords and hence in Lebanon's new constitution as a prerequisite for achieving "balanced growth." Therefore, government investment was not based on what would yield the highest rate of return but rather suited to appease all the different sectarian leader's demands for a horizontal distribution across all sects and, therefore, areas across the country.

Such redistribution methods were critical in the reconstruction of the country's physical, political, and social capacity, as well as in the reintegration of communities into a united and cooperative framework that required the legitimization of the postwar government. However, in the postwar period, regional and sectarian redistribution came at the price of distribution along income groups, a phenomenon particularly outlined through the government's newly devised tax policy.

Table 8-A: Regional Shares of Investment in Horizon 2000 Plan *(Souce: UNDP 1997)*

Region	Beirut	Beirut Suburbs	South	North	Bekaa	Mount Lebanon
Horizon 2000	14%	20%	19%	18%	14%	15%

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45 (Dibeh 2005, 7)

The taxation structure was first modified in a traditional supply-side approach, with lower marginal tax rates on income and profits. Profits' highest marginal tax rate was decreased from 50% to 10%. The top marginal wage tax rate has been cut from 32% to 10%, and corporate tax rates were reduced to a flat 10%[46]. The government's desperate need for revenue amid a fiscal crisis drove them to depend on indirect taxes as the main source of state revenues. The sustained growth in indirect taxes (particularly the gasoline tax) and the adoption of the value-added tax (VAT) in 2001 resulted in a severely regressive tax regime in postwar Lebanon. The regressive and indiscriminate tax system was viewed as a key contributor to the problems experienced by the majority of the population throughout the redevelopment crisis.

The tax system was increasingly utilized to generate income without concern for its distributional consequences. Furthermore, when the state's budget situation worsened, most of the social aspects of the rehabilitation plan were abandoned. By 1998, the state's fiscal and economic functions had been restricted to revenue generation. Furthermore, contrary to popular belief, the state gained money from the new assets created by the rebuilding program (electricity, landline telephone, and cellular network). Consumer welfare, a major concern for such utilities, was not even taken into account[47]. The government's failures to generate revenue forced the social welfare programs into oblivion.

8.1 Fiscal Failure in Postwar Lebanon

Three variables influenced fiscal policy in the postwar period. First, the economic rehabilitation strategy demanded massive infrastructure development investments with the government not utilizing the adequate funds required to meet the strategy amid an environment of sectarianism and corruption. Second, the requirement for state construction resulted in massive spending on the state's military, security, and administrative machinery, sidelining other revenue-generating sectors and social welfare programs (explained by the questionable rationale of the peace dividend). Third, post-Taef Accord sectarian politics and the distribution of political power among the various sects as defined by the collective executive authority vested

[46] (Dibeh 2005, 10)
[47] (Dibeh 2005, 10-11)

in the council of ministers has resulted in massive corruption through distributive and rent-seeking predatory activities by representatives of the various sects in the postwar period [48]. The two major instruments of corruption brought about by distributive politics of sectarianism were embodied by kleptocracy and nepotism in job placement and favors, as well as through the sectarian demands on public resources and money, many of which belonged in investments that should have benefited the Lebanese people.

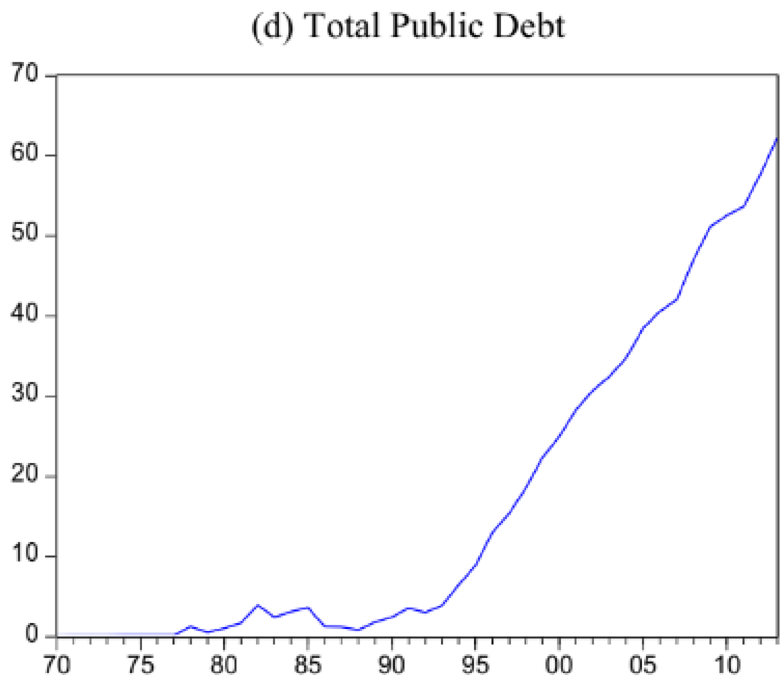
As a result, the government had no money, the fiscal crisis ravaged on, the people were not benefiting from any regenerative policies or social programs, and the government ranks were peaking with corrupt actors that were sustained by the confessionalist system. In order to maintain some form of development, the government needed to borrow money to maintain functioning.

