

Lebanon in Freefall

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Lebanon's luck ran out in 2019. The country's unsustainable debt, bad governance, internal contradictions and vulnerability to foreign interference, finally caught up with it, sending the country into economic freefall. These factors had been present for many years, but Lebanon had seemingly mastered walking by the brink for so long that many of its political elites believed that they could somehow keep on evading the laws of economic gravity and good governance. But that was not to be.

Years of increasing poverty, unemployment, and sheer government incompetence led to the eruption of widespread protests against the entire political class in October. The protesters succeeded in obtaining the resignation of Prime Minister Saad Hariri, but the sectarian political system survived. It responded to the protests with a so-called "technocratic" government that has no political independence nor sufficient prerogatives to implement a rescue plan to stop the financial meltdown.

The financial crisis was compounded by the Covid-19 shock and the decline in oil prices in the Gulf, which led to a drop in remittances, tourism and financial flows. The World Bank estimates that poverty will almost double in 2020, impacting perhaps as much as 50% of the population. The Lebanese, like the refugees and migrants in their midst, are now experiencing food insecurity. Amidst this gloom, escalating US-Iranian tensions have fuelled local tensions and made economic recovery even more complicated.

A Crisis Long in the Making

Lebanon's economic crisis is, at its core, a governance crisis emanating from a dysfunctional sectarian system that has developed a culture of corruption and waste, while failing to adopt a productive economic model.¹ The country has lived beyond its means for decades on a model that exported its people rather than goods or services. To service its current account deficit and expanding dollar-denominated debt, the country has needed ever higher capital inflows. To keep these flows coming, Lebanon has had to regularly raise interest rates. As external financial flows into Lebanon slowed, the central bank resorted to desperate and extremely expensive financial engineering efforts to attract them. With a 152% debt to GDP ratio in early 2019, Lebanon was the third most indebted country in the world, after Japan and Greece. The state was spending most of its revenues on interest payments and salaries/pensions for its inefficient civil-service sector – filled with appointees of sectarian leaders – rather than investing in needed infrastructure, job creation or basic services such as health and education.

Decades of pursuing this model have left the economy with a bloated banking sector, increasingly dependent on lending to the state at high interest rates. This has been very profitable for the banks and their shareholders – many of whom are connected to Lebanon's political elites.² The great need for regular capital inflows rendered the country extremely vulnerable to external and regional shocks. And by 2019, capital inflows had dried up as a result of a combination of regional factors and increasing

¹ For further analysis of the economic crisis, see ARAB REFORM INITIATIVE, *For an Emergency Economic Rescue Plan for Lebanon*, 10 November, 2019 www.arab-reform.net/publication/lebanons-economic-crisis-a-ten-point-action-plan-for-avoiding-a-lost-decade/

² A 2015 study of the banking sector's ties to political elites found that 18 out of the top 20 banks have major shareholders linked to political elites. JADCHAABAN, *Mapping the Control of Lebanese Politicians over the Banking Sector*, 15 September, 2015 <https://jadchaaban.com/blog/mapping-the-control-of-lebanese-politicians-over-the-banking-sector/>

concerns that the country's debt was no longer sustainable, especially after the credit-rating agency Moody's had downgraded Lebanon's status to junk in January 2019.

Faced with a ballooning debt, the government passed an austerity budget over the summer of 2019 and announced a series of economic emergency measures in early September, including new taxes on free services such as Whatsapp. These measures mostly targeted the poor and increasingly impoverished middle classes, pushing many of them past their breaking point. The share of the population in poverty had already approached 30% (World Bank estimation), unemployment stood at 25% (with youth unemployment estimated by some at 37%), and the country was already one of the most unequal in the world. Based on income tax figures, the richest 1% of Lebanon's population claimed 25% percent of the total national income between 2005 and 2014.³ Bank deposits were a reflection of this unequal distribution, with less than 1% of all deposit accounts holding 50% of total deposits at the end of 2015.⁴

The October Revolution

Protests erupted on October 17, 2019 drawing an unparalleled constellation of groups and individuals across sectarian, regional and class lines, calling for sweeping economic and political changes. The protests tapped into public rage over years of mismanagement, particularly visible in the state's failure to provide basic services – from electricity to water, garbage collection, education and health. The protesters' demands were not limited to socio-economic conditions, but contested the entire post-civil war political order, a system put in place nearly 30 years ago by the 1989 Taif Agreement, which kept the civil war sectarian leaders in power.

The protests represented a dramatic shift from previous efforts to contest the political system. They erupted across the country, something that past efforts with their focus on Beirut never managed to achieve. The

protesters' demands were a lot more ambitious, as they rallied around the slogan "all [of them] means all [of them];" not only rejecting the entire political class but also demanding the overturn of the sectarian system itself, in favour of a civil system that protects the individual rights of citizens.⁵ Particularly striking and unexpected, was that each community seemed to rise up against its sectarian leaders. In the southern cities of Tyre and Nabatieh, traditional strongholds of the Shia parties, protesters marched and led chants against the Shiite political parties, Amal as well as Hezbollah. To the north, in Sunni-dominated Tripoli, people not only called for the resignation of the Sunni Prime Minister, but also chanted their solidarity with Shia protesters in the south, a simple act that would have previously seemed inconceivable. Organizationally, the movement was highly decentralized, with youth and women playing a significant role.

