

## Post-war Lebanon and the influence of international financial institutions: A “Merchant Republic”(\*)

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### Abstract

Social and economic policies adopted in Lebanon during the post-war era—including orthodox macroeconomic policies promoted by the international financial institutions (IFIs) and other foreign actors—have fell short of tackling the constant rise in inequality, exacerbated poverty, and the decline in productivity and competitiveness. Furthermore, support loans provided to the Lebanese government on the occasions of international donors’ conferences have failed to stabilize debt in the country, as it has risen to worrisome figures and managed to divert a significant amount of resources away from development objectives—necessary for the rebuilding of the country—and into debt servicing. This article provides a brief overview of the post-civil war economy of Lebanon and the principal donor conferences that pledged loans to the Lebanese government. Furthermore, the paper assesses the policy-conditionality associated with the loans and its impact on economic and social development in the country.

**Keywords:** Donor Intervention, International Financial Institutions, Socio-economic reforms, Public debt.

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### Post-Civil War Context and Donor Intervention

Following 15 years of civil war<sup>1</sup>, the Lebanese economy hit rock bottom in 1990, with 25 billion US Dollars worth of physical assets destroyed and a real GDP per capita amounting to one third that of 1974; not to mention that 48% of the population was housed in illicitly built dwellings<sup>2</sup>. Economic and social rights of Lebanese citizens were placed on hold, pending political developments that would attenuate the calamity the civil war violence had spawned.

Attempts to rebuild the country succeeded the Lebanese parliament's ratification of the National Accord Agreement in the Saudi city of al-Ta'ef in 1990. One year later, Omar Karami's government revived the Council for Development and Reconstruction (CDR)—established in 1977—with the aim of rebuilding the infrastructure, after the institutional collapse in the late 1980s. The process was integrated within a three-year plan, the National Emergency Reconstruction Program (NERP), which was presented during a donor meeting sponsored by the World Bank in Paris, in December 1991.<sup>3</sup>

The core of the funds was received from the World Bank and the Commission of European Communities (now known as the European Union). However, regional political complexities, along with a lack of commitment on the side of the Lebanese government to engage in a full-fledged economic reconstruction reform program, prompted the failure in launching NERP. In 1992, when the late Rafik Hariri became Prime Minister, a thirteen-year plan (1995-2007), entitled Horizon 2000 was adopted; one where US \$11 billion would be allocated for spending on public and social infrastructure, as well as on convincing investors of the conducive investment environment for capital and finance in Lebanon.

However, as the new millennium drew near, the government recognized that the Lebanese economy was challenged by a difficult economic situation and was on the verge of a recession. GDP growth had stagnated and the overall fiscal deficit reached close to 25% of GDP in 2000.<sup>4</sup> Consequently, the government resorted to an economic strategy that included borrowing as an essential element that would help finance economic activities and achieve better results. This paved the way for augmented international financial institution (IFI) intervention and presence in the Lebanese economic scene. It was often through loans contingent on social and economic policies inclined towards integration in the global economy, through trade and investment liberalization, borrowing, expansion of privatization deals, and overall economic deregulation.

In February 2001, the Paris I meeting was held, with the Lebanese government requesting support from the international community to complement its efforts in bringing about a virtuous cycle of lower fiscal deficits, declining debt ratios, and lower interest rates, which could unleash the potential of Lebanon's private sector. A strategy was presented to the donors, which included liberalizing and facilitating trade, containing public expenditure—including cutting subsidies on some food products, privatization (in telecommunications, water, and electricity sectors), attracting foreign direct investment (FDI), and modernizing the tax system.<sup>5</sup> In exchange, more than 500 million Euros were provided to Lebanon in accordance with pledges by the Lebanese government to stimulate the economy in line with the aforementioned points.<sup>6</sup>

However, amid stagnating economic growth and escalating public debt that reached to 170% of GDP, a second round of the international donor conference—dubbed Paris II—was held in November 2002. The conference sought to help Lebanon manage its economic crisis, pursuant to the terms put forth by the Lebanese government, which included fiscal, financial, and privatization reforms.<sup>7</sup>

In the context of Paris II, the government's economic plan, lauded by the donor community, served as a mere repackaging of the traditional market-oriented policies, which aimed at reducing both the current and capital expenditures, as well as increasing the tax revenue with a major contribution from the Value Added Tax (VAT) introduced in the same year. In return, the conference donors pledged some \$4.4 billion to the Lebanese government.