8.2 Peace Dividend Paradox

In most post-conflict societies, the common trend indicates that as the battle ends, military spending consequently declines and the needs of the people transform from security to development, as the demands of the most vulnerable segments of the society are expected to be addressed as post-war reconstruction policies spring to action. However, in Lebanon, a paradoxical form of peace dividend existed alongside a substantial increase in military spending followed by an increase in the national debt to meet the crucial socioeconomic developmental demands. Shares of public expenditure indicate that in both 1994 and 1995 military and security spending were higher than the shares given to the health and education sectors combined [49].

[48] (Dibeh 2005, 11)
[49] (Dibeh 2005, 13)

Figure 8-A:



Source: (Neaime 2015, 130) IMF Direction of Trade Statistics and International Financial Statistics

Further, PM Hariri's initial effort to implement a fiscal adjustment failed. Following an early reduction in 1993, the deficit to GDP ratio returned to pre-1992 levels, indicating a failure in fiscal adjustment. Instead of the inflationary finance that was the norm in the 1980s, the government adopted a restrictive monetary policy and substituted bond financing of deficits. As a result, government debt increased throughout the postwar period. The reason for that is attributed to the fact that commercial banks in Lebanon were required to invest 40% of their LBP deposits in treasury bills until 1997 when the regulatory framework overseeing the monetary system was removed. This regulation had the effect of allowing treasury bills to suck up any remaining reserves that banks might have wanted to keep, and in the process, it undoubtedly contributed to higher money growth and inflation[50]. The plan that had been devised to curb inflation and maintain currency stability achieved the complete opposite.

[50] (Bolbol 1999, 1864)

The only reason that the economy did not crash was solely due to the foreign debt that was keeping the government functioning afloat. Otherwise, the disastrous fiscal policies were inflating a bubble that would inevitably explode, sentencing the country to a certain economic disaster.

9. Post-Reconstruction Economy

The country survived for a long time with a lagged economy and a rapidly deteriorating infrastructure that inevitably follows a failed reconstruction plan plagued with corruption at the most foundational level. The clientelist system born of the sectarian confessionalist order that developed following the civil war brought about endless disasters for Lebanon, on both social and economic foundations. The biggest example of which the clientalist system manifested itself was through the distribution of social services and public employment, both supposedly government functions that had been transformed and instrumentalized to become a tool used by politicians to boost their popular bases and political parties. Government jobs from the smallest jobs to the highest positions were filled by political actors as clientalist favors with political motivation. However, the rather unequal institutional distribution of public jobs, as a consequence of the aforementioned peace dividend paradox, resulted in an overwhelming emphasis on security forces and Lebanese Army Forces, where out of the 300,000 state employees, 120,000 to 150,000 were occupied by the armed forces. Salaries and benefits for military personnel accounted for a staggering 63.1% of the public sector employment budget in 2017 [51].

Further, the government's disastrous failure to implement any constructive improvement in Lebanon's economy, infrastructure, socio-economic conditions of the people drove them to establish numerous PPP (Public-Private Partnership) initiatives to manage some of Lebanon's most basic infrastructural and foundational necessities from telecommunications, solid waste management, postal services, and even parking meters and duty free at the Rafiq Hariri International Airport. By 2019, services made up 78.85% of the GDP, followed by manufacturing at 5.6% and agriculture at 3% attributable to measures like these. The reliance on foreign capital inflows and

[51] (Daher 2022, 12)

remittances from the Lebanese diaspora was also a reflection of this deficit in the productive sectors. Since 2010, FDI has been averaging between $2 and $3 billion, with the majority of it focused in investments connected to real estate and tourism [52].

Lebanon's PPP initiatives were not immune to the corruptive system in Lebanon. Rather, it is widely speculated that it was perhaps motivated by it, for many of the private companies that were employed by the government to handle the most essential jobs were wither owned or had major ties with politicians[53]. Lebanon's politicians strategically divided the government's issuing of the company contracts across the board to revolve around a tactic of embezzlement and self enrichment.