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The protests succeeded in pushing Prime Minister Saad Hariri and his government to resign on 29 October, but their demands for a truly independent and transitional government failed. The traditional political parties eventually regrouped and, with Hezbollah's backing, named Hassan Diabas Prime Minister in January 2020. The academic and former Education Minister, who was little-known in Lebanon, insisted in his first comments that his cabinet was a technocratic one that would strive to meet protesters' demands. However, in practice, the new government is dependent on the traditional political parties, and it quickly became clear that it would not have the prerogatives nor backing to enact the needed reforms.

³ Lydia Assouad, Rethinking the Lebanese economic miracle: The extreme concentration of income and wealth in Lebanon 2005-2014 <https://wid.world/document/rethinking-lebanese-economic-miracle-extreme-concentration-income-wealth-lebanon-2005-2014-wid-world-working-paper-201713/>

⁴ IMF, 2016 Article IV Consultation, 24 January, 2017, www.imf.org/en/Publications/CR/Issues/2017/01/24/Lebanon-2016-Article-IV-Consultation-Press-Release-Staff-Report-and-Statement-by-the-44572

⁵ For more background on the evolution of political slogans in protest movements in Lebanon, see Fares HALABI, From "Overthrowing the Regime" to "All Means All": An Analysis of the Lebanonisation of Arab Spring Rhetoric, 18 December, 2019 www.arab-reform.net/publication/from-overthrowing-the-regime-to-all-means-all-an-analysis-of-the-lebanonisation-of-arab-spring-rhetoric/

Divided They Rule (while the Country Continues to Fall)

One of the first major decisions by the new government was to stop payments on its debt and request assistance from the International Monetary Fund (IMF). Negotiations between Lebanon and the IMF will be complicated and protracted, especially since the Lebanese side is heavily divided with the government presenting a plan that is contested by the central bank and the powerful Lebanese Association of Banks. The major stumbling block is who should bear the cost for the major losses incurred over the years. The resignation of two key officials in the Lebanese Finance Ministry delegation that were negotiating with the IMF on the basis that the political class had no genuine will to implement reforms or restructure the banking sector hints at the challenges ahead.

Meanwhile, the economy continues to stumble. The Lebanese pound, long pegged to the US dollar, had lost over 80% of its value by early July 2020. US-denominated savings in Lebanese banks are inaccessible to depositors, unemployment is soaring, wages are plummeting and prices of most goods in import-dependent Lebanon are skyrocketing. According to Lebanon's consumer price index (CPI), the cost of certain basic goods rose by 60% between March and June 2020. The government estimates the inflation rate at 25% for 2020. According to UN officials, by the end of April over half of the country was struggling to put the most basic produce on the table, as food prices had risen dramatically. Lebanon is also host to an estimated 1.5m refugees (the most per capita in the world), 83% of whom are, according to the World Food Programme, now surviving on less than \$2.90 per day, the minimum needed for physical survival.⁶

Lebanon's Regional Balancing Act Stumbles

To make matters worse, Lebanon appears quite lonely in its downfall. The country's long standing efforts to walk the tightrope between the two major competing regional blocks – namely Iran/Syria and the

GCC/Western camp – have seemingly faltered, leaving the country with little regional or international support in its crisis. This uneasy balancing act has shown strains since 2011, after the conflict in Syria drew in Lebanese parties, notably Hezbollah. The Baabda Declaration of June 2012, reached after a process of national dialogue, was meant to secure Lebanon's neutrality in regional conflicts, with parties in Lebanon promising to hold back on external alliances and coexist, despite major differences over regional issues like the war in Syria, the standoff between the US and Iran or relations with the Gulf states. But the Baabda Declaration proved futile after the regional balance of power started tilting in favour of Hezbollah, and Lebanon's neutral position became increasingly tenuous to preserve.⁷ This impacted Lebanon's relations with its traditional financial backers in the GCC countries leading to a decrease in investments and bank deposits.

In the coming period, Lebanon will face hyperinflation, widespread poverty and state breakdown

The escalation in US-Iranian tensions, notably with the recent US push to use sanctions to punish Iran and its regional allies, also caught up with Lebanon. The US Administration's latest round of sanctions against Syria through the Caesar Act has worried Lebanese bankers and businessmen who were hoping to profit from Syria's reconstruction efforts.

Where to Now?

The country looks like a rudderless ship in the middle of a storm. The sectarian political elites have no desire to reform and are unable to reach even a modicum of consensus between themselves. The President's efforts to call for a national dialogue among the traditional political class in June 2020 ended in failure as many did not even show up.

The protest movement has been unable to come together and form its own alternative. The leaderless

⁶ WFP official statements to the media. www.telegraph.co.uk/global-health/science-and-disease/people-will-die-within-months-lebanon-heads-famine-pandemic/

⁷ www.chathamhouse.org/expert/comment/lebanon-paying-cost-its-dysfunctional-politics

structure, which helped protests in the early phases of contestation, has also hindered the formation of a coherent platform for change. Time will tell if recent efforts to create broader coalitions between the protesters succeed in developing a political alternative. The intensifying US-Iran tensions announce future turbulence in the region. The EU, meanwhile, is largely absent. Its financial support appears dependent on Lebanon's success in negotiating with the IMF – a process with an uncertain outcome at this stage. In the coming period, Lebanon will face hyperinflation,

widespread poverty and state breakdown. Two scenarios are possible. As the situation worsens, sectarian parties take over providing basic security and assistance to their sects, leading to a reemergence of sectarian enclaves reminiscent of the civil war years. Or, increasing hunger and anger lead to a second wave of massive mobilization which may sweep out some if not all of the sectarian political leaders, though who replaces them remains unclear. The only certainty at this stage is that Lebanon faces a bleak period ahead.