Lebanon in the midst of multiple crises : Hope Born Out of Despair

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Executive Summary

This policy brief looks at the key socio-economic and political features of Lebanon, the drivers of its fragility exacerbated by the Covid-19 pandemic and the devastating explosion at Beirut's port on August 4, 2020. This colossal explosion has exacerbated the impact of the ongoing pandemic and eroded confidence in an economy that was already in crisis, in a country that is also grappling with inept leadership. The brief highlights how the country can cope with this succession of severe crises in an attempt to help political leaders in taking adequate decisions. It also presents preliminary findings of a recent research that examines whether using a measure of (economic) sentiment of the Lebanese population can produce a reliable diagnosis on the changes in the country's economic outlook. Our research underscores the benefit of including sentiments (as an indicator of anxiety among Lebanese people) to improve the overall forecast of growth rates. Ultimately, we identify potential policy priorities in the face of nearer-term pressures.

1. Introduction

The impact of the Covid-19 pandemic on the global economy has been largely disruptive, as the crisis has been deep and unexpected. Almost all governments worldwide have tried, through drastic measures, slowing the spread of the virus and mitigating the economic impact of the health crisis. Lebanon is no exception to this rule. But the disruptions caused by the pandemic have occurred while Lebanon is still struggling to move out of a profound economic and political crisis. The coronavirus pandemic worsens the situation. In this context, the Beirut port explosion on August 4, which killed more than 200 people, left thousands homeless and pointed out a corrupt and negligent political leadership, has only compounded its woes. This disaster that has shaken the whole country has many direct and indirect economic impacts including increased export and supply chain disruptions and extensive damage to hospitals, businesses, housing and public infrastructure.

Prior to the explosion, and in response to the spread of Covid-19, as many governments in the regions across the globe, Lebanon had been in strict lockdown and had imposed travel restrictions to ensure adequate levels of social protection and to prevent a high death toll. These restrictive measures have caused a significant slowdown in economic activity, which was exacerbated later by the explosion. Meanwhile, since the explosion in Lebanon's capital, the cases of Covid-19 have been dramatically spiking. According to the country Director for the International Rescue Committee "since the day of the explosion one month ago we've seen over a 220 per cent increase in the number of Covid cases in Lebanon, and it's showing no signs of slowing down. Almost everyday, 500 to 600 new cases are being confirmed and there are multiple clusters which is making it even harder to slow the spread." Consequently, the authorities announced two full two-week nationwide lockdowns in August and September and finally opted for a "zone approach" whereby areas are completely locked down for eight days, based on the number of daily infections and recoveries [1].

Lebanon deserves consideration as a subject of study and analysis for several reasons, but there is one which prevails over all other considerations. It is a place where the old Eastern Mediterranean cultures frequented those younger of the West. From their meeting was born Lebanon, a unique example of harmonious multi-ethnic coexistence and prosperity. It is on this ideal that the founding fathers imagined this country. This presupposes the requirement that everyone assume their belonging without excluding others. Today, this inspiring ideal, which has mobilized so many Lebanese's men and women, seems to have lost its relevance.

Since the independence of Lebanon, few leaders have shown a great sense of state. While the sectarian division of power in Lebanon has helped ending the devastating civil war of the 1970s and 1980s, the frantic search for domestic consensus and for interests based on clan considerations and the ensuing temptation to extract privileges, has created an unsustainable political situation and an unusual economic and social disorder. The October 2019 revolution (or the massive protests that have erupted across Lebanon) was born out of the ruins of a weak and structurally deficient system. Therefore, the Covid-19 health crisis comes on the heel of an unprecedented political, economic and social crisis and amplifies already abysmal inequalities. This may seem pessimistic, but hope is born from the abyss.