The most famous example of corruption between the private-public relationship is solid waste management, highlighted by the 2015 garbage crisis in Lebanon. In 1994, the national government began subcontracting garbage management in Beirut and Mount Lebanon to a company called Sukleen. However, post-war central administrations, notably Prime Minister Rafiq al-Hariri, saw the vulnerability of local governments as a chance to benefit themselves and their major corporate friends by deregulating and privatizing waste management. For example, Maysara Sukkar, the founding director of Sukleen, was a business partner of Hariri in Saudi Arabia before the launch of post-war reconstruction and development. After 1994, Sukleen's contract in Beirut and Mount Lebanon was repeatedly extended by the government. The per-ton price for overall garbage management (collection, transportation, treatment, and disposal) increased each time. Sukleen charged Lebanon's government $45 per ton for dumping alone in 2015. The global average for such services was $11 per ton. The Sukleen agreements were lucrative for all involved [54].

Remittances from Lebanese expats were a substantial source of foreign money, accounting for between 15% and 20% of GDP in the 2010s. Lebanon attracted around USD 94 billion in capital between 2005 and 2015. Around USD 72 billion, or 70% of the total, were used to acquire real estate and imported

[52] (Daher 2022, 10)
[53] (Straub 2019, 9)
[54](Abu-Rish 2015)

consumer goods, while the remaining USD 22 billion were deposited in banks, mostly to support the State's debt. Lebanon's political economy in the post-civil war period was characterized by widening socioeconomic inequality. As of 2018, 0.8% of accounts (24,421 accounts) held 51.8% of deposits ($85,286 billion), while 60.5% of accounts (1.749,104 accounts) controlled just 0.5% of deposits ($935 million). Moreover, around 44% of the Lebanese population lacked, in 2019, any health insurance coverage according to the Central Statistics Office. Meanwhile, since 2018, half the workers and more than a third of farmers live below the poverty line [55].

More broadly, Lebanon has one of the most uneven wealth distributions in the world, and one of the greatest concentrations of billionaires per capita. The wealthiest 10% of persons controlled 70.6% of the country's wealth in 2019 [56]. At the same time, the top 10% of the country's wealthiest individuals collected between 49 and 54% of national income between 2005 and 2016: the middle 40% earned 34%, while the lowest 50% of the population (including refugees and foreign migrant workers) received between 12 and 14% [57]. The Pandora Papers leak, which revealed the identities of hundreds of Lebanese officials, politicians, and businesspeople, including incumbent Prime Minister Nagib Miqati, demonstrate this concentration of power. The Pandora Papers exposed the international financial elite's use of opaque offshore tax havens to hide their wealth. Lebanon's 346 companies are actually the most important client of Trident Trust, a specialist in offshore company domiciliation. In comparison, the United Kingdom, which ranks second, has only 151 firms [58].

9.2 Beginning of the Banking Crisis

The central relationship between the banks and government, one that continuously funded the government's deficit spending did not cease to exist. Rather it grew and entrenched deeply within the Lebanese system, benefitting the politicians and feeding into the bottomless pit of institutional corruption.

[55](Straub 2019, 9)
[56] (UNESCWA 2020)
[57](World Inequality Database 2021)
[58] (International Consortium of Investigative Journalists 2021)

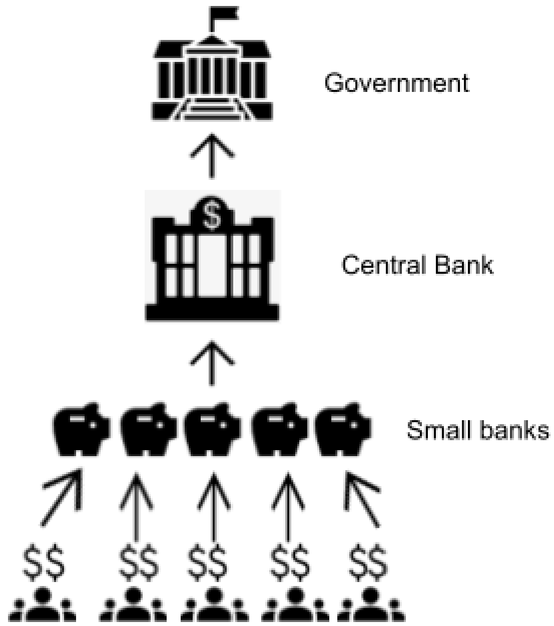
The different factions of Lebanon's bourgeoisie were mostly involved in banking, trade (both imports and exports), and real estate development/construction via big family-owned enterprises. This sectoral distribution of economic interests is connected to the previously mentioned reconstruction era state-bank relationship. It has also been distinguished by a high level of interdependence between the political and economic realms, with these powerful families holding high-ranking positions in banking, business, and government. Many politicians possessed unusually large shares in banks or held positions of influence within the banks, such as chairing the board of directors.

