

POLITECNICO DI TORINO

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"Evolution and prospects of the economy of Lebanon."

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Table of Contents

Acknowledgments.....	2
Abstract	7
1. Introduction	8
1.1. Research objectives	10
1.2. Lebanon’s Geography Map	11
1.3. Lebanon’s Demographics	12
1.3.1. Ethnic and linguistic composition of Lebanon.....	12
1.3.2. Religious composition	13
1.3.1. Patterns of settlement	14
1.3.2. Demographic patterns	15
1.4. Lebanon’s Economy and Infrastructure	16
1.4.1. Fishing & Agriculture.....	17
1.4.2. Power & Resources	17
1.4.3. Manufacturing industries.....	18
1.4.4. Financing	18
1.4.5. Trade& Commerce	19
2. Post-Independence (1943 – 1989)	21
2.1. Post-World War II	22

2.2.	Civil war (1975)	24
2.3.	Israel War (1982)	24
2.4.	Aftermath	26
2.5.	The Paris Agreements	27
3.	Post-Taif Agreement (1989 – 2005)	29
3.1.	The Taif Agreement.....	29
3.2.	The post-Taif state and application of the Agreement.....	29
3.3.	The Hariri Trend	31
3.4.	Economic Situation in the parallel Time Period:	31
4.	Economic Indicators	38
4.1.	Banking structure and evolution, 1950–2002	38
4.1.1.	Overview	38
4.1.2.	Financial versus economic intermediation	40
4.1.3.	From reconstruction to debt management	43
4.1.4.	Reconstruction phase—macroeconomic indicators.....	44
4.2.	Recent economic and policy developments	48
4.3.	Output and Demand	49
4.4.	Labor Markets.....	52
4.5.	Fiscal Policy.....	53
4.6.	External Sector.....	54

4.7.	Financial Markets.....	57
5.	Current Crisis.....	62
5.1.	Start of protest and Resignation of Hariri Government	62
5.2.	Lebanon's banks reopen after two-week of closure amid protests	63
5.3.	Strike of Banks and beginning of Dollar crunch	64
5.4.	COVID 19 and its impact.....	65
5.5.	Eurobonds.....	67
5.6.	Lebanon weighs Eurobond debt defaulted on its debt payments	69
5.7.	Default and consequences on the banking system	71
5.8.	Depreciation of the currency and consequences	73
5.1.	The risk of lifting subsidies	76
5.2.	Beirut Port blast and its economic consequence	78
6.	Current economic indicator	79
6.1.	GDP annual growth rate.....	79
6.2.	GDP Per CAPITA	80
6.3.	Lebanon Government Debt to GDP.....	80
6.4.	Inflation Rate	82
6.5.	Interest Rate	81
6.6.	Unemployment Rate	82
6.7.	Food inflation.....	83

6.8. Lebanon Remittances.....	84
6.9. Lebanon Electricity Production.....	85
7. Conclusion and recommendations.....	85
8. References	87

Abstract

The state of Lebanon's economy is growing worse day by day. This issue has garnered international attention after the continued protests, which started in October 2019. The Beirut blast in August once again put Lebanon's problem on everyone's radar. However, the economy did not deteriorate overnight. Lebanon's current situation is a culmination of all the bad policies which the Government pursued and the inherent corruption and incompetence; the subsequent government bodies possessed since its independence from France. Another major factor was the involvement of Lebanon in many wars, both external and civil. Lebanon was a playground of regional powers involved in proxy wars, which left a lasting scar on the economy. Add to the fact the structure of Lebanon's Parliament, divided based on different religions and sects; the politicians were involved in constant blaming of one another. The development took a backseat. In this thesis, historical analysis is performed, and a detailed report is presented on how a country that was once dubbed as "The Switzerland of the Middle East" is on the verge of bankruptcy, how a country which was a haven for investors in the financial market is now struggling to maintain the value of its currency. This thesis will also discuss the current measures taken by the Government in the wake of COVID-19 and other disasters and will analyze its long-term implications. This report will discuss the underlying causes of the dire state of the economy of Lebanon and even attempt to propose a solution to revitalize the economy. This is empirical research that will give more importance to the data than the opinions of people

1. Introduction

During the year 2020, it was no less than a disaster for the Lebanese economy; on March 7, 2020, Lebanon's Government announced its decision to default on the US\$ 1.1 billion Eurobond maturity. At the same time, the world was facing economic collapse due to the COVID-19 pandemic. The economies shutting down, while the Lebanese economy, which was already subjected to decline, was on the verge of shattering into pieces, leaving its citizens abandoned and no remedy to this unforeseen default. This was not a bad fortune for Lebanon; in fact, it resulted from poor governance. The clash of Lebanese Prime minister Hassan Diab and the Governor of Banque du Liban, "Salameh," had led to the collapse of the unofficial forex exchange rate of the Lebanese Pound against the U.S. dollar, this resulted in violent riots and clashes that were against the bank's different parts of the country. On May 1, 2020, the Lebanese prime minister and the country's financial amenities had no other choice rather than requested the International Monetary fund to intervene in the Current Situation. The main purpose was to ask monetary funds fueling anxieties and tensions amongst the competing divisions of a fragmented political landscape. The crisis can hardly be separated from the political stalemate that has paralyzed the country over the last two decades, blocking any form of strategic plan or investment. It poses open questions on the long- term sustainability of the current sectarian system.

The Lebanese banking system has long been revolving around the Laissez-faire economic policy. The concept of liberalization of the currency and its capital markets in 1948 placed Beirut at the center of the regional financial services provider. The banking sector thrived on the Palestine capital after the 1948 war and the Beirut as a new choice for Palestinian Bourgeoise. A new strict secrecy law given in 1956 compelled helped to attract Egyptian and Syrian capital, which was the main aim of Nasserist nationalization schemes and by the onset of the Baath party rule after the Syrian war 1963. High integration of the influx of oil money from the gulf in the early 1970s brought the ratio between bank deposits and national income increased from 20% in 1950 to 122% in 1974. A state-driven project was launched after 1959 by the administration of President "Fouad Chehab," aiming to improve the infrastructure and promote economic development in an area considered to be the poorest in the nation. This plan aimed to recognize the risk rendered to uneven

development and increase inequality in the distribution of wealth, overlapping with local in the context of fault lines.

The newly elected President "Charles Helou" in 1964 saw a return to more habitual patterns of "Laissez-Faire" economic system, clientelism, and nepotism in the public sector. The new administration was focused on navigating between the will to reassure an anti-statist oligarchy with a high aim to maintain a minimal state as a basic facilitator to the economic growth prospect. The invasion of Israel in 1982 caused the public debt and spiraling out of control. The U.S. dollar began to be used as a medium of economic exchange, one of the main causes of the uprising inflation rate in the late 1980s. It subjected a more massive post-war reconstruction scheme, especially the magnificent plan for the Beirut central district that sparked an uncontrollable and irreversible debt crisis. The indulgence of dollarization of the economy was mere an irreversible perspective that could not be undone, and in 2002 donors conference known as Paris-II which was focused on the stabilization of the exchange rate between the currency of Lebanon and the U.S. dollar and ultimately on the consolidation of the Prime Minister Rafiq al Hariri. In the late 2000s, international press coverage praised the Lebanese central bank that it has opted for the right direction in strengthening the economy.

1.1. Research objectives

The research is merely based on the current economic scenario of the Lebanese economy is stagnant with low prospects of growth. The research is based on the historical patterns of the Lebanese economic cycle taken from 1943 till 2020. Following are the research objectives that would help to understand the research and its accumulated objectives;

1. To determine the key constraints in the economic growth of Lebanon.
2. To give a brief understanding of the Current Situation and continuous economic recession amid due to poor governance.
3. To indicate the factors that can help to achieve the desired economic growth to pull the country out of an acute economic recession.

The objectives stated above are the sole purpose of the research, which will give a clear picture of the historical events and their impacts on the Lebanese economy.

1.2. Lebanon's Geography Map



Figure 1 Lebanon map-<https://www.britannica.com/place/Lebanon>

Lebanon's hilly terrain, closeness to the sea, and strategic location at an intersection of the world were pivotal factors influencing its history. The economic, political, and religious activities that either started in the region or crossed over to leave an impression upon the society of Lebanon give shape to the history.

The role of Lebanon in the region, in the world indeed at large, was influenced by trade. The area, which was once part of the region known as Greater Syria, filled in as a connection between the Mediterranean world and India and East Asia. The vendors of the district sent out oil, grain, materials, metalwork, and earthenware through the port urban areas to Western markets. The linkage job of Lebanon was additionally improved by the migrants of the Syrian and Arabian abandons who visited the urban communities of Syria to exchange. The bands created constrained courses that regularly prompted the beachfront metropolitan cities of Tripoli, Beirut, Sidon, or Tere. This made a trader class and carried

riches to the occupants of the locale. The exchange among East and West prompted the advancement of cosmopolitan culture in Lebanon's port urban areas, whose occupants got known for their multilingualism, adaptability, control, and business sharpness.

Territorial political clashes and social developments additionally influenced Lebanon. The abundance of the district pulled in incredible rulers who pined for its assets. The critical area was likewise alluring; it was utilized either as a protective situation against adversaries moving toward the Arab hinterland or as a venturing stone toward Lebanon's neighbors. Throughout the hundreds of years, individuals from the migrant clans of the Arabian Peninsula looked for a more prosperous life in Lebanon. Until today, numerous Lebanese families invest heavily in following their plummet to old groups of Arabia.

Additionally, refugees belonging to the minority sects have settled in its trying to reach mountain valleys. Thus, the district turned into a blend of cultural and social interaction among different gatherings, in a social culture where blood heredity accepted power as a wellspring of distinguishing proof and connection, the difference between the new Arab settler clans and the settled occupants of the land now and again created clashes.

1.3. Lebanon's Demographics

1.3.1. Ethnic and linguistic composition of Lebanon

Lebanon has a heterogeneous society made out of various ethnic, religious, and family relationship gatherings. Long-standing connections and neighborhood communalism predate the production of the current regional and political element and keep on getting by with fantastic steadiness. Ethnically, the Lebanese create a blend where Phoenician, Greek, Armenian, and Arab components are detectable. Inside the bigger Lebanese people group, ethnic minorities, including Armenian and Kurdish populaces, are likewise present. Arabic is the official language, albeit some part of the population speaks in Armenian-or Kurdish; French and English are additionally spoken. Syriac is utilized in some of the Maronite Churches (Roman Catholics following an Eastern ceremony).

Ethnic composition (2000)

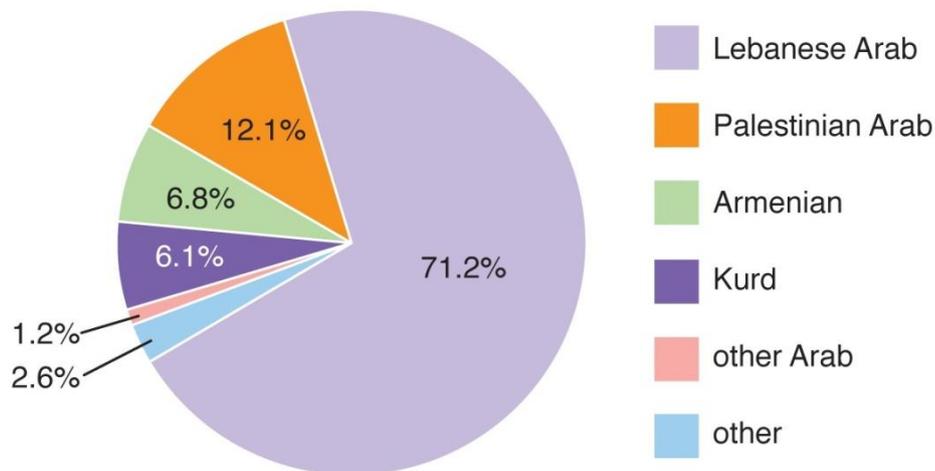


Figure 2 Lebanon Ethnic composition-<https://www.britannica.com/place/Lebanon/Climate#ref279109>

1.3.2. Religious composition

Perhaps the most particular component of Lebanon's social structure is its diverse religious composition. Since the seventh century, Lebanon has filled in as a shelter for oppressed Christian and Muslim gatherings. As religion and Government in Lebanon are profoundly and officially interlaced, the overall extents of the nation's strict networks is an exceptionally delicate issue. An official census has not been organized since 1932, be that as it may, and the information delineating Lebanon's confession booth arrangement is variable. In general terms, the two biggest gatherings are the Shi'i Muslims and the Sunni Muslims, each including more than one-fourth of the populace. Maronites, a Roman Catholic Eastern ritual gathering that began in the district, make up more than one-fifth of the masses. Various other Christian people groups are additionally present, including the Greek Orthodox and the Greek Catholics. The Druze comprise a small percentage of the populace, however, plays an essential role in Lebanese society. There is additionally a tiny Jewish minority.

Religious affiliation (2012)

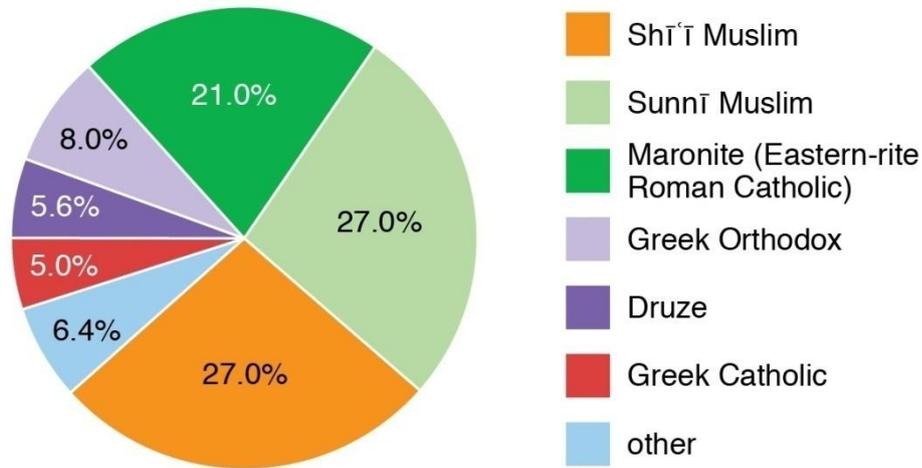


Figure 3: Lebanon Religious composition-<https://www.britannica.com/place/Lebanon/Climate#ref23393>

1.3.1. Patterns of settlement

The majority of the population dwells on the coastal plain, and continuously fewer individuals are discovered farther inland. Provincial towns are sited by water supply and the accessibility of land, as often as possible, incorporating terraced farming in the mountains. Northern cities are generally prosperous and have some modern architecture. Cities in the South have been commonly more unfortunate and less steady: nearby agricultural land is less fertile, and, due to their closeness to Israel, numerous towns were liable to visit separation, intrusion, and pulverization from the earliest starting point of the civil war in 1975 until the finish of the Second Lebanon War in 2006. Most urban communities are situated on the coast; they have been immersed by migrants and uprooted people, and various rural areas, often miserable, have been made as a result. Before 1975 numerous towns and urban communities were made out of a few distinctive religious groups, generally living respectively in harmony. The rustic style mirrored solidarity of form regardless of religious identity. Since the civil war started, a realignment has moved a large number of Christians north of Beirut along the coast, and a vast number of Muslims south or east of Beirut; thus, settlement designs reflect the gorges are isolating segments of the Lebanese individuals from one another.