Lebanon's economic growth has experienced a sharp deterioration in 2019 on the back of economic difficulties mixed with a political and social crisis leading to low confidence and high uncertainty. This brief aims to analyse the relationship between the population's sentiment concerning the situation of Lebanon and economic growth, and whether it can be a potential driver of growth. Such sentiment may influence the economy because it influences agents' current and future decisions. Conducting forecasts of economic growth has certainly drawn attention since the beginning of the pandemic, and these early efforts are undoubtedly required. But there are difficulties in estimating and forecasting the growth rate in a context of rising anxiety amid the spread of Covid-19. In that context, the use of traditional data may be inappropriate. Hence the potential efficiency of accounting for the sentiments of the population, which may be perceived as a proxy of their anxiety, feelings or preoccupations in these times of distress. **We therefore test whether taking into account a measure of population sentiment would improve the overall forecast of future growth rates**.

2. Context: some key socio-economic and political features of Lebanon

In many respects **Lebanon has been, and still is, an exceptional case in the Middle East**. The Lebanese political system is defined primarily by confessionalism and ensures representations for its many sectarian communities. The confessional representation system gives equal parliamentary representation to Muslims and Christians, and the Lebanese president is always a Maronite Christian, the prime minister a Sunni Muslim, and the speaker of the parliament is Shia Muslim. The country's complex power-sharing

system makes it very difficult for any political party or group to gain a majority of seats in parliament and leads sometimes to paralysis of the decision-making policy process and to corruption practices. Recently, the presidency was vacant for two years due to the lack of political consensus on a successor to Michel Suleiman, whose term ended in 2014. Lebanon was in a state of a paralysing two-year standoff until 2016. The Lebanese's political system is supposed to enhance the equality between the biggest ethnical groups living in the country (Shia Muslims, Sunni Muslims and Maronite Christians) but it seems responsible to a wider degree of Lebanon's economic crisis. As all parties represented in parliament should participate in government, this has turned it into an inflated consensus apparatus, constantly blocking meaningful reforms.

Consequently, Lebanon's economy is strangled by one of the world's largest debt burdens as a result of years of inefficiency and corruption. Transparency International has documented Lebanon's serious problems and obstacles of corruption as well as the difficulty in implementing anti-corruption regulations, ranking it 138th out of 180 countries in the Corruption Perception Index for 2018 and 2019. Also, the Lebanese have suffered from deteriorating country infrastructures, water and electricity shortages, mixed with an acute trash crisis which began in 2015 from which the country is always grappling. Therefore, the country was affected before the pandemic by a serious financial and economic crisis, with low growth, high public debt, current account deficit, and funding needs (IMF, 2019). By the end of 2019, public debt was projected to increase to 155 percent of GDP. Unemployment was estimated at about 20 percent, with youth unemployment at 37 percent. Furthermore, when the Covid-19 pandemic arrived, a socio-political crisis had already been added to the mix when widespread protests raged across Lebanon. Protesters had forced the prime minister to resign and had achieved the formation of a new government in early 2020. However, to date, the process of forming a government remains blocked.

3. The country's economic challenges in 2020

Lebanon is facing exceptional times and the situation has worsened markedly in recent months. As claimed by Mr. Nasser Saidi, the former minister of economy "we are heading the way of Venezuela". In fact, preliminary estimates suggest that GDP growth will contract by almost 25% in 2020 [2]. Prior to the Covid-19 pandemic, estimates for 2020 were already predicting a severe drop in GDP.