The role of IFIs was noteworthy, along with international actors, the likes of the International Bank for Reconstruction and Development (IBRD) (\$486 million) and European Investment Bank (EIB) (\$412 million) provided the largest share in terms of loans to the Lebanese government.<sup>8</sup> Regional financial institutions also pledged a significant share of the funds to Lebanon, with the Arab Fund for Economic and Social Development, Kuwait Fund for Arab Economic Development, and the Islamic Development Bank allocating \$330 million, \$200 million, and \$92 million, respectively.

The third international donor conference for Lebanon–Paris III–was held in January 2007. The economic reform plan presented by the Lebanese government rested on a number of pillars, which included speeding up negotiations around Lebanon’s accession to the World Trade Organization (WTO), a privatization program designed to increase investment, maintaining price stability through adjusting monetary and exchange rate policies, promoting the private sector, phased fiscal adjustment through streamlining expenditures and raising revenues, and implementing tax reforms including increasing VAT rates.<sup>9</sup>

Lebanon’s official bid for WTO accession took place in January 1999 and a Working Party—a group of WTO members negotiating multilaterally with an applicant country—was established shortly after. In October 2000, the government adopted an Accession Master Plan—a document providing an assessment of the economic and legislative reform required for conformity to requirements of the WTO—and the Ministry of Economy and Trade was designated to lead the accession process. In June 2001, the Memorandum of Foreign Trade Regime (MFTR)—a basic document providing a full summary of Lebanon’s legal and foreign trade regime—was presented to the Working Party. After seven Working Party Meetings (the last taking place in 2009), Lebanon has yet to pass and enforce all WTO agreements and thus remains as an ‘Observer’ at the organization.<sup>10</sup>

Becoming a member at the WTO entails eliminating, or significantly lowering, trade barriers and complying with WTO standards of trade. Today, the WTO legislation has been put on the back burner by the Lebanese government, whose pressing problems are security and political crises spilling over from regional turmoil.

It is worthwhile noting the similarity in the donor structure between the two most recent Paris agreements, where IFIs have come into prominence with the large sums of money they promised to pour into the Lebanese economy, through its central bank, on one hand, and its private sector, on the other. Among others, the EIB (\$1,248 million), WB (\$975 million), and IMF (\$77 million)<sup>11</sup> have all pledged to provide loans. However, their utilization is contingent on open market economic reforms, deregulation, enhancing the role of the private sector, and attracting FDIs.

### **The socio-economic context during and after economic reforms**

There has been a lack of national consensus on how to address the evolving and problematic debt conditions as well as the slump in economic activity. The Lebanese government adhered to the economic reform agendas that donors, including IFIs, imposed as prerequisites to facilitating any form of aid or grants for the country.

Today, after more than two decades of donor-backed socio-economic reforms, the Lebanese economy has fallen short of achieving the desired levels of development and jumpstarting inclusive and sustainable growth needed to ensure better provision of economic and social rights.

As a result of the borrowing spree, public debt rose from \$2 billion in 1992, to \$15 billion in 1998, and to \$38 billion in 2004. Yet, the most worrying numbers arise from the staggering gross public debt that

Lebanon witnesses today. Corollary to the rise in budget and trade deficits, accumulated public debt reached \$63.5 billion at the end of 2013, compared to \$57.7 billion in 2012—a rise of 10%.<sup>12</sup>

Aside from the mounting debt problems, the Lebanese economy has not generated sufficient and decent job opportunities, serving as a low-added value service-based economy, externally oriented, and dependent on foreign capital.<sup>13</sup> Sustainable economic growth has been highly impeded by the lack in economic diversification and the concentration of economic activity in sectors that have failed to generate positive spillovers into the overall economy.<sup>14</sup> In addition, the increasing share of the informal sector has been a serious threat to the ability of the Lebanese state to regulate its economy for development purposes, on one hand, and to better target citizens in need for social protection, on the other. On the balance of payments side, the lack in production and competitiveness has, alongside the regional turmoil, led to a 12% decrease in exports, thus indicating a 3% expansion in the foreign trade deficit<sup>15</sup> in 2013; the same year that witnessed an upsurge in fiscal deficit by 31.4%.