This fusion of Lebanon's political and economic elites was visible in official policies that favored the banking industry. Successive administrations provided unusually high interest rates on public debt instruments, acquired by Lebanese banks directly or through the Banque du Liban (BdL). These banks, on the other hand, offered attractive rates to depositors while functioning at extremely high returns. At the end of the 1990s, the system was improved to achieve an artificially manufactured USD/LBP peg in 1997, with the establishment of the parity of the Lebanese pound and the State's debt in dollars, which spurred an inflow of capital [59].

Between 1993 and 2019, the Lebanese government paid $87 billion in interest to banks. During this time, public debt soared by more than 2000%, from $4.2 billion to $92 billion, while bank assets surged by more than 1300% (to a total of $248.88 billion) and GDP by just 370%. Furthermore, between 1993 and 2018, private banks' net profits increased by 3,000%, from $63 million to $2 billion [60].

[59] (Straub 2019, 13)
[60] (Abdo et al. 2020, 9)

Figure 9-A: Image representing the structure of Lebanon's banking and government relationship.



What prevented the economy from folding was the high interest rates that the banks were offering and the confidence in their ability to pay it back. Without those two key components, the Lebanese economy would have not lasted long before completely crashing while running on this failure of an economic model. Confidence, nonetheless, was the foundational component. The moment the confidence was lost, the entirety of the scheme would be exposed and would instantaneously fall apart. That moment came twice; the first was in the outbreak of the Syrian Civil War in 2011, where foreign investors were worried about any outspils of the war, primarily with the years that followed in 2014-15, when the threat of terrorism from the ISIL was increasing and major concerns for its spread to Lebanon were becoming serious. The second moment followed in 2017, when then Prime Minister Saad Al-Hairir disappeared from Lebanon only to unexpectedly resign his office through a television statement made from Saudi Arabia, where reports emerged indicating that he was forcely kept and coerced to resign [61]. Confidence was lost, investors hurried to pull their money out, and the system egan collapsing.

[61] (Vox News 2020)

9.3 October Revolution and Port Explosion

By 2019, the government was in a deep crisis. While the collapse was taking place, unbeknownst to the public, the government was fully aware of the fiscal crisis that was about to explode. They had absolutely no source of income, and their only source of revenue was irreversibly damaged. The government convened and then decided on $6 a monthly tax for using WhatsApp among other imposed taxes on tobacco and gas. The public was enraged, and soon the government was met with unprecedented mass protests beginning in October 2019 that amassed millions of Lebanese to protest the culmination of corruption represented in the WhatsApp tax [62].

Although the protests did achieve the resignation of Prime Minister Hariri, they did not achieve the sweeping reforms necessary to impose substantial change in Lebanon. Although there exists secular and/or opposition groups in Lebanon today, whose origins and motivations can be traced to the October revolution, there currently does not exist a large enough political group that is capable of inflicting consequential change into the heart of the Lebanese problem: confessionalist system of governance.

In the midst of the unfolding economic crisis, on August 4th, 2021, an explosion rocked the capital city. Another tragedy befell the Lebanese people due to government negligence, where a storage facility holding 2,750 tonnes of explosive fertilizer (Ammonium Nitrate) had been stored in the Beirut port for six years without proper safety precautions, despite many notices being sent to various members of the government informing them of its extreme dangerousness. It caught fire leaving 218 dead, 7,000 wounded, and over 300,000 displaced [63].

10. Today's Lebanon

Despite all the events that have taken place, many of the same leaders since the civil war (or their family) remain in positions of power today in Lebanon. This indicates that despite a deep discontent that exists among the Lebanese people, the sectarian system is designed to divide the public in such a way that

[62] (BBC 2019)
[63] (Fakih and Majzoub 2021, 1)

it maintains their grip on power while prohibiting the people from forming a legitimate political opposition void of sectarian lines. The inflation spike caused by the collapse of the economy has reached unprecedented levels, where the pegged dollar that was once approximately 1,500 LBP for 1 USD now trades of upwards of 43,000 LBP for 1 USD (as of December 2022).

Figure 10-A: Lebanon's Market Exchange Rate

Source: Lira Rate; Dollar to Lebanese Lira Today

The prices of goods change hourly based on the black market exchange rate, and people have now become more dependent on foregin remittances than ever before. The Lebanese government has moved forward with capital control laws, harming million who have their money trapped in banks unable to move them out [64]. The government remains incapable of developing any sound policy to help Lebanon move forward and outside the crisis. During the earlier stages of the crisis during negotiations between the IMF and Lebanon regarding possible aid packages, a European diplomat claimed: "You would not think this would be difficult," "We have been begging them to behave like a normal state, and they are acting like they are selling us a carpet." [65]

[64] (Chehayeb 2022)
[65] (Chulov 2020)

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