1.3.2. Demographic patterns

Lebanon's birth rate is somewhat below the world's mean, while its death rate is well beneath the worldwide average. Around one-fourth of the population is under age 15, with more than half of the people are under age 30, and life expectancy in Lebanon is higher than both the provincial and world averages. One of the most remarkable demographic characteristics of Lebanon is the uneven dispersion of its population. The nation's general population density changes regionally. It is, in general, a lot of lower than that of Beirut and the encompassing region yet a lot higher than that of the most inadequately populated Al-Biqā' valley.

Lebanon age breakdown (2017)

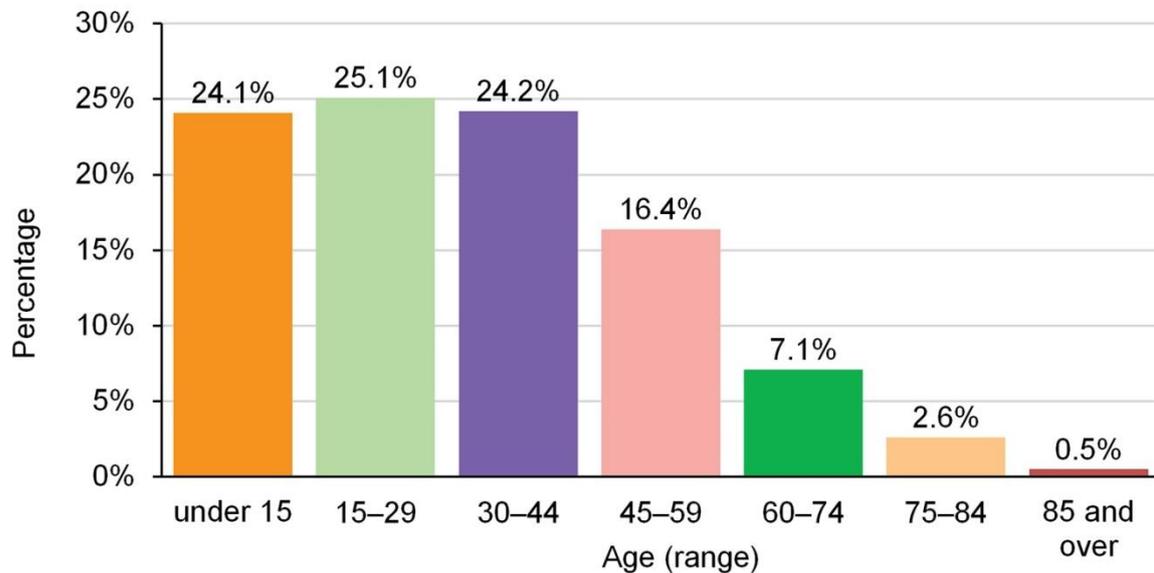


Figure 4: Lebanon age breakdown-<https://www.britannica.com/place/Lebanon/Climate#ref23393>

Before the civil war started, the development of individuals from rural regions was a central point in the nation's increasing rate of urbanization. The more significant part of the inward migration was to Beirut, which represented the significant, more substantial part of Lebanon's urban populace. The civil war prompted a considerable return of individuals to their towns and to a massive relocation abroad, primarily to the United States, Europe, Latin America, Australia, and parts of the Middle East; inside Lebanon, it also prompted a process of population dispersal and trade in numerous territories that had recently been portrayed

by the conjunction of Christians and Muslims, and after the war, endeavors to switch this procedure through projects intended to resettle the displaced were not immediately useful. Following the fighting between Hezbollah (Lebanese Shi'i activist gathering and ideological group) and Israeli military in 2006, many more Lebanese residents—an expected one million occupants, especially those living in the nation's South—were uprooted from their homes.

1.4. Lebanon's Economy and Infrastructure

Geographical factors in ongoing decades have set a considerable strain on the economy of Lebanon, which had delighted in status as a regional and business focus. The Lebanese economy was characterized by less government intervention in a private undertaking joined with a salary and benefit tax-exempt condition. Even though imports far exceeded remittances, components, for example, the travel industry and settlements from workers working abroad, helped balance the trade deficit. Income was generally increasing, and Lebanese Products were finding a spot on the worldwide market.

A long-lasting civil war (1975–90) created long-term effects on the economy. For the first decade of the civil war, the Lebanese economy proved surprisingly robust; after the mid-1980s, nonetheless, the value of the Lebanese Pound plunged as the continued devastation of the country's infrastructure took its toll. Following the civil war, Lebanon boarded on a grand program of social and economic reconstruction that entailed the extensive renovation of the country's slumping infrastructure. Started by Prime Minister Rafiq al-Hariri in the 1990s, it aimed to revitalize Beirut as a regional financial and commercial center. Beirut's reconstruction program made significant progress in the late 20th and early 21st centuries. However, at the expenditure of an increasing internal and external government debt load: most of the rebuilding program was funded through domestic borrowing, which led to the development of both budget deficits and growing public debt. Still, to attract and encourage investment, tax rates were lowered. This led to severe budgetary austerity, causing only reduced investment in the social infrastructure of Lebanon and a growing dependence on returning indirect taxation to meet fiscal shortages. Hence, while a tiny proportion of Lebanese became incredibly rich in post-war Lebanon, at the start of the 21st-century, one-third of the Lebanese populace lived below the line of poverty.

Despite Lebanon's troubled economic improvement, its economy stayed resilient during the global economic recession of 2008. Increased domestic security added to investment and growth, while its small export base shielded the economy from the global slump. From 2007 to 2010, gross domestic product (GDP) growth averaged 8%.

Lebanon's fortunes changed in 2011, however, with the rebellion in Syria and the ensuing civil war there. With Lebanon reliant on Syria's economy and dealing with a massive inflow of refugees, GDP growth in Lebanon reduced to less than 2 percent from 2011 to 17. In 2018, a financial crisis emerged as the debt-to-GDP ratio surpassed 150%. Political squabbling and corruption, severe austerity measures, and the incompetence of the Government to address concerns added to a significant loss in consumer and investor confidence, ultimately culminating in October 2019 with massive protests countrywide.

1.4.1. Fishing & Agriculture

Arable land is rare, but the climate and the relatively plentiful water supply from springs favor the intensive cultivation of an array of crops on mountain slopes and in the coastal regions. Market vegetables, citrus plants, and bananas are grown on the irrigated coastal plain. In the foothills, the main crops are olives, tobacco, grapes, figs, and almonds. At upper elevations (about 1,500 feet [460 meters]), peaches, plums, apricots, and cherries are sown, while pears and apples thrive at an altitude of about 3,000 feet (900 meters). Cereals, sugar beets, and vegetables are the main crops grown in Al-Biqā'. Poultry is also a significant source of agricultural income, and sheep, goats, and cattle are also raised.

As a consequence of the violence which ensued throughout 2006, many small farmers lost their livestock, and there was a perceptible drop in the production of many crops. The creation of hemp, the source of Hashish, has thrived in Al-Biqā' valley. However, the hashish is illegally exported through ports along the coast. Already the third-largest producer of cannabis globally, Lebanon in 2020 legalized cannabis production to boost its economy.

1.4.2. Power & Resources

Lebanon's mineral resources are scarce. There are lignite and high-grade iron ore; building-stone quarries; high-quality sand, appropriate for glass manufacture; and lime. The Liṭānī

River hydroelectric project produces electricity and has risen the amount of irrigated land for agriculture. Lebanon's power networks and facilities were dented during the country's civil war and by Israeli airstrikes conducted during the irregular warfare of the late 20th and early 21st centuries.

1.4.3. Manufacturing industries

Leading industries in Lebanon include the manufacturing of food products, bricks, cement, ceramics; wood products; and textiles. Many of the country's industries were affected by the civil war, and its impacts on the textile industry were particularly severe. Even though some of the country's large complexes were unharmed, Beirut's industrial belt was razed; besides, Israel's occupation of south Lebanon led to an inflow of Israeli imports that also affected Lebanese industries. The construction industry has pushed much of the postwar economy, although it frequently suffered downturns because of persistent damage to infrastructure in the early 21st century and regional insecurity in the 2010s.

1.4.4. Financing

During the first decade of the civil war, Lebanon's finance sector, including insurance and banking, showed an exciting expansion. The monetary reserves of Lebanon continued to rise despite political uncertainties. The strength of the Lebanese Pound and the balance-of-payments position indicated large inflows of capital, mostly from Lebanese expats abroad (whose numbers increased considerably during and after the civil war) and due to the high level of liquidity of commercial banks. By 1983, nonetheless, inflows from Lebanese living abroad had started to decrease, and the value of the Lebanese Pound fell radically.

As a consequence, two significant challenges for post-civil war Lebanon were to obtain enough capital to bankroll its reconstruction program and to reestablish the value of the Lebanese Pound through a program of industrial maintenance. Lebanon was compelled to rely on capital bond issues in the European market and domestic borrowing via the issuance of treasury bills, which resulted in a rise in the level of both local and international obligations. By 2018 Lebanon had the third-highest debt-to-GDP ratio in the world.

1.4.5. Trade & Commerce

Beirut's airport and seaport and the country's free economic and foreign-exchange systems, favorable interest rates, and banking secrecy law (inspired by that of Switzerland) contributed to Lebanon's domination of trade and services, particularly before the onset of the country's civil war.

Lebanon major export destinations (2017)

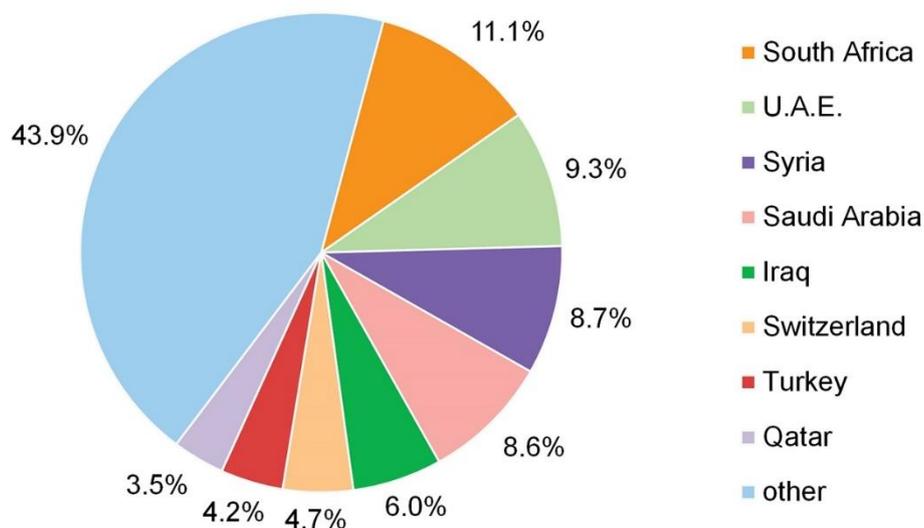


Figure 5: Lebanon major export destinations-<https://www.britannica.com/place/Lebanon/Trade>

During the civil war, nevertheless, widespread smuggling, secret foreign aid to armed factions, and illegal drug production combined to conceal the country's pattern of trade. Exports, textiles, chiefly vegetable products, and nonprecious metals are dispatched mainly to Middle Eastern countries. Imports such as consumer machinery, goods, transport equipment, petroleum products, and food come mostly from European countries, the United States, and China. A huge trade deficit has been in part covered by "invisible" items such as foreign remittances and government loans. Multiple economic and trade agreements signed with Syria after the end of Lebanon's civil war resulted in a substantial degree of industrial and commercial incorporation between the two countries. Their financial relationship remained close even after widespread protests in 2005 forced the withdrawal of Syrian troops from Lebanon.

Lebanon major import sources (2017)

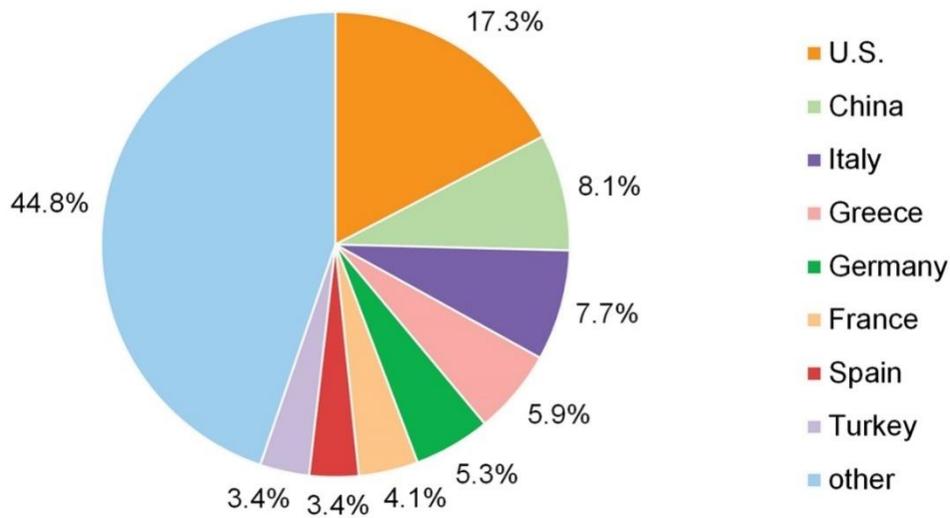


Figure 6: Lebanon major import sources-<https://www.britannica.com/place/Lebanon/Economy>

Lebanon's trade balance is inherently negative. In 2017, the trade deficit touched \$20.3 billion. The country imported \$23.1 billion worth of goods and services and exported \$2.8 billion.