It is not by chance that Lebanon has experienced such unprecedented setbacks in economic activity and development. The economic and social policy choices that the Lebanese government has adhered to in the past few decades played an integral role in shaping the development trajectory of the country. Those policies fall within the model promoting liberalization, deregulation, and an enabling environment for corporations, which has, in turn, induced a regression in social indicators, despite the mediocre positive economic growth rates the country has witnessed during the second half of the previous decade. Moreover, austerity measures often targeting developmental and social spending have led to exacerbating vulnerability and economic dependency of the poor and marginalized.

Besides the non-inclusive nature of adopted socio-economic policies, it is worthwhile noting that a major impediment against sustainable development in Lebanon has been the problematic of crony capitalism, confessionism, and clientelism inherent to the Lebanese political and economic system. The country has always been marred by consociational democracy organized along religious/sectarian lines, the main theme around which the Lebanese socio-economic society was shaped and formed.<sup>16</sup> However, such multi-confessional social structure produced an unstable system of governance, deficient democracy, and an unfavourable environment for equal opportunities. Corruption has impacted the relationship of citizens with the state, entrenching a patron-client relationship, whereby political leaders provide jobs, money, and favors to their clients, in return for their loyalty.

Today, the focus of the donor community and IFIs in particular rests on the financing gap resulting from the increasing budget deficit facing the Lebanese government. The most important claim related to resources is the amount of debt servicing that can be extracted from public revenues. In addition, IFI interventions are associated with policy proposals that serve in the interest of the global economy and the enabling business environment. Time and again, such policies translate into blanket investor protections and impeding capital controls, which unduly hampers domestic development-oriented policies.<sup>17</sup> Quite the opposite, policy proposals in favor of the aforementioned “enabling environment” could suggest an erosion of the policy space needed by the Lebanese government to design a dynamic longer-term plan based on enhancing productivity, encouraging production, generating decent employment, and attaining social justice. These policies hardly create any platform for long-term and sustained public investment responsible for creating decent jobs and spurring new economic activities, which would benefit the wide spectrum of the Lebanese society.

The contractionary policy advice attached to foreign loans holds significant structural constraints to development-oriented economic policies. For instance, austerity measures, which require containing government spending including the phasing out of subsidies while increasing revenues through levying VATs, failed to prevent rising poverty, inequality, and unemployment in the country. Alarming, 28% of the Lebanese population qualifies as poor, with 8% (approximately 300,000 Lebanese citizens) living in extreme poverty<sup>18</sup>—that is, unable to meet basic food and non-food needs. Furthermore, according to Credit Suisse Global Wealth Databook 2013, at least 48% of Lebanon's privately-held wealth is concentrated in the hands of some 8,900 citizens who constitute 0.3% of the adult population.<sup>19</sup> As for unemployment, it is in excess of 10%, with youth unemployment close to 25% despite the high rate of emigration of educated labour.<sup>20</sup>

It is noted that in a country like Lebanon, an increase in VAT would translate in a significant rise in both extreme and overall poverty rates. The deteriorating living standards would be due to the impact of rising prices on the poor and lower middle class, with a potential threat to households currently living just above the poverty, who risk falling into poverty as a result of VAT increases, and hence in prices.<sup>21</sup>

As for trade policy proposals, further trade liberalization and investment deregulation induced a shift away from the productive manufacturing sector, towards the services sector. This transformation led to a significant decline in manufacturing capacities and de-industrialization. It also exposed the Lebanese emerging productive sectors to fierce global competition, which forced many industries in Lebanon out of business.

Since March 2011, and amid the mounting violence in neighboring Syria, Lebanon has been witnessing a tremendous influx in Syrian refugees. It is noted that in a country with just over four million residents, approximately 1.2 million Lebanese citizens are directly affected by the influx of refugees. Moreover, amid the absence of political consensus and the lack of appropriate funding to provide assistance to refugees and local municipalities, Lebanon has seen increased pressure on infrastructure, public health, labor, education, rent, and security.<sup>22</sup>

Following requests from the Lebanese government, the World Bank prepared an economic and social impact assessment of Syrian refugees in Lebanon. The outcome of a similar approach by the Bretton Woods institution towards Jordan has led to \$150 million in support for that country in the form of a loan, not a grant. This has left Jordan's people to shoulder the debt burden alone. Although tackling a humanitarian crisis of such magnitude requires direct aid from international institutions and actors, the loan scenario is imminent for Lebanon. The possibility of incurring a new debt burden is one that civil society has constantly voiced concerns over. In figures, Lebanon's total external debt amounts to 163% of GDP, with a large foreign debt. In 2011 the government spent \$5.2 billion on foreign debt payments, 55% of revenue, the highest of any government in the world.

## **Conclusion and Recommendations for IFIs and the Lebanese Government**

In Lebanon—where a significant fraction of the populations suffers from poverty, unemployment, and depressed wages and its government grapples with heightened political upheaval—policy proposals



brought forward by the donor community, of which international financial institutions are an integral component, brought about undesirable socioeconomic repercussions for Lebanon's vulnerable economy.

The macroeconomic framework adopted in Lebanon often placed pressure and limitations on using macroeconomic policies in support of a longer-term development strategy—whereby macro-economic policies gave priority focus to financial stability—while neglecting the productive sectors. Such policy orientations created impediments to the generation of decent jobs and crowded-out the potential support tools to build the productive sectors and lend a hand to the private sector to get involved. Furthermore, policies oriented towards deepened liberalization of trade in agricultural products have put additional stress and limited the space to rethink policies in support of reviving the sector.

Such trends necessitate revisiting the policies implemented over the post-war era, which were centered on integration in the global economy through trade and investment liberalization, borrowing, expansion of privatization deals, and overall economic deregulation.

In a nutshell, Lebanon is in need of a longer-term vision for reversing the slump in productive economic activity and decline in productive capacities, as well as towards empowering locals economically. Accordingly, and in the framework of the post-2015 development agenda supervised by the UN, the revision and reform in the macroeconomic policy framework, including that of the Bretton Woods institutions and other international and regional institutions, remain critical.

In this regard, the following recommendations are addressed to policy-makers, at both the international and local levels:

- The Lebanese government should focus on nurturing productive capacities and enhancing their dynamic comparative advantage. For those purposes, they need to selectively use and adjust macroeconomic policy instruments in support of production, productivity, and industrialization.
- The development and macro-economic dialogue in Lebanon, especially pertinent to the intervention of IFIs and the rest of the donor community, ought to be broadened to include space for perspectives from civil society organizations including labor unions, NGOs, and municipal authorities, regarding economic reform agendas and national development plans.
- Details regarding the IFIs' engagement and negotiations with the Lebanese government should be publicly disclosed. Greater transparency on bilateral meetings will enhance public awareness around economic reforms and generate broader societal consensus over reform agendas.
- IFIs should avoid proposing generic reform agendas, and alternatively tailor policy recommendations for each country's political, social, and economic circumstances taking into account homegrown national development visions that aim toward greater social, economic, and political inclusivity, as well as international human rights standards. This necessitates

designing policies aimed at enhancing social protection schemes as well as strengthening productive economic sectors responsible for generating decent jobs and contributing to sustainable and inclusive growth.

- IFIs are expected to urge national governments to consult with civil society organizations including labor unions, NGOs, and municipal authorities regarding economic reform agendas and national development plans, especially concerning the development of social protection schemes.

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(\*) "The Merchant Republic" is the name given to Lebanon by historian Albert Hourani. Adapted from: Khalil Gebara, 2007, Reconstruction Survey: The Political Economy of Corruption in Post-War Lebanon, Lebanese Transparency Association (LTA), Lebanon, [http://www.transparency-lebanon.org/working\\_papers/reconstruction\\_survey\\_lebanon.pdf](http://www.transparency-lebanon.org/working_papers/reconstruction_survey_lebanon.pdf) (accessed on July 2, 2014).

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