Since the end of 2019, the Lebanese pound had plummeted, losing more than 80% of its value, and a collapse in confidence has since rendered the lira worthless. Debt is also deemed to be unsustainable, with public debt reaching more than 150% of GDP which is among the highest in the world. Lebanon heavily depends on imports, which contributes to capital fleeing the country and yielding a currency collapse. As a result, inflation is igniting, resulting in unparalleled levels of economic hardship for Lebanese families. In recent months, the devastating explosion in Beirut, the Covid-19 pandemic, and the deepening financial crisis have further exacerbated the tremendously difficult economic situation of a significant part of Lebanon's population and businesses. These overlapping shocks have worsened the poverty rates, which were estimated at 55.3 per cent of the population in May 2020 prior to the explosion (ESCWA, 2020). At the same time, Lebanon's most vulnerable, including workers in the informal economy, are bracing for even more anguish. While facing these challenges, Lebanon continues to host the largest refugee per capita population in the world because of the syrian conflict. This has exerted pressures on the Lebanese labour market, influencing competition for lower-skilled jobs in the informal sector which contains a large share of refugees. Before the pandemic and the financial crisis, a high degree of informal employment was widespread among both the Lebanese and refugees but these conditions have added another challenge to the country's vulnerable workers. The International Labor Organization estimated the share of informally-employed persons in Lebanon at about 50% (ILO, 2015).

A major challenge facing Lebanon today is that the bulk of the country's human capital will have no choice but to emigrate. The country braces for new waves of emigration as it sinks into heightened political uncertainty and deepening financial crisis. This could undoubtedly magnify brain-drain at a time when the country really requires its most capable people to take part in the reconstruction efforts.

In such an emergency situation, a rescue package from the International Monetary Fund (IMF) seems needed, but this would depend on whether Lebanon's government is willing to start structural reforms. In March 2020, Lebanon defaulted on its sovereign debt repayments and there were talks with the IMF for an infusion of $20billion from foreign states in order to allow the government to swiftly pursue an urgent reconstructing of its shattered economy. Nonetheless, the government and the IMF were unable to agree on a credible program of domestic reforms. The latter incorporate the reform of the country's subsidy-riven electricity sector and a major financial reform.

4. Using sentiment data to forecast the economic activity

Considering how confidence effects impact on economic activity, the argument for **using sentiment data as a proxy for panic or loss of confidence** is evident. However, in the case of Lebanon, the difficulty is that it is hard to forecast the immediate and near-term impacts of the several crises in a context of heightened uncertainty amid the alarming spread of the Covid-19 and the added difficulties posed by such series of severe crises.

In our analysis, we choose to use data from the Google Trends platform [3], which we then relate to economic growth. One of the key features of the Google Trends data for the economic outlook lies in the fact that they can be mobilised swiftly and at a higher frequency than most traditional economic data, which could imply that the economic conditions can be assessed with a much shorter delay than with most economic indicators. Over the last years, the trending searches by Google users have devoted the attention of forecasters as an information source that could enhance their predictions. In the case of Lebanon, the search volume of crisis-related keywords can well represent a fearful attitude towards the economic situation. Figure 1 describes the evolution of Google Trends and next-quarter Lebanon GDP for the period from 2010:Q1 to 2020:Q2. We first observe that the (economic) sentiment is a phenomenon subject to time-variations. Furthermore, the next-quarter GDP and Google Trends seem to often operate in opposite directions while occasionally evolving in the same direction. This highlights a possible significant relationship between the proxy of population sentiment and growth.

Figure 1. The evolution of GDP and Google Trends (Normalized data)
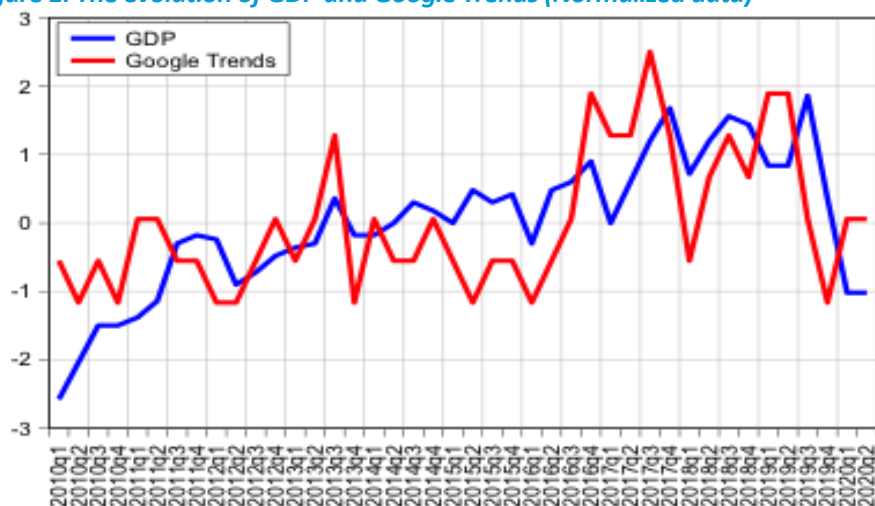
Source: Data collected and completed by the authors by using data taken from the IMF and the Central Administration for Statistics for Lebanon.

Generally, in times of high uncertainty and increasing anxiety, it is essential to have information that is as up to date as possible in order to define and forecast activity and macroeconomic variables in a given country. However, many of these variables are not sampled at the same frequency. For instance, as in the case of Lebanon, the gross domestic product (GDP) is sampled quarterly, whereas financial and macroeconomic variables explaining it are often sampled monthly. Estimating and forecasting models, nevertheless, require data series to be of the

same frequency. Throughout this analysis, we solve this problem by performing the mixed data sampling approach. This technique has been previously used by Ghysels et al. (2004), Clements and Galvão (2008) and Foroni et al. (2015) to forecast quarterly GDP growth by using monthly indicators such as industrial production, employment and variables from qualitative business tendency surveys. In this study and due to the availability of data, we follow the same strategy by using the quarterly data of GDP from the Central Administration for Statistics for Lebanon (2016:Q1 to 2020:Q2) and the International Monetary Fund (IMF) [4] and the monthly data of Google Trends and other control variables commonly considered as the main determinants of economic growth (in particular, investment, remittances, trade openness and credits to private sector) for the period from 2010:Q1 to 2020:Q2. As far as we are aware such data has never been used before to analyze the impact of sentiment on the economic growth. **To assess the relevance of sentiments in forecasting the economic activity, we make predictions of the quarterly GDP growth obtained from the model, taking into account its fundamental determinants as predictors, to which we then add the monthly Google Trends for the keyword "recession" as a supplementary predictor. In doing so, we can verify the accuracy of the prediction once the Google Trends variable is included.** We note that the forecast error [5], measured by the difference between the observed value and its forecast, becomes relatively moderate. Also, it is shown that the addition of sentiment data allows improving the fit of the model significantly, highlighting the robustness of the evidence that sentiment indicators contain supplementary predictive information.

5. Conclusions and some recommendations

Intuitively, economists and observers find it plausible that the confidence and uncertainties are likely to play an important role as drivers of economic fluctuations. They see the root of macroeconomic fluctuations in purely psychological waves of optimism and pessimism. This policy brief exclusively addresses the question of whether the measure used as proxy of (economic) sentiment of the Lebanese population can produce a diagnosis on changes in the economic outlook in Lebanon. **Our results confirm that making sentiment of the Lebanese into consideration would improve the forecast of quarter growth in an uncertain context.** In such turbulent times, making an accurate and faster diagnosis of short-term economic projections needs early indicators available, virtually in real time.

For Lebanon, the COVID-19 crisis arrives when it was facing compounded crises (political, economic and social). Such exceptional conditions that Lebanon is facing call for exceptional solutions and recommendations. This highlights the need for a disruptive analysis. Along these lines, any improvements made require actions at three levels.

The first one concerns the economic vision. The current unusual times might offer a window of opportunity to undertake structural reforms without further delay, notably by tackling internal and external imbalances, regaining investor confidence and achieving sustainable and inclusive growth. These reforms are an important first policy step to help raise confidence among investors and donors. They could aim at reforming the electricity sector, lowering the cost of doing business, improving the collection of existing taxes such as value-added tax, etc. The governance framework should be improved, beginning with fighting corruption which in turn will help channelling financial inflows into more productive investment and therefore boosting investment, growth and exports. Thus, urgent and swift actions to tackle the problem of corruption by enforcing anti-corruption norms can only be fruitful. In this line, Lebanon's parliament has recently (May 2020) approved a law to remove the decades-old banking secrecy rules. This opens the way for investigations into bank accounts of officials. Still, further concrete steps should be urgently taken to reduce corruption.

But these economic reforms will not be enough, since social unrest is heavily associated with real inequalities; hence the second wave of reforms. Given the wide number of people living below the critical threshold even prior to the explosion, it is unthinkable to impose painful economic reforms without accompanying them with **direct aid to the poor and most vulnerable including workers in the informal economy.** The World Bank stresses that given Lebanon's state of insolvency and lack of sufficient foreign exchange reserves, interna-

tional aid and private investment will be essential for comprehensive recovery and reconstruction. Ensuring provision of health and social protection systems is vital, but donors and the international community, including both humanitarian and development actors, should also focus on offering long-term support. With the aftermath of the enormous Beirut catastrophe, several governments and international organisations have rushed emergency aid for instantaneous recovery. Also, a possible rescue package from the IMF promises much required funds but would also impose Lebanon's implementation of credible and large structural domestic reforms, while preventing corruption and elite capture.

It must be stressed at this stage that the most recent negotiations with the IMF failed as Lebanese politicians displayed remarkable ineptitude to present a unified front. In reality, **the root of the economic and social problems of the country is the system itself.** This is the third aspect which seems to us the most emblematic; it is the sea battle. In fact, the political rivalries and factional interests have often prevented the formation of government and are accused of keeping politics locked in a vicious circle where religious figures interfere in politics. Historically, the Lebanese have identified themselves by sect before nationality. This has stimulated feelings of malaise among the Lebanese population. The popular movement that started in October 2019 shows Lebanese protesters remarkably united in demanding the total replacement of the system of governance and in blaming sectarianism for their economic plight. Eliminating all sectarian considerations from government and policy is necessary for changing the political system. Responsibilities need to be divided, not based on a clan membership, but instead on skills, and additional efforts must be made in the area of administrative, judicial and financial appointments by the adoption of competency, merit-based and transparent recruitment practices. In fact, "There is no alternative"- a slogan of the Conservative former British Prime Minister Margaret Thatcher. It is more than necessary to build a new secular republican pact consisting of securing a common and prosperous future with a single national voice. To that end, strong pressure from the street is as instrumental as pressure from the international community for supporting the popular demands.

Notes

[1] For a summary of the measures put in place by the Lebanese government, please consult the section dedicated to Lebanon in the IMF's Policy Tracker platform: https://www.imf.org/en/Topics/imf-and-covid19/Policy-Responses-to-COVID-19#L

[2] https://www.imf.org/en/Countries/LBN

[3] The Google Trends reflect the proportion of searches for the keyword "recession", compared to the region where the rate of use of the same keyword is the highest (value of 100). This implies that a value of 50 means that the keyword was employed half, and a value of 0 means that the data for this keyword is insufficient.

[4] The annual data obtained from the IMF for the period 2010-2015 are transformed to quarterly frequency using Eviews 9 (http://www.eviews.com/help/helpintro.html#page/content%2FBasedata-Frequency_Conversion.html%23ww233498)

[5] RMSE: Root-Mean-Square-Error.

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The recent coronavirus crisis threatens the health, economies and societies of all countries, regardless of level of development. In the South Mediterranean countries the fight against the pandemic is even more complicated. It must be done with limited health and economic resources compared to other regions. In addition, it takes place in a unique social and geopolitical context.

Cooperation and EU-Med strategies in key sectors are needed. Therefore, CMI and FEMISE have decided to join forces and launch this series of Policy Briefs to pave the way for thematic analyses and prescriptions, which will be explored throughout this series.