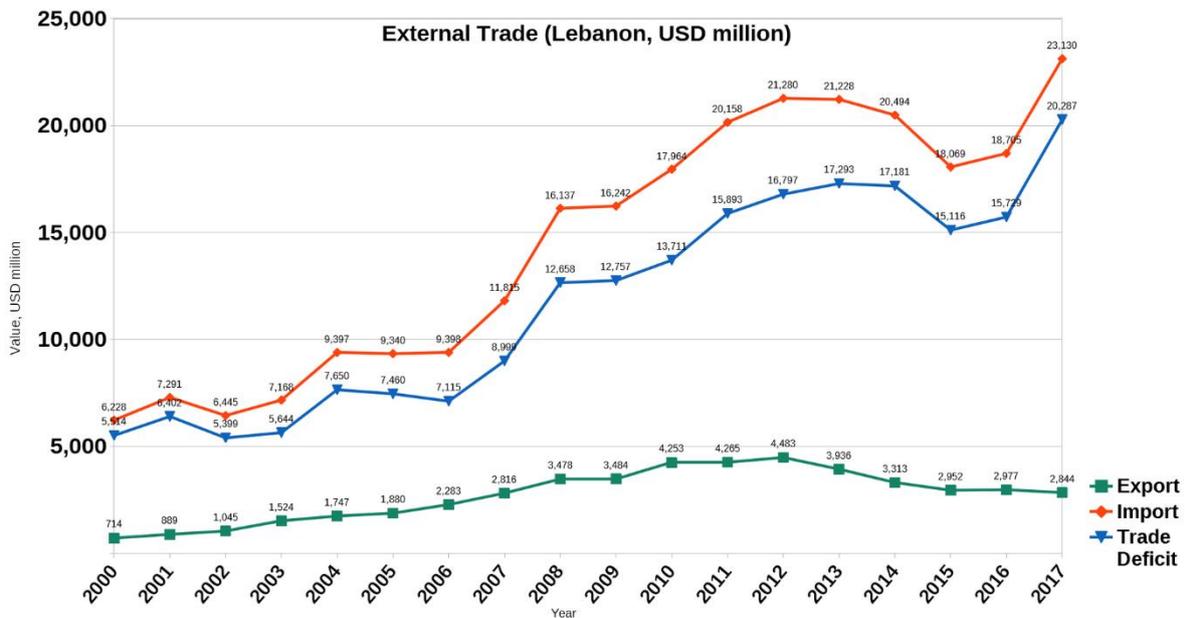


Figure 7: External Trade-https://en.wikipedia.org/wiki/Economy_of_Lebanon#Trade

Lebanon has a competitive and free-market system and a strong laissez-faire industrial tradition. The Lebanese economy is service-oriented; the main growth sectors consist of banking and tourism. There are no limitations on capital movement or foreign exchanges.

2. Post-Independence (1943 – 1989)

Modern Lebanon was officially created in 1920 when Greater Lebanon was established with its present-day boundaries under a directive given by the Allies to France. A parliamentary constitution was formed after that of the French Third Republic and promoted in 1926. In 1943, Lebanon became truly independent, with an area of 10.4 thousand square kilometers (More than 4 thousand square miles) and a population of about 1.1 million. By the end of 1946, all foreign soldiers had left Lebanon.

Lebanon entered its new era, soon after the Second World War (WWII), with a drastically transformed economic and social structure and very favorable economic conditions. Trade and a diversified industry were vigorous activities, significant foreign balances had been accumulated, and employment was apparently full. The decline of the feudal class, together with the advent of a new middle class, had already begun in 1861 and ended with forming a parliamentary system in 1926. However, independence brought with it new economic and political problems.

Arab nationalism, with its longing for one borderless Arab nation, was a definite popular opinion in the region. Lebanon's population, which was then almost equally divided between Muslims and Christians, was also divided between Lebanese nationalists and Arab nationalists, who were supporting an independent Lebanese entity. The existence of the newly independent state was not the only contentious issue.

The type of the economic system to be implemented was also the subject of intense debate, primarily since neighboring Syria, with whom Lebanon was then allied in a customs union, envisaged an active and vital role for the Government in economic affairs. In contrast, Lebanon explicitly and openly opted for laissez-faire. This financial system would involve little interference by a political class whose legislative, executive, and administrative powers were designed to be shared along sectarian lines.

2.1. Post-World War II

The 1930s witnessed a significant increase in capital investment in the industry. The overall tonnage of central industrial machinery imported into Syria and Lebanon quadrupled during 1934–38. The increase in the general tariff rate in 1926 and the following introduction of protective duties may have added to the noticeable increase in domestic demand for industrial products in Syria and Lebanon. With the beginning of WWII, circumstances became still more favorable to the industry.

During WWII, the Lebanese industry received an unpredicted boost in demand due to military expenditures by the Allied troops presenting Lebanon when imports were being strictly reduced. From 1940 to 1944, the Allied forces expended some £76 million in Syria and Lebanon, with Lebanon's annual share being approximately 10 percent of its national income. The two countries enjoyed an aggregate surplus of 607 million Syrian Lebanese pounds on their current account balance between 1939 and 1945 or approximately 40 percent of their joint national incomes in 1945. Additionally, the restrictions on the importation of machinery led to a rise in the rate of capacity utilization.

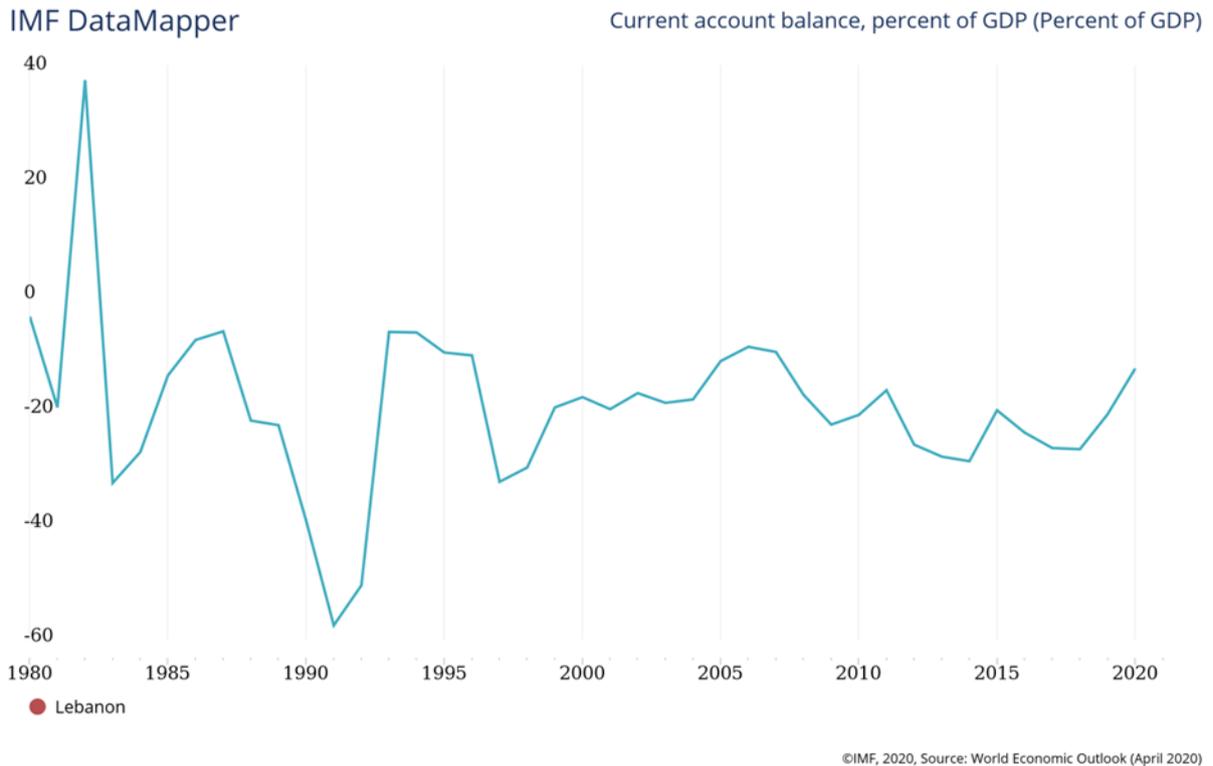


Figure 8 Percentage of GDP & Current Account (1980-2020)-World Economic Outlook(April 2020)

Detailed industrial statistics reveal that, by 1946, a diversified industry had endured the decline of its dominant silk branch and started to include food processing, textiles, beverages, printing, chemicals, etc. The increase in food processing was an indicator of broader industrial linkages with agriculture, which had then diversified to the plantation of fruit and olive trees and witnessed a surge in investment.

The industrial resurrection, which occurred roughly between 1926 and 1945, confirmed a strong potential for constant industrialization as the industry took excellent advantage of the new environment of protection and increased demand. The number of industrial establishments sharply increased, production became more diversified, and profits were reinvested to expand capacity or start new enterprises. These enterprises included refineries and manufacturers of glass, textiles, food, cardboard, metal products, and industrial machinery. Although there is no direct evidence concerning industrial employment at the time, most indirect evidence points to a substantial expansion in industrial jobs since the early 1930s until 1945.

Soon after the end of WWII, the Lebanese industry was exposed to the shock of the starting up to world trade, with the simultaneous disappearance of Allied expenditures and tariff protection. Available data for the 1945–50 period is sparse, but the picture regarding industry is one of a declining level of industrial employment after the WWII boom. Already, in 1948, the Lebanese Society of Political Economy's president of the was lamenting the long commercial growth of 1840–1914, attributing its demise, however, to the protective policies of the mandatory authorities

2.2.Civil war (1975)

The period was marred by numerous and spectacular developments, including the participation of several foreign armies and armed groups in the fighting, the assassination of two newly elected presidents, one prime minister, and several other significant political figures. The most effective result of these developments, however, has been the tens of thousands of civilian victims and the destruction of property on a vast scale. The assessment will focus on the economic performance of laissez-faire against this unsettled background.

War erupted in Lebanon in April 1975. Largely haphazard and focused in Beirut, it gradually became more widespread and lethal until the election in 1976 of a new President. President Elias Sarkis' six-year term was characterized by sporadic and intermittent, but relatively short, periods of fighting that ended with a destructive and deadly Israeli invasion in the summer of 1982.

2.3.Israel War (1982)

Briefly, for about a year in 1983, there was a rise of political and economic hope in the wake of a timely presidential election and promises of withdrawals of all foreign troops from Lebanon. Political pessimism, however, soon descended as fighting resumed, swiftly followed by a new political structure. The following few years also were politically unstable but relatively quiet, meaning that armed conflicts were localized and short-lived, with economic activity often moving towards normality. Output gradually picked up, and GDP growth during 1984–87 was positive, estimated at approximately 4 percent per annum.

While the political environment remained unstable and marked by scattered periods of intensive fighting, the fighting was primarily confined to the lower half of the country, in Beirut and the South. Most enterprises, particularly in the industry, mostly located in and around the capital, steadily moved to safer surroundings. Moreover, as most rural areas were safe from the ravages of war, agriculture was less affected when it came to production and more in terms of marketing and exports.

In the summer of 1988, a brand-new political crisis arose with the looming deadline of the presidential election. This was succeeded, over almost two years, by periods of intensive fighting within the so-called one Christian political camp, also among political fields, leading to severe disruptions in economic activity, significant destruction of property, and an increasing wave of emigration. In 1989, a brand-new constitutional arrangement, known as the Taif Agreement (named after the city in Saudi Arabia where the deal was brokered), was accepted by most political parties and, most importantly, by the pertinent regional and international powers. A new president, Mr. Elias Hrawi, was elected soon after the assassination of his former counterpart Mr. René Moawad. The Agreement did not succeed, however, to win the approval of the then acting Prime Minister, General Michel Aoun. Intermittent but intensive fighting then resumed, followed by an extended period during which two “legal” governments were functioning in practice. The bizarre Situation came to an end in October 1990, when General Aoun was thrown out by the Syrian Army and the consequent assertion of one official authority over the whole country.

During the war period, government power had weakened, and the tax base was destroyed in favor of several illegal ports that were dispersed along the coastline of the country. Nonetheless, the Government succeeded in preserving a minimally functioning central authority and public administration. Although revenue from customs duties, its primary source of income, dried up, wages in the public sector were regularly paid, and subsidies of wheat and fuel were maintained. Citizens, however, were indirectly paying illegal taxes that were being levied on commercial transactions by the various militias. Overall, private enterprise could often operate generally except for the additional but major constraint of sporadic and sometimes intense and widespread fighting.

2.4. Aftermath

Following fifteen years of civil war, the Lebanese economy plummeted to the lowest in the year 1990, and at least 25 billion U.S. Dollars' worth of physical assets were destroyed and a real GDP per capita of approximately one third that of 1974; not to mention that 48% of the population was housed in illicitly built dwellings. The economic and social rights of Lebanese citizens were suspended, pending political developments that would mitigate the calamity the civil war violence had created.

Attempts to rebuild the country accomplished the Lebanese Parliament's authorization of the National Accord Agreement in the Saudi city of al-Ta'ef in 1990. A year later, Omar Karami's Government restored the Council for Development and Reconstruction (CDR)—founded in 1977—with the aim of restoring the infrastructure, following the institutional collapse in the late 1980s. The procedure was integrated within a 3-year plan, the National Emergency Reconstruction Program (NERP) was introduced during a donor meeting supported by the World Bank in Paris, in December 1991.

Most of the funds were received from the Commission of European Communities (now known as the European Union) and the World Bank. However, local political complications and a lack of commitment from the Lebanese Government to participate in a full-fledged economic restoration reform program triggered the failure in releasing NERP. In the year 1992, when the late Rafik Hariri became Prime Minister, a thirteen-year plan (1995-2007), entitled Horizon 2000 was adopted; one where \$11 billion would be assigned for spending on social and public infrastructure, also on convincing investors of the favorable investment atmosphere for finance and capital in Lebanon.

Nevertheless, as the new millennium drew close, the Government realized that the Lebanese economy was tested by a difficult economic condition and was facing a recession. GDP growth had slowed down, and the overall fiscal deficit reached close to 25% of GDP in 2000. Consequently, the Government adopted an economic strategy that consisted of borrowing as a crucial element that would assist in financing economic activities and accomplish better results. This cemented the way for augmented international financial institution (IFI) mediation and presence in the scene of the Lebanese economy. It was often

through loans conditional on social and economic policies oriented towards assimilation in the global economy, by means of trade and investment liberalization, borrowing, expansion of privatization deals, and overall financial deregulation.

2.5. The Paris Agreements

The Paris I meeting was organized in February 2001, with the Government of Lebanon requesting support from the international communities to assist it in its efforts in bringing about a good cycle of lower fiscal deficits, decreasing debt ratios, and lower interest rates, which in turn could realize the potential of Lebanon's private sector. A plan was presented to the donors, consisting of liberalizing and facilitating trade, keeping in check public expenditure including reducing subsidies on some food products, privatization of public sectors (such as telecommunications, water, and electricity sectors), modernizing the tax system, and attracting foreign direct investment (FDI). In exchange, north of 500 million Euros were given to Lebanon in adherence to the pledges by the Lebanese Government to invigorate the economy in line with the points mentioned above.

However, amid deteriorating economic growth and mounting public debt that reached 170% of GDP, a second round of the international donor conference dubbed Paris was held in November 2002. It sought to help Lebanon handle its economic crisis, adhering to the terms outlined by the Lebanese Government, which included financial, fiscal, and privatization reforms.

In the context of Paris II, the economic plan of the Government, lauded by the donor community, acted as a mere repackaging of the traditional market-oriented policies, which focused on reducing both the current and capital expenditures, also increasing the tax revenue with a significant contribution from the Value Added Tax (VAT) which was introduced in the same year. In return, the conference donors promised some \$4.4 billion to the Government of Lebanon.

The role of IFIs was significant, along with international actors, such as European Investment Bank (EIB) (\$412 million) and the International Bank for Reconstruction and Development (IBRD) (\$486 million) offered the largest share as loans to the Lebanese Government.

Regional financial institutions also pledged a significant percentage of the funds to Lebanon, with the Arab Fund for Economic and Social Development, the Islamic Development Bank, and the Kuwait Fund for Arab Economic Development allocating \$330 million, \$92 million, and \$200 million respectively.

The 3rd international donor conference for Lebanon, Paris III, was held in January 2007. The economic reform plan was presented by the Lebanese Government. It consisted of several pillars, including speeding up negotiations around Lebanon's consent to the World Trade Organization (WTO), a privatization program designed to further investment, maintaining price stability through adjusting monetary and exchange rate policies, endorsing the private sector, phased fiscal adjustment through streamlining expenditures and raising revenues and implementing tax reforms including increasing VAT rates.

Lebanon's official bid for WTO accession happened in January 1999, and a Working Party, a group of WTO members who negotiate multilaterally with an applicant country (in this case Lebanon), was established shortly after. In October 2000, the Government implemented an Accession Master Plan, a document providing an evaluation of the legislative and economic reforms required for compliance to requirements of the WTO, and the Ministry of Economy and Trade was chosen to lead the accession process. In June 2001, the Memorandum of the Foreign Trade Regime (MFTR), a primary document containing a full summary of Lebanon's foreign and legal trade regime, was presented to the Working Party. Following seven Working Party Meetings (the last of which took place in 2009), Lebanon has yet to approve and enforce all WTO agreements and thus remains as an 'Observer' at the organization.

Becoming a member of the WTO involves eliminating or significantly lowering trade barriers and complying with WTO standards of the trade. Today, the legislation of WTO has been put on hold by the Lebanese Government, whose urgent problems are security and political crises trickling from regional instability.

It is useful to note the similarity in the donor structure between the last two Paris agreements, where IFIs have come into fame with the large sums of money they promised to pour into the Lebanese economy, via its private sector, on the one hand, and, its central bank on the other. Among others, the EIB (\$1,248 million), World Bank (\$975 million), and

IMF (\$77 million) have all promised to provide loans. Their utilization is conditional on open market economic reforms, deregulation, enhancing the role of the private sector, and attracting FDIs.

3. Post-Taif Agreement (1989 – 2005)

3.1. The Taif Agreement

The Taif Agreement also the National Reconciliation Accord or Document of National Accord) was an agreement reached to provide "the basis for the ending of the civil war and the return to political normalcy in Lebanon. Negotiated in Taif, Saudi Arabia, it was planned to finish the Lebanese Civil War, reassert Lebanese authority in Southern Lebanon (then controlled by South Lebanon Army and supported by Israeli troops). However, the Agreement set a time frame for Syrian military withdrawal, stipulating that the Syrians withdraw within two years; the actual withdrawal did not take place until 2005. It was signed on 22 October 1989 and ratified by the Lebanese Parliament on 5 November 1989

3.2. The post-Taif state and application of the Agreement

Around five years after the initialing of the Taif Accord, many upgrades have been achieved. The war has ended, and most Lebanese, excepting for one part of the southern inhabitants, have enjoyed a long-neglected peace since late 1990. State institutions have restored their power, the army is united and growing strength, and the weakening in economic situations have halted. However, a lot must be done to face a severe fiscal deficit and economic immobility. Though, the Taif Agreement was and is still being executed within a different equilibrium of internal powers and a different balance of provincial, Arab forces than initially intended. This is indicated through the increase of the Syrian effect and a lack of balanced internal depiction in Parliament because of the "Christian" judgment to reject the elections conducted in the summer of 1992. This difference has led some of those who take part in and backed the Agreement to join the opposition and announce that what is being applied is not the Taif Agreement.

In the first two years of the application of the Agreement, it was apparent that the Lebanese agreed on the need for state rebirth, but they differed on the model that they should

embrace. Did it have to be the conventional liberal model that happened before the war, the Shehabist strong-state model, or a new style that would give for both a sharing and strength of power?

The Agreement followed in a reproduction of the Lebanese confessional state under a new plan. Sectarian balance and sectarian involvement replaced one-sect domination; thus, power became dispensed.

At the state level, the Agreement generated a three-man show or "troika" comprising of the three Presidents: The President of the Nation, that of the Council of Ministers, and that of the Legislature. In practice, the perception among these three presidents as entities has come to mean that the three organizations, qua institutions, have paled insignificance. This undermines the fundamental purpose of the Accord, which was to restore the rule of the entity (the President) by the rule of the organizations. Furthermore, many different versions of the way to execute the Agreement have surfaced. These disagreements result from the effort of each President, as a spokesperson of his confessional society, to enhance his status and his rights. Moreover, the persistence of the President of the Republic to work out many of the rights that the Agreement has already canceled characterizes an attempt to preserve some common unrecorded practices in order to refresh the old, pre-war system, thus curbing the intent of the Taif Agreement through different exercise. For example, one may cite the insistence of the President of the Republic on joining and thus presiding over every discussion of the Council of Ministers in order to declare that he still has control over the executive authority.

Yet, the most disturbing results of the application of the Agreement has been the escalation of confessional conflicts and disagreements, leading to the paralysis of the political and administrative powers. The dispute on the position of the Class One public posts has been a sign of such dispute. Wien, some of these nominations, were declared. They showed a confessional distribution based on negotiations that were based on neither competency nor capability.

The Taif statute has not yet been able to determine a clear and comparatively stable plan to rule, govern, and exercise power. In addition to the earlier mentioned difficulties, one can

note the lack of new socio-political forces and governance that can apply the Agreement fully, guiding the nation towards a more democratic structure.

The Lebanese state in the post-Taif age has been subjectively guarded by conflicting socio-political powers. On one side, the guerrillas that were influential during the war years were invited and inspired to participate in the political restoration process because they were judged to be representative of a reality that needs to be recognized first and slowly altered later on. On the other hand, new socio-political powers overseas to the war forces came into force; they represent the economic strength of local capital allied with the regional hub, with essential support from the rich and fundamentalist Gulf countries as well as that of European and American nations. At the same time, the impact of the traditional confessional principals greatly weakened during the war years, and this process remained in the Taif.

This new socio-political alliance does not have a decided upon program because it includes conflicting visions and interests. Moreover, the role of the old bourgeoisie, which is rather tied to the general market and to the local social assembly, has been losing its reputation as new elements who are externally oriented at the financial and profitable levels, and who are tied more to regional and global economic projects and interests, have been the acquisition of influence and regulator over the Lebanon Market.

The happening of Rafik al-Hariri to force as a prime minister in Oct. 1992 exhibited such improvements. The changes in the Lebanese approach cannot be considered due solely to changes in leaders. Furthermore, overstating the role of the entity does not help to understand the Lebanese condition completely, nor its impacts upon Lebanon's domestic and exterior relations. In fact, an assessment of the new qualitative stage of advancement in the Taif state is essential for the understanding of the current position.

3.1.The Hariri Trend

The Hariri phenomenon is carried out in the context of specific regional and interior improvements. Locally, it came about in the outcome of the Gulf war and the launching of the Madrid Peace Summit. The American Government admitted the Syrian role; in return,

the Syrian regime altered itself to the new situations and become accustomed to the interests of others, particularly those of the Americans and the Gulf countries in Lebanon. On the Inside, the social base of the old system was already shaky, if not demolished, and there was a serious need to reform a new one. Consequently, the Hariri government presented representatives of the new sectors of the bourgeoisie who were imported to the political procedure, most of whom had stayed out of the country throughout the war years. Substantially, these persons came into power with their own package of restoration and advancement. This program was unbiased of the internal conventional and sectarian militia but was submissive to regional and interregional.

This new socio-political alliance is based on these parts of the big middle class controlling internal economic and economic structures. These systems have grown to be more centralized and are focused under a small group led by Rafik al-Hariri himself. This alliance was politically backed by both the forces and some of the neo-traditional militaries. The internal Agreement between these two factions, and the Agreement between the Syrians and a sort of harmonizing Gulf control headed by Saudi Arabia, favored by the U.S., has created an unbalanced, incoherent, and somewhat conflict-ridden decision procedure.

The militia in power has established their own political procedure on their knowledge of the war years. This experience is described basically by the use, exploitation, and division of the accessible resources of the Government. At the same time, these forces often resorted to traditional deployment methods signifying the sectarian political society.

The Hariri faction, once in authority, could not determine a different political philosophy nor create a clear, definitive political system. Moreover, the Hariri government seems reluctant to meet its duties, especially the political ones, whether they concern the peace mediation process or the coming back of the relocated.

Many government activities have been conflictual; however, such a state was particularly true of the organizational "reform" that turned out to be a badly planned administrative removal. Instead of revolutionizing and reforming the current Government, the Government kept it integral and established at the apex, a corresponding one knotted to the Prime Minister. Even the cabinet is separated into two. The first part signifies Hariri, and controls

the ministries of finance, the economy, and the crucial services; another is a political one alliance the militias and a number of Syrian-backed or politician were traditionally tied.

This planning is a compromise that is replicated in other institutions of the Government. Such a situation may possibly be viewed as the result of the lack of proficient social services able to transcend the politics of confessional power-sharing to figure a national and non-sectarian character.

Furthermore, if we examine the sentiments expressed by Rafik al-Hariri, it seems that he is not concerned about improving the existing system. When he was questioned about this substance, he reacted that "there was no need for political reform because reform has previously taken place. What we want is an election. The election will give a new headship to the country".

As for the transformations or conflicts with the President of the Republic and the Orator of the Parliament, Hariri ponders that it is a substance of "different individual moods and what is present is the best conceivable system; what is needed is better harmonization and more hardworking resources. Another system, other than the troika, will generate difficulties that we cannot predict."

At the economic policy level, the administration has a clearer vision that is best replicated through the ten-year progress plan, a plan that was expressed by the International Bechtel Co. and the Lebanese Dar al-Handasaas asked by the Council of Development and Reconstruction (CDR). The plan is alienated into three phases: rehabilitation, recovery, and development. The first phase of the plan will take three years, another phase five year, and the third phase two years. The total cost of the strategy is around \$11.5B. The delivery of these costs over segments replicates heavy stress on organization and services, and relative negligence of the fruitful sector and social projects. In effect, 41% of these costs are allotted to infrastructure, 24% to socio-economic projects such as public transport, water resources, and tracks, and 27% to social developments, such as edification, wellbeing, housing, and social matters; though, this 27% will be mostly spent on ensuring the rebuilding of buildings and providing reimbursement to the evacuated. Lastly, only 8% will be assigned to economic projects in the productive sectors of agriculture and industry. The CDR is accountable for

formulating the overall planning and for locking financing for the application of these developments. The CDR performs on behalf of the Council of Ministers and reports straight to the Prime Minister. This plan is highly reliant on foreign loans and has a tendency to overspend on luxury projects. Furthermore, it lacks any positioning of importance.

Current knowledge has shown that the size to administer and manage such projects under the existing administration is less than inspiring. A fresh report of the Bureau of Accounting stated that above 58% of the agreements awarded were consensual among the contractors and the various departments. Furthermore, a lot of condemnation has been directed against the Solidère Company, and the administration plan to rebuild the commercial center of Beirut.

Though, the most disturbing fact is the existence of many institutions that act independently of any reviewing or assessment by either administration or Parliament. What is essential is their way of spending large sums of funds and their political consequences. These organizations are the CDR, which transmits information only to the Prime Minister, the Council of South Lebanon, which is knotted to the Orator of the Parliament Nabih Berri, the Fund for the Return of the Expatriates and Refugees, which is tied to the Minister of the Immigrants Walid Jumblatt, and the Higher Commission for Reprieve which is also knotted to the Prime Minister. The ways in which such institutions operate their funds advise that some sort of circulation of assistance is happening. The Prime Minister panels the basic financial and economic decision-making processes through his governor. In order, the old forces control other resources and play a significant political role in the cabinet and the assembly.

Notwithstanding its deficiencies, the Hariri government is seriously involved in the process of renovation. Moreover, many of the future regional progress will certainly affect the situation, function, and role of the Lebanese nation. The question sustains as to whether Lebanese society will be able to defend itself from undesirable developments and benefit from constructive sorts.

Moreover, in the two above-mentioned cases, it is necessary to solidify national union and to transcend the differing political, confessional formula into a more stable and secular democratic one.

3.2. Economic Situation in the parallel Time Period:

The occurrence of the civil war in Lebanon was in the year 1975. This war continued until 1989 and severely damaged civilian infrastructure and the economy and caused large destruction at all levels. In 1983, Lebanon entered a serious economic recession. Economic activity deteriorated, capital inflows dropped, the budget deficit widened, and the Lebanese Pound's exchange rate collapsed. Therefore, Lebanon gradually lost his position as a financial center and as a storeroom for funds. In history, Lebanon used to be a model for economic and social development in the region until the year 1975, when a 15-year civil war destroyed the infrastructure and severely damaged the economy. However, post-war policies for reconstruction and rehabilitation during the 1990s were kind of successful but did not achieve what was expected and aggravated the political and economic situation. Public debt and deficit increased rapidly due to a large expansionary government expenditure policy. Several countries and global organizations such as the World Bank Group insured billions of dollars to support the Lebanese Government financially with the Paris 1, Paris II, and Paris III conferences in 2001, 2002, and 2007, respectively. The execution of the program of construction didn't come with the wanted results since it was hindered by numerous political interruptions and misconduct of the reforms. The main financial problem that faces Lebanon is its huge public debt that reached 180% of GDP in 2006 and is considered between the highest in the world (Note 2). The Lebanese banks held about 80% of the public debt at that time. Afterward, these banks were much more capable of absorbing local shocks than were before due to high oil prices that resulted in significant capital inflows from the Gulf countries. These inflows were translated into waves of new loans to the domestic private sector and were responsible for 70% of the GDP growth considered in the period 2007–2010.

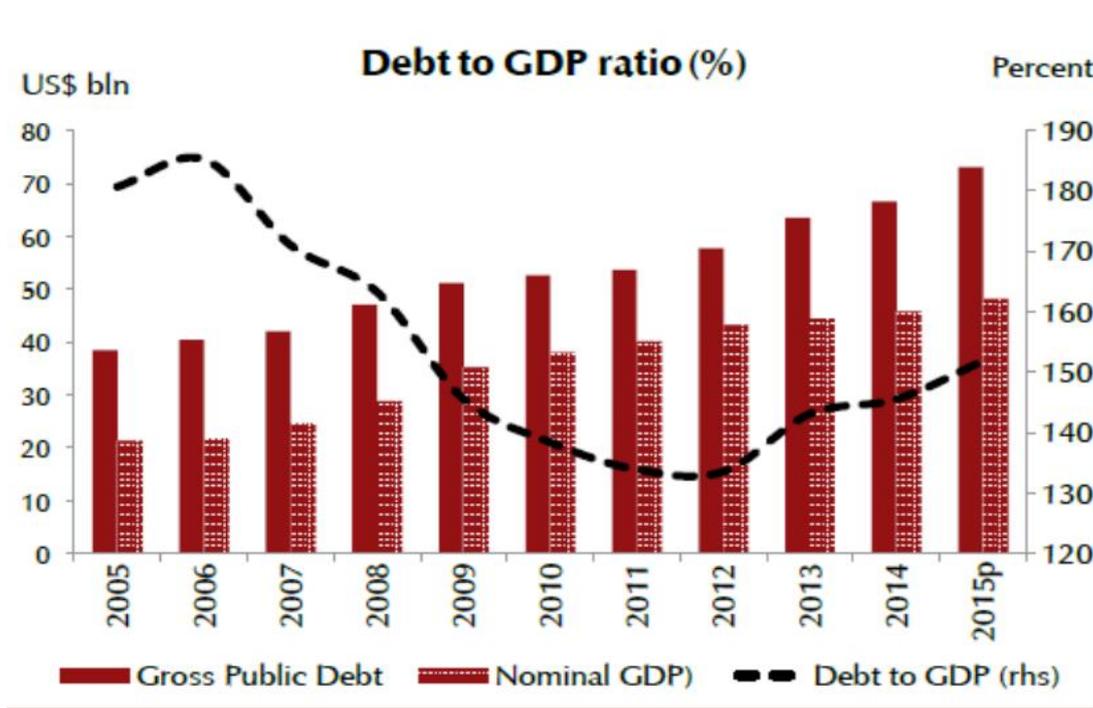


Figure 9 Percentage of Debt to GDP Ratio -Trend (2005-2015-...)/Lebanon economic monitor_spring_2014/Bdl, CAS and W.B. staff calculations

After four years of high economic growth, the Lebanese economy started declining in 2011, affected by the internal political Situation compounded with the regional turbulence. However, the debt to GDP ratio has started to decline since 2006. Although the amount of public debt continued to increase consistently, the ratio of the debt to GDP decreased to 143.87% and 124.94% in 2011 and 2012, respectively. With respect to the domestic and foreign debt, the local currency debt was about 61% of the total public debt, and the foreign currency debt was 39% in 2011. These proportions changed in 2012, the domestic currency debt registered 57.72% of the gross public debt, and the foreign currency debt reached 42.28%. The economic growth dropped from about 8% during the period 2007–2010 to 1.6% and 1.5% in 2011 and 2012, respectively.



Figure 10 Trend of Tourism Sector Economy (2011-2015) /Lebanon economic monitor_spring_2014/Byblos Bank, ARA consulting and research, World Bank staff calculations

The economic recession as of 2011, translated by regression of demand for exports, as well as tourism and real estate activities, led to a slowdown in credit demand and, therefore, a decline in lending rates. Although the legislation is liberal in Lebanon in terms of not differentiating between domestic and foreign investors, investors have always been suffering from the weight of bureaucracy and the outdated regulations that need a lot of modernization. Lebanon's economy is service-oriented and mostly based on financial services, trade, and tourism. The Lebanese economy is highly conditional on the services sector, which makes it more vulnerable to external shocks beside the internal ones. The global economic recession and the national and regional events that took place had its negative repercussions on the Lebanese economic growth during 2011–2012. This Situation was translated by regression of demand for exports, as well as tourism and real estate activities

4. Economic Indicators

4.1. Banking structure and evolution, 1950–2002

4.1.1. Overview

Practically all economic commentators have placed Lebanon's comparative advantage in services, and banking in particular. Beirut continues to be seen as a prominent regional financial center that has survived war and instability, maintaining banking secrecy and a substantial deposit base.

The central bank, Banque du Liban (BDL), was established in 1964. As noted earlier, this belated establishment was due to a 1924 Convention, renewed in 1937, between Lebanon and the French mandatory authority whereby a French private bank, the Banque de Syrie et du Liban, would be the Government's fiscal agent and retain the exclusive concession of note issue until 1964.⁹ Until then, banks were subject to ordinary commercial law rather than to specific monetary regulations. Nonetheless, the authorities had already realized the importance of banks in attracting foreign capital since a Bank Secrecy Law was passed in 1956. The law was instrumental in contributing to rapid growth in banks and bank deposits, especially since it was passed at the beginning of a long period of political instability and increasing economic controls in several neighboring Arab countries, including Syria, Jordan, Iraq, and Egypt.

Banking growth was strong, as illustrated in Table 6.2 below. The number of commercial banks increased from 7 in 1945 to a high of 86 in 1966, just before a series of bank failures reduced the number to 74 by the end of 1974. At the end of 2002, the number of operating commercial banks fell to 53, following a series of mergers. Although the number of banks has been quite large relative to the size of the economy, the banking sector has been portrayed by a high degree of concentration. Currently, in mid-2003, the five largest banks control about half the volume of total deposits.

In the fall of 1966, Intra, the largest Lebanese bank, failed, also provoking the failure of a few other banks. A recession followed in 1967, which was further compounded by the sequels of the Arab-Israeli war in that year. The authorities, however, were quick at

circumventing the impact of the bank failures. The economy then quickly rebounded in 1968, largely compensating for lost output in the previous year.

Foreign banks have dominated the banking market until the early 1980s, more so in terms of deposits than claims. In fact, by 1974, only the bottom three of the largest ten banks, in terms of deposits, were Lebanese-controlled.¹⁰ The picture, however, needs to be qualified since, in the early 1970s, about 40 percent of the foreign banks were of mixed ownership, with Lebanese management control in many instances. It was not until the middle-1980s that foreign banks started to close or drastically reduce their operations, and that banks with a majority of Lebanese ownership or control became dominant. At end 2002, only 11 out of 53 operating banks were foreign, with a corresponding minority share in deposits and claims.

One should not deduce from these observations that, at any pointing time, foreign capital has actively dominated financial or economic activity in Lebanon. Foreign banks have, in fact, played a passive role that mainly focused, in addition to the management of correspondent relationships, on the collection and recycling of deposits. Few of the foreign banks have had branches outside Beirut, and they regarded themselves as specialized wholesale bankers catering to the local banks rather than local borrowers. Their claims on the private sector have usually concentrated on a few relatively large and prime businesses.

These prime businesses, few in number, also dealt with several other banks and were thus able to command a negotiating advantage. The structure and evolution of the assets of foreign commercial banks indicate that their assets mostly were in the form of deposits with correspondents overseas, who usually are mother or sister branches. It should be noted, however, that this characteristic of a collector and recycler of deposits is a dominant characteristic of commercial banking activity in Lebanon rather than of foreign banks alone.

Table 1 Percentage of GDP (Avg. of annual stocks and other elements) – From the 1950s up to 2002—Political Economy of Lebanon, 1948–2002—TOUFIC K. GASPER

(In % of GDP; annual averages of stocks, unless otherwise indicated)

	1950–52	1964–66	1972–74	1986–88	1994–96	2000–02
<i>Banking system</i>						
Net foreign assets	11	40	86	186	87	52
Claims on private sector ^a	24	65	65	38	56	87
Claims on the public sector—net	<0	–6	–10	11	32	97
Money ^b	35	88	111	105	128	198
Value added—financial services	4.6	3.5	3.8	8.7	5.0	
<i>Commercial banks</i>						
Net foreign assets ^c	~1	18	29	62	16	8
Foreign assets		46	51	87	35	49
Foreign liabilities		29	22	24	19	41
Claims on the private sector	24	62	64	38	55	84
Claims on the public sector—net	<0	0	–3	10	46	89
Deposits—private sector	20	72	94	100	121	192
% of deposits in foreign currencies	~12		27	82	60	70
Number of banks (end period)	~20	86	74	79	74	53
Concentration ratios (% deposits) ^d						
First 5 banks				29	44	48
First 10				42	66	70
First 20			75	71	87	89
Claims on (% of claims on private sector)						
Industry		13	17	9	12	13
Agriculture		6	3	1	2	1

4.1.2. Financial versus economic intermediation

The development and modernization of banks, and the rapid growth in foreign-currency deposits, provided a unique opportunity to a developing country that, at the same time, had several locations, educational and entrepreneurial advantages in the region. Financial resources were clearly not a constraint, and banks, as financial intermediaries, should have

provided the transmission link between the supply of financial resources and investment. But this did not happen.

Considering the pre-1975 period, banks' contribution to growth was average and far short of the potential role they could have played. Activity continues to be concentrated on commerce and short-term lending, mainly in the form of overdrafts and advances, and import letters of credit. At the height of their access to bank crediting 1972–74, agriculture and industry, which then had a 40 percent share in total employment and 25 percent in GDP, received only about 11 percent of total bank claims, domestic and foreign. Clearly, at least until the mid-1970s, the issue of the crowding-out of the private sector was irrelevant since net credit to Government had been negative since its independence. Thus, banks operating in Lebanon were mainly financing imports and recycling foreign funds to the major financial centers in Europe.

During 1964–74, commercial bank deposits with correspondent banks abroad averaged about 43 percent of total claims. Although this type of asset management that seeks high liquidity represented by deposits with foreign correspondent banks may be construed as prudent banking behavior, it singularly reflects, at the same time, the failure of the well-endowed banking sector to play a leading role in the economy, let alone the role of an engine of growth.

In parallel, most bank credit to enterprises was financing working capital. Funds for fixed investment mainly came from profits, own funds, or, more generally, from outside banking sources. As an indicator of the weak linkages between banking and investment in the private sector, bank credit during 1950–74 represented, on average, less than the third of total private investment.

Banking remains a profitable business. It is difficult, however, to supply reliable data in this regard since profit and loss statements are notoriously unreliable for all business concerns in Lebanon, including banks. However, an indirect proof of bank profitability has been the persistently strong demand for entry to the commercial banking sector, which was met by freezing by the central bank of the new license issue.

The claim that Beirut was a financial center was somewhat exaggerated, an exaggeration that has survived to date. By 1975, banking activity was still focused on short-term lending for trade and on the recycling of deposits. Financial instruments were elementary, and the interbank and money markets small. Yet, financial capital was relatively abundant, as illustrated by the volume of deposits or the net foreign asset position of the banking system in relation to GDP, or by the level of interest rates.

Indeed, prior to 1975, interest rates on L.L. deposits have generally been significantly lower than Eurodollar rates. In addition, as Table 6.3 indicates, real interest rates on L.L. loans and deposits were on a declining trend until 1974. Bank credit could furthermore be utilized in any currency of choice by the borrower, a practice that holds to date, which is a reflection of a free exchange market and of a relatively easy capital situation.

Through its banking system, laissez-faire has therefore turned Lebanon into a net capital exporter. Instead of focusing on providing the crucial link between financial savings and domestic investment, banks continue to play the principal role of directing capital overseas.

The following provides an illustration of this role. In 1972 and 1973, the Government of Algeria, the State Bank of India, and the World Bank placed various L.L. bond issues in the Beirut market. In other words, major governments and international institutions were borrowing medium and long-term money from a market that would not provide more than simple short-term financing for commerce to its domestic enterprises. These bond placements, which were then taken as proof of Beirut's emergence as international money and capital market, were, in fact, stark illustrations of laissez-faire's failure in a domain where it was supposed to display its greatest strength

Table 2 Projection of Lebanon Financial Situation (1950-2002)-A Political Economy of Lebanon,1948-2002-TOUFIC K. GASPER

(Annual averages, in % unless otherwise indicated)

	1950-52	1964-66	1972-74	1986-88	1994-96	2000-02
<i>Commercial banks</i>						
Interest on LL deposits ^a	3.0	3.0	4.3	17.2	14.3	10.4
Spread on LL advances ^b	+3.5	+3.0	+4.0	+17.2	+10.2	+6.9
Spread on \$ advances ^b				+7.0	+6.9	+5.6
3-month LL-TB yield	N.A.	N.A.	N.A.	27.1	16.4	11.1
13-week US TB yield			6.3	6.2	4.9	3.6
<i>Dollarization-commercial banks</i>						
\$ claims (%—on private sector) ^c			10	84	87	85
\$ deposits (%—nonbank deposits)	~12		27	82	60	70
<i>Memo</i>						
Inflation (CPI % increase)	-0.4	2.7	7.3	221.0	9.2	0.5
LL/\$ exchange rate						
-average	3.6	3.1	2.7	224	1,624	1,508
-end period	3.6	3.2	2.3	530	1,552	1,508

4.1.3. From reconstruction to debt management

The Government's economic strategy effectively rested on two policies, ensuring a stable exchange rate and an ambitious expenditure program. Both policies have indeed been implemented, but the outcome has been quite different from what was projected. If anything, the period since 1992 has been distinguished by two outstanding trends: a sharply rising public debt and falling growth rates. In a small and open economy like Lebanon's, economic development largely depended on growth and the financial condition being compatible with the policy of a stable exchange rate. In particular, fiscal policy had to minimize waste and apply the golden rule of allocating most of the proceeds from government borrowing to capital expenditure, mainly in the domain of physical and human infrastructure. Monetary policy had to ensure that the high-interest rates would at least fall in line with improved stabilization. Structural reforms were needed to streamline public administration and to contain waste (the widely used euphemism for corruption) and

political patronage. Finally, growth had to be significant enough to support the rise in consumption and debt reimbursement requirements. These basic rules are essential for creating a financially stable environment that would promote private investment, productivity, and reduce the burden of the public sector debt. Reconstruction's principal failure was on the growth front. During 1993–2002, the average annual growth in GDP was only 3.7 percent, less than the pre-war average of 6.2 percent. Growth per capita during the period was a mere 0.7 percent. Worse, the economy quickly became breathless, with the growth rate consistently decelerating since 1996 to 1 percent in 1999 and a standstill in the year 2000. Employment opportunities remained few, and the unemployment level high. Despite the paucity of data on the labor market, senior officials have openly acknowledged the seriousness of the unemployment situation and the persistent wave of emigration of skills, particularly among the educated young.

4.1.4. Reconstruction phase—macroeconomic indicators

To appreciate the extent of this failure, one needs to put it in context. Not only has growth started in the early 1990s from a relatively low level of output after several years of disruption, but economic activity was also driven by extensive government spending and supported by a strong macroeconomic position, in particular a decelerating inflation rate, a low level of debt and a comfortable position in foreign reserves and net foreign assets.

It should be noted, however, that the apparently satisfactory external performance, since the mid-1990s, has been mainly due to external indebtedness and was, in fact, weaker than indicated. If we disregard external public debt disbursements and amortization, then the balance of payments has been in deficit throughout 1995–2002, except for a small surplus in 1996. In fact, during 1995–2002, the announced cumulative surplus of the balance of payments is \$1.3 billion, whereas it has been a deficit of \$5.7 billion if we exclude the

Table 3 Percentage of GDP and Other Macroeconomic Indicators during Reconstruction phase-A Political Economy of Lebanon,1948-2002-TOUFIC K. GASPER

(In % of GDP and annual averages for 1972–74, unless otherwise indicated)

	1972–74	1992	1994	1996	1998	2000	2002
GDP							
Current \$millions	2,767	5,843	9,601	13,694	17,036	17,345	18,264
Index (100 = LL 7,186 millions) ^a	100	66	79	88	93	95	98
Growth p.a. (%) ^a	6.9	4.5	8.0	4.0	3.0	0.0	2.0
Balance of payments							
Current account balance	13	1	12	6	-3	-2	9
Trade balance	-4	-48	-43	-33	-36	-29	-29
	-24	-55	-50	-45	-35	-29	-27
Fiscal overall balance							
Revenues	1	-11	-16	-20	-18	-23	-16
o/w income and wealth taxes	16	12	17	17	18	19	23
	3	1	3	3	3	3	4
Expenditures							
o/w -interest	16	23	34	37	36	42	39
-investment	-	5	9	12	13	16	17
	3	2	9	9	8	5	2
Public debt^b							
o/w in foreign currencies	< 0	41	51	77	101	134	161
	-	4	8	14	24	40	80
Interest rate on TBs (%)^c							
	N.A.	25.5	21.1	19.3	17.0	14.5	14.0
Net foreign assets^d							
	103	115	100	77	57	53	56
CPI (% increase)							
	7.3	99.8	8.0	8.9	4.5	-0.4	2.0
Exchange rate (LL/\$ average)							
	2.7	1,713	1,680	1,571	1,516	1,508	1,508

external debt flows. That has been an unprecedented weak performance for laissez-faire, a front where it has systematically excelled in the past.

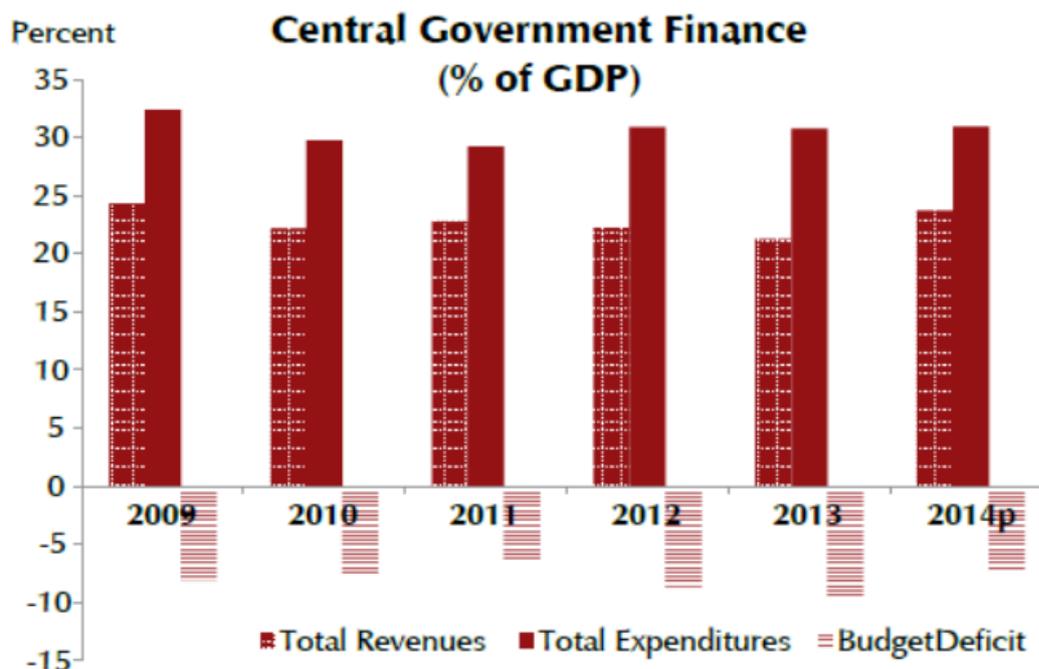


Figure 11 Central Government Finances in Percentage of GDP 2014 and earlier/Lebanon economic monitor_spring_2014/Mo and W.B. staff calculations

This weak growth and financial performance should have alerted the authorities to the existence of serious structural deficiencies in the system. However, officials attributed the weak performance to adverse political developments. The South of the country, occupied by Israel from 1978 until its liberation in May 2000, was the domain of almost continuous fighting and Israeli raids. Two extensive Israeli incursions took place in 1993 and 1995. These developments clearly had their impact on economic activity and expectations, though not to the extent usually claimed by the authorities. Most of the country and economic activity was, in fact, shielded from developments in relatively small areas in the South and, as in the past, the activity would usually rebound to its previous normal levels, following fighting outbursts that usually lasted only a few days. The problem was in-house generated rather than driven by external developments. Government failure was indeed systematic on all the major fronts of fiscal, monetary, and structural reform policies. Fiscal deficits remained high, and public sector indebtedness rapidly increased, all driven by mounting current expenditure, particularly on interest; moreover, despite falling price inflation and an appreciating exchange rate, nominal interest rates on the LL-TBs remained entrenched at relatively high levels. In fact, interest paid by the Government was even higher than

indicated in the table above since the central bank also paid to commercial banks interest rates that were significantly above the market, particularly in the secondary T.B. market, including swap transactions to reschedule T.B. maturities. Moreover, very little was accomplished by way of structural reform.

Already since 1997, discourse about reconstruction began giving way to concerns about the high levels of the fiscal deficit and the public debt. However, it is only in 2001 that, alarmed by their mounting indebtedness and the gathering pressure on the Lebanese Pound in the foreign exchange market, the authorities then felt compelled to announce ambitious reform programs, particularly in the domain of privatization.

The Government's political efforts recently culminated with the receipt of substantial amounts of foreign aid. At an international meeting for Lebanon, held in Paris in November 2002, financial assistance of up to \$4.4 billion was pledged by several countries. In substance, aid consisted of about \$3.1 billion in soft loans that can be used to refinance foreign-currency debt at significantly lower interest rates, namely at about 5 percent rather than the then current 10 percent. The balance of \$1.3 billion was for loans for standard infrastructure investment projects, which the authorities, anyway, could have access to in the past. The domestic banks later joined the international donor effort by pledging a package of \$2 billion in TB financing at zero interest rate. In return, the Lebanese Government has undertaken to implement further fiscal consolidation and reforms, including, in particular, the privatization of the telecommunication and energy sectors.

The aid package practically meant a saving of about 25 percent of the annual interest cost of about \$2.2 billion, and for a limited period. Given that total net debt was \$31 billion at the end of 2002 and given the economic and political structural problems in the country, the risk remains that the aid package would prove to be of little effect. Nonetheless, following the announcement of the aid package, interest rates sharply fell from a 14.6 percent yield on the 2-year LLTB to 9.4 percent. The central bank significantly replenished its foreign exchange reserves through purchases in the market. While most reforms and privatization have been front-loaded for implementation in 2003, little had been accomplished by November.

4.2.Recent economic and policy developments

After three years of typically Syrian-crisis related economic conditions, calming forces can be detected. Due to the Syrian war, Lebanon's economy had to undergo fundamental variations since 2011. Conventionally reliant on capital inflows to finance consumption as well as drive precise sectors (i.e., travel and real estate), this model has been severely negotiated by the regional turmoil that has inhibited foreign investors and trades. Instead, the influx of immigrants shifted market dynamics; while refugees' buying/investing power does not match that of the old-style foreign consumers/investors (i.e., GCC) in Lebanon, the loss has been partially remunerated. In 2014, we saw tentative symbols that the country known for its resiliency in the face of huge external shocks had made a good way in the rough evolution between the two basics

Rehabilitated improvement in overall security conditions, the creation of government, and the launch of discussion between aggressive political parties helped to buoy consumer and investor mawkishness. A positive political and security environment has usually translated into a rise in economic activity. Such growths raise hope that security incidents can be confined, and the political process can continue with the appointment of a new president, a position empty since May 2014. Though pending a determination of the political impasse, governance of the country is at a standstill with the Position, the executive, and Parliament either vacant or on de minimis style. Additionally, episodic security events persevere; spillovers from the regional chaos have been manifested by more recurrent clashes along the Syrian boundary between Lebanese Armed Forces and activists (ISIS and Al Nusra), who cross the border between the two nations. In addition, anxiety is growing over the subtle equilibrium of power along the connecting Syrian- Israeli-Lebanese border; in vengeance to a deadly Israeli assault against Hizbollah members in the Syrian area of Quneitra, which lies close to the Israeli boundary, on January 28th, Hezbollah targeted an Israeli armed group in the Shebaa Farms killing two Israeli soldiers

The influx of Syrian immigrants decreases, but they still account for over a quarter of Lebanon's pre-Syrian conflict population. Measures increasingly introduced by the Government of Lebanon since October 2014 to limit the influx of Syrian immigrants are becoming actual. Following a large growth in the number of Syrian immigrants incoming

Lebanon in 2013 (i.e., 675,742 or 15 out of a hundred of the Lebanese population), the Lebanese government started daunting stricter conditions on the influx of immigrants in October 2014, further tightening the application of these new policies in Jan. 2015. This has caused a sharp slowing in the influx of immigrants. According to the UNHCR, as of Mar. 12, 2015, the number of Syrian immigrants, both registered and awaiting registration, enlarged by 0.1

Million since June 2014. Anyhow the sharp slowing in new entrants, Lebanon hosts a total of 1.17 million immigrants, which represents 26.7 out of a hundred of the total Lebanese inhabitants. This marks the uppermost refugee-to-population ratio compared to all other adjacent countries.

4.3. Output and Demand

Refining security situations led to a spontaneous economic movement in the other half of 2014. Anyhow severe security intervals such as the joint ISIS-Al Nusra attacks in Aug 2014, a development in average security conditions in the other half of 2014, and a less bitter political atmosphere laid productive grounds for an upturn in economic motion. This, along

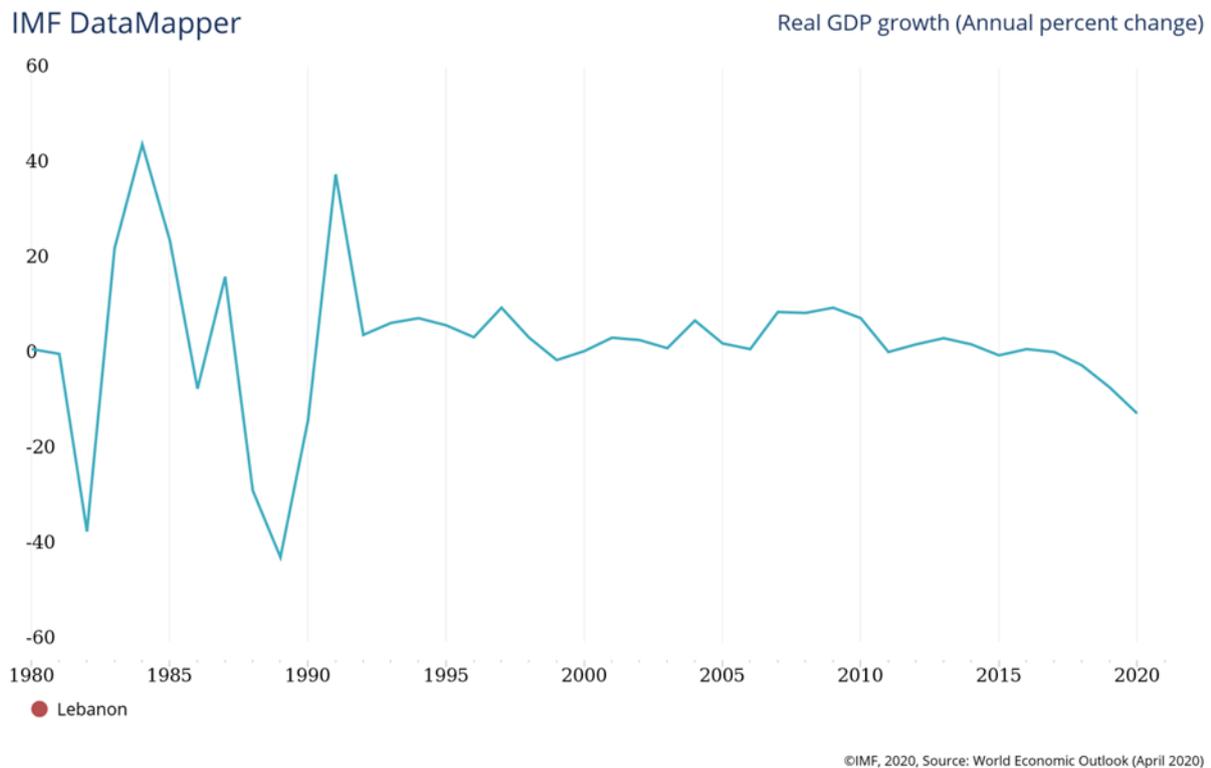


Figure 12 Real GDP growth/World Economic Outlook(April 2020)

with minor oil prices, pushed real GDP growth to an estimated 2.0 out of a hundred in 2014, compared to 0.9 percent in 2013.

Out-of-date drivers of Lebanon's economy have exhibited either better or steadied presentations. Of the former, the travel sector recovered impetus in 2014 with tourist comings growing for the first time since 2011 by 6.3%, after falling 6.7% in 2013. Iraqi residents escaping worsening security conditions at home provided crucial support for the sector. Assorted performance in the real estate sector, an additional old driver of the economy, points to steadying; while cement deliveries declined by 5.4%, construction permits grew by 4.8%, subsequent to the latter's decline of 12% in 2013. In addition, enlarged activity in the agricultural sector can be separated from 6.7% development in borrowing from Kafalat in 2014. The industrial sector has also been well-positioned to

benefit from the decline in oil values, a factor that helps clarify a notable slowing in the contraction of the BLOM purchasing managers'

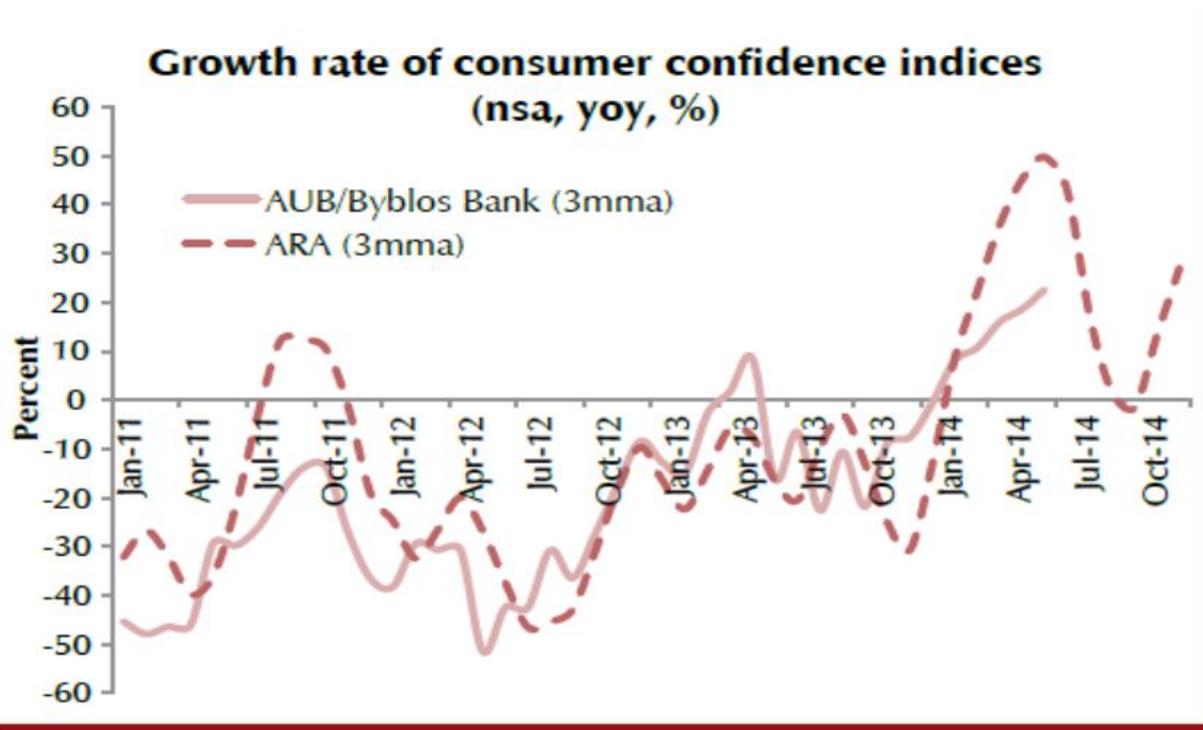


Figure 13 Trend of Growth Rate of Consumer Confidence Indices (Up to 2014 and onward) /Lebanon economic monitor_spring_2014/Byblos Bank, ARA consulting and research, WB staff calculations

From the demand side, enhanced security and lower oil prices boosted consumer sentimentality, strengthening private demand. The ARA purchaser confidence index rose by 21% in 2014 compared to 2013, reversing the undesirable trend in retail trade. Private demand is also reinforced by Syrian speculation; as the Syrian turmoil bears, Syrians in Lebanon are progressively shifting their economic role from being mainly customers reliant on handouts to becoming revenue earners, albeit for many, limited within the familiar sector. This includes beginning micro and small businesses that sell goods (including those inventing in Syria) at lower prices targeting the Syrian communal, on issues related to the extent of economic activity by Syrian immigrants and residents. Though, Lebanese trades that are not able to cope at those prices are negatively obstructed. The external sector was also a positive sponsor to real GDP development due to falling imports (as a ratio of GDP), helping to thin the trade deficit in goods and services. Public investment and feeding, on the other hand, were more altered in 2014 as the Bureau of Finance has provided more scrutiny on expenditures

4.4.Labor Markets

Given their extended existence, Syrian residents have de facto become part of the labor marketplace; this has produced significant negative distributional influences amongst Lebanese. With about half of the working-age Syrian immigrants economically energetic (ILO, 2014), by the end of 2014, the labor supply in Lebanon is estimated to have expanded by 50% (IMF, 2014¹¹). The mainstream of Syrian immigrants is low- to semi-skilled laborers, involved mostly in construction, agriculture, and personal and internal services, concentrated in the informal sector. While producing economic activity in Lebanon, the rivalry created at times fuels social dissatisfaction and tensions between the immigrant and host communities, but, since the sheer number of refugees, these frictions have been unusually muted. Lebanese proprietors and business owners, on the other hand, benefit from the availability of less costly labor. These results are reliable with signal of de facto (but seldom de jure) labor market presence witnessed in similar prolonged refugee presence in host countries (e.g., World Bank, 2011¹³). They also confirm the simulations assumed in the World Bank (2013)¹⁴-led report: specifically that the Syrian dispute and the massive influx of immigrants into Lebanon would generate both winners and losers amongst Lebanese (and refugees); those having good human or physical capital are not strongly impacted or even benefit (e.g., landlords or trade store owners in regions with high immigrant influx), while those with limited such assets would be worse off (e.g., lower wages, fewer jobs).

Lebanon's incapability to generate sufficient jobs has acute socio-demographic inferences. Real estate, construction, finance, and vacation industry have been the old drivers of economic activity. Since these sectors either are not labor severe or attract lower-skilled and cheaper foreign labor, growth observed in Lebanon does not sufficiently generate employment for Lebanese residents. In fact, the long-run employment growth elasticity is estimated to be 0.2 (World Bank, 2012¹⁶), much lesser than an estimated MENA average of 0.5 (IMF, 2014). Also, during the 2005–09 dated, Lebanon created only 3,800 jobs per year (one for every six new applicants to the labor market), while some 22,000 new Lebanese participants are expected each year until 2022 (excluding the Syrian immigrants)—World Bank (2012). The unemployment rate in 2011, still yet unpretentious by regional hostilities, stood at 11%, slightly above the MENA average of 10%, and reflecting insufficient job

opportunities. While no data happen yet, unemployment is estimated to have worsened. Meaningfully since then (World Bank, 2013). This structural labor market dimness is altering the socio-demographic fabric of the country: educated Lebanese have sought employment in nations with a demand for high expert labor, creating a large diaspora; meanwhile, non-Lebanese dominate the inexpert labor market, pricing out the residents

4.5. Fiscal Policy

Unique, technical, and unmaintainable measures rather than policy movements helped improve the fiscal equilibrium in 2014. The overall fiscal deficit pointed to an estimated 7.2% of GDP, a weakening of 2.3 pp of GDP from a year previous. This retrieval was led by the primary (i.e., without interest payments) balance, which improved by 2.7 pp of GDP, fluctuation back into surplus for the initial time since 2011. The primary fiscal enhancement was driven almost completely by enhanced revenue gathering, especially non-tax revenues, with total revenues growing by an estimated 2.4 pp to reach 23.7% of GDP. The quality of this development, however, was poor as these reflected primarily a one-off measure—a surge in transmissions from the telecom sector related to the collection of past telecom transfer debts— that will revert and is therefore not maintainable. On the expenses side, while primary expenditure fell by 0.3 pp from 2013 to 2014 (as a ratio of GDP), the fundamental expenditure was significantly advanced than actually documented because of a delay in transferring a substantial amount (about 1% of GDP) in telecom revenues. These have been together on behalf of municipalities by the fundamental government (CG), which documented it on the income side of the CG budget in 2014. When distributed, these transfers will be recorded on the spending side of the CG budget, radically reverting the technical, fiscal development documented in 2014. debt-to-GDP rose for the third successive year as Lebanon's cost of financing expressively surpasses its income development rate, which, in turn, significantly outstrips the advantage of a primary fiscal surplus. Total public debt sustained rising in 2014, albeit at a gentler rate, reaching 145.7% of GDP (US\$66.6 billion) by end-2014, compared to 143.1% of GDP at end-2013 and 133.5% of GDP at the end of 2012. The upsurge in 2014 was driven by a rise in internal debt service, which more than balancing the primary budget surplus. The earlier was the

consequence of a large positive gap between the (average real) real interest rate at which Lebanon borrows (3.3% in 2014) and the rate at which the economy's volume to generate income and repay that debt is rising (estimated out of a hundred in 2014). This trend, based on present policies and real GDP growth rates, is already unmanageable; it is expected to particularly worsen once international dollar interest rates start regularizing (a pace which is predictable to start with a narrowing of policy rates by the U.S. Federal Reserve Board later in 2021). The government remains to primarily finance the fiscal shortfall by issuing Treasury bills and Eurobonds. In Feb. 2015, the government elevated US\$ 2.2 bn through two Eurobond issuances. The stock of debt unsettled remains mostly internal, whereby, as of the end of 2014, 75.5% of gross public obligation is held by commercial banks and the central bank, Banque du Liban (BdL).

Longstanding structural blocks in public finance continue and continue to impair progress towards the development of the country. In the meantime, 2005, budgets have not been approved by parliament, while fiscal accounts have not been formally shut since 1993. Expenditure has been conducted largely through treasury loans and ad-hoc procedures in times of pressure. This leaves fiscal policy without a pillar. Even previous to 2005, fiscal policy has been absent from a medium-term viewpoint. The lack of proper oversight and extra-budgetary objects that receive significant government funding help entrench a culture of non-transparency in fiscal affairs

4.6. External Sector

Lebanon's existing account balance improved in 2014 but remains structurally weedy. The current account shortfall is projected to have improved by 4.4 pp of GDP from 2013 to the year 2014, reaching 22.2 % of GDP. A shortfall that remains among the largest in the world, exposing the country to important refinancing risks. The relative largely to a 13.6% deterioration in capital imports. Concurrently, services-led a 0.5 pp increase in total exports to reach an estimated 46.2 percent of GDP in 2014. Merchandise exports, however, contracted by 15%, led by an 88% fall in energy exports and an 11% contraction in capital transfers. The earlier reflects both lower oil prices and variations in volume, which deteriorated by 90% in 2014, while the latter mirrors a similar economizing in capital ingresses. Lebanon frequently exports services (e.g., tourism, financial services, advertising)

to the province, and as such, the Syrian and Iraqi turmoil have begun substantial market loss. Remittances in 2014 enlarged by 0.6 pp to 6.1% of GDP. Lebanon is architecturally and heavily reliant on capital influxes to finance its current account deficit. Later 2012, leading sectors towards which the mainstream of foreign capital gravitated have grieved significant decay inactivity, becoming a less beautiful destination for FDI (e.g., real estate, tourism).

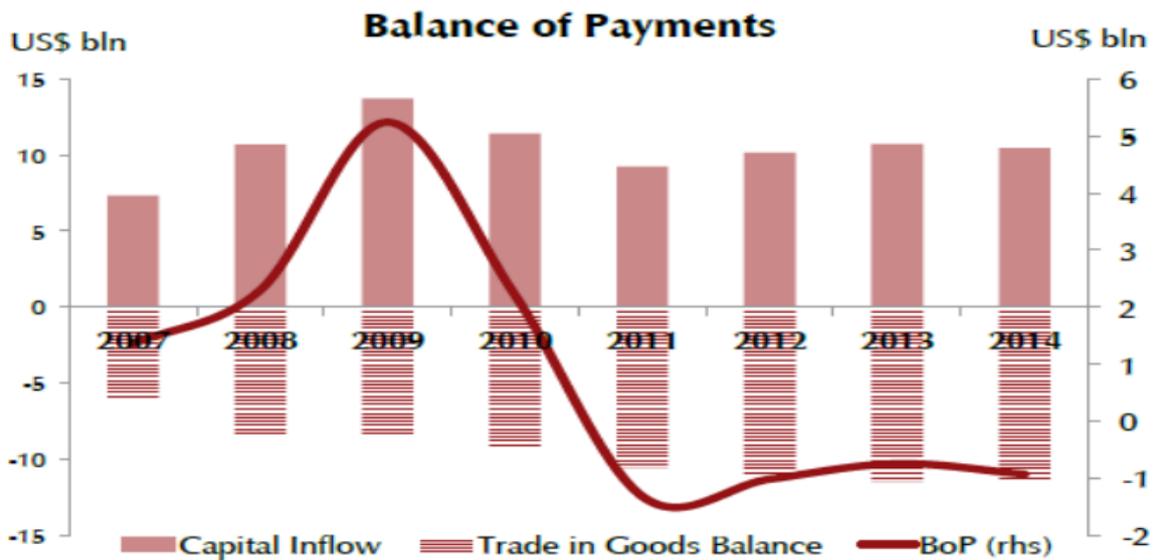


Figure 14 Balance of Payments Decline in the Economy (2014-onwards Trend) /Lebanon economic monitor_spring_2014/Bdl, Lebanese Customs and WB staff calculations

Net FDI in 2013 declined by 60% to US\$973 bn, equivalent to 2.2% of GDP, associated with an average of 9.5% of GDP for the pre-crisis period of 2000-2010. We approximated a slight growth in 2014 to 2.7% of GDP. The presence of Syrian refugees, though, has partially remunerated for this loss of influxes; the longer the Syrians are evacuated from their country, the more probable they will seek more medium-term alterations to their financial condition. This contains investments and other arrivals to their host country, in the form of FDI and short-term flows. Moreover, international aid pointing Syrian refugees provides development was driven by a fall in ingresses from 75.4% of GDP in 2013 to 73.5% in 2014 due to additional support to the balance of payments.

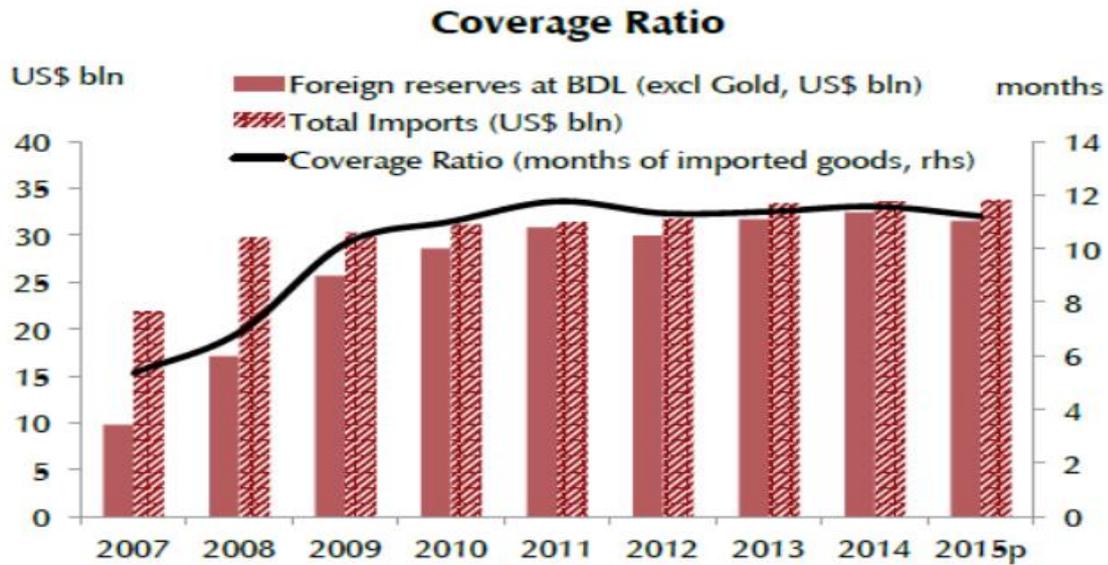


Figure 15 Economic Coverage Ratio/Lebanon economic monitor_spring_2014/Bdl, Lebanese Customs and WB staff calculations

Deposit transfers and global aid aided short-term capital flow to almost double in 2014 to a projected US\$ 3 bn. This is also strengthened by the wide blowout between domestic and global interest rates that reached an average of 421 basis points by mid of 2014. As a result, total capital influxes have held up at \$15.8 bn by 2014, albeit decreasing by 2.4% from 2013, leading to a 24% expansion in the balance of payments shortfall accumulation of gross foreign assets by the bdl remains robust. The stock of gross global reserves (excluding gold) at the central bank sustained rising as it touched US\$ 32.4 bn (8.5% of GDP) by the end of 2014, increasing by 2.2 % associated to end-2013. In terms of months of trade in goods, the coverage ratio increased from 11.4 % in 2013 to 11.6 % in 2014. We project that by the end-2015, assets would remain around 11 % of imports.

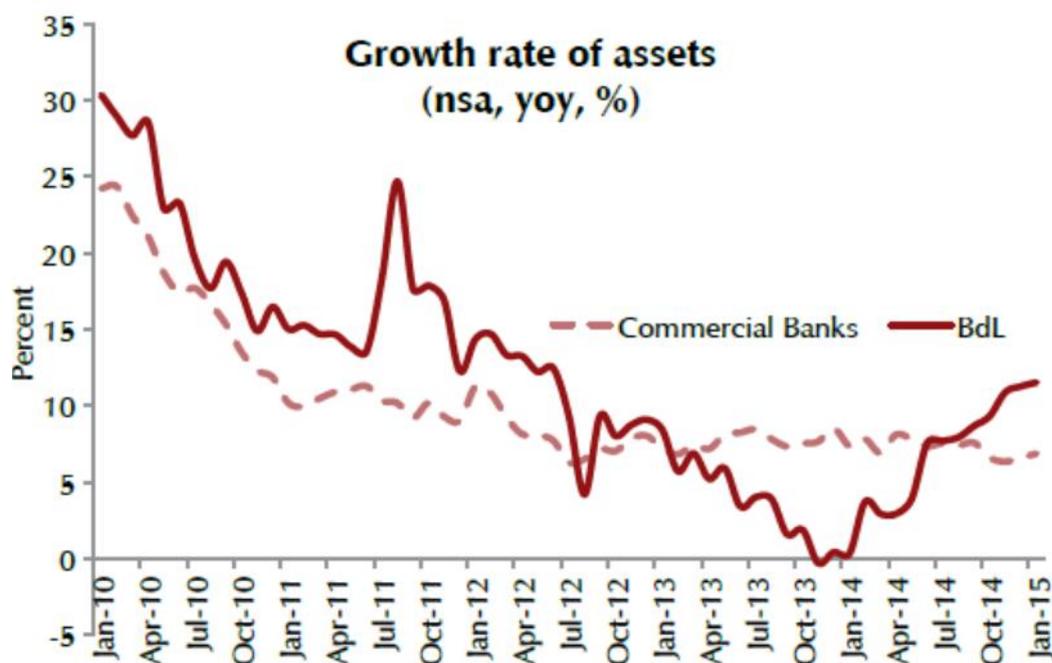


Figure 16 Trend in Assets Growth Rate/Lebanon economic monitor_spring_2014/Bdl and WB staff calculations

4.7. Financial Markets

Lebanon's banking segment is liquid, lucrative, and well-controlled, but highly unprotected to the public sector. Banks are well capitalized and hardy owing to prudent investments and conservative rule by BdL and the Banking Control Commission. In 2013, the Tier One capital-to-risk-weighted-asset ratio was 12.2 %, which was double what was required by Basel III. The liquid asset-to-total credit ratio, an indicator of short-term liquidity, stood at 68.8 by the end- of January 2015, compared to 66.3 at the end- of December 2013. Moreover, banks' profits remain rising while non-performing loans (NPLs) are low, and return on impartiality is in the double digits. However, commercial banks are highly unprotected to sovereign credit risk as they are a large stakeholder in public debt. In fact, Lebanese banks' independent debt exposure. They were increased slightly from 55.8% end-of 2013 to 57.5% by January 2015. In an attempt toward variation, banks expanded regionally, an effort that has been severely compromised by the recent regional upheaval.

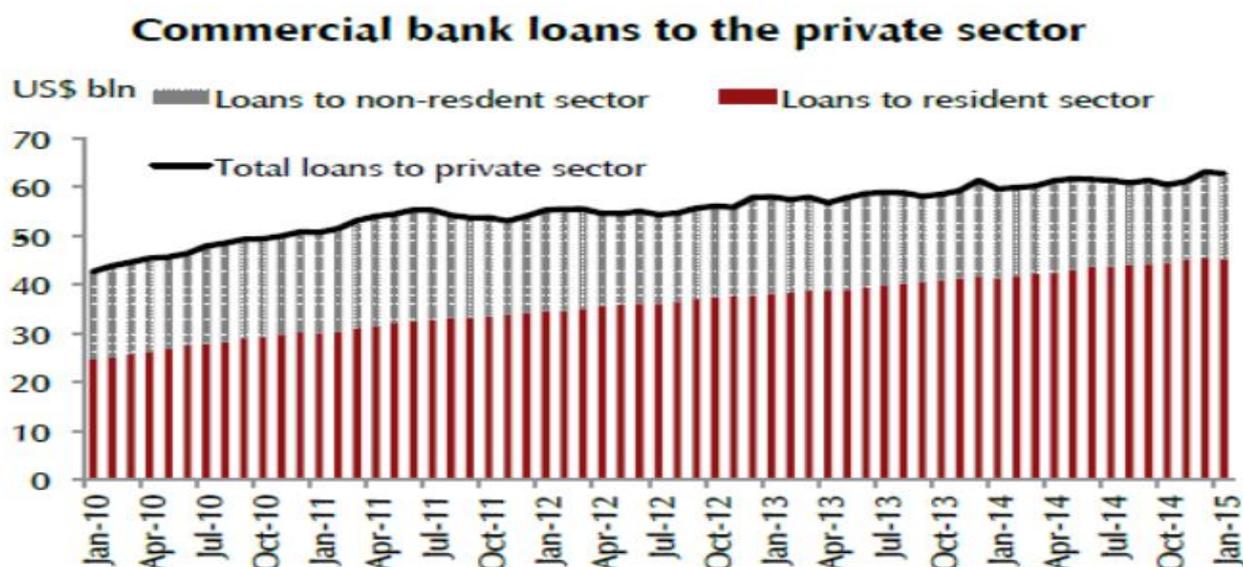


Figure 17 Loan to Private Sector - Trend up to 2015/Lebanon economic monitor_spring_2014/Bdl and WB staff calculations

Deposit growth slows. Commercial banks' balance sheet continued to grow, increasing by 6.6 %t in 2014, equating to 8.5 % in 2013. Deposits establish the principal funding source for commercial banks, with the deposit-to-total obligations ratio at 86.9 % by the end- of January 2015, associated with 87.7% end- of December 2013. These deposits are mainly driven by non- resident private sector deposits, whose development slowed to 6.4 % in 2014, likened to 18.2 % in the year earlier. Resident private sector deposit progress also regressed, but much less intensely from 6.8 % in 2013 to 5.9 % in 2014. Non-resident deposit development has been a vital factor in the steadiness of the banking sector and, in fact, the whole economy.

Attracted by interest rate spreads, it has been expanding at an average of 18 percent annually since 1993. However, a deceleration over this period signals the unsustainability of such a high rate; non-resident credit growth decayed from an annual average of 21.5 % for the period 1993-2002, to 16.2 % during 2003-2011.

Since 2011, the local turmoil has additional exacerbated this trend to average growth of 10.3 %. However, this remains enough to meet financing needs. Additionally, these deposits, which are largely sourced from Lebanese deportees, are resilient to shocks due to the movement's familiarity with the country's political and security volatilities. Moreover,

the BdL has verified its readiness to be the ultimate sponsor of the financial sector via its large external exchange reserves, intermediation between antagonistic parties, and good crisis administration overall.

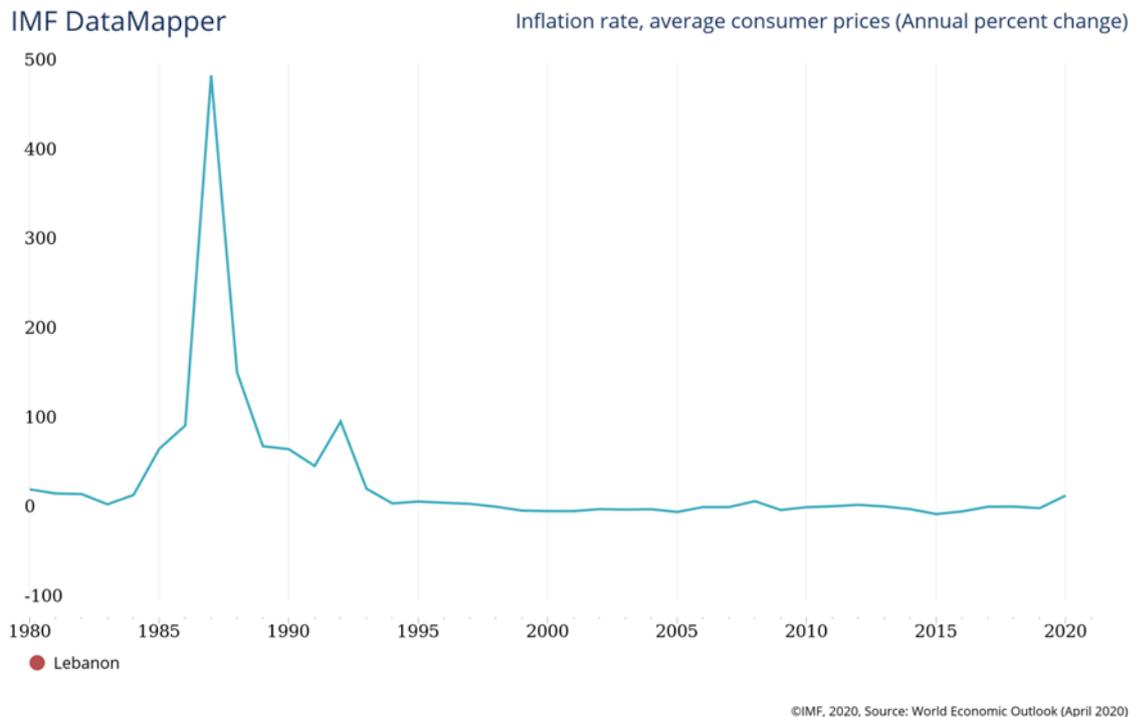


Figure 18 Inflation Rate up to Start of 2020/World Economic Outlook(April 2020)

While the Lebanese economy is progressively adapting to the undesirable spillovers from the regional turmoil, these are probable to continue holding it back. A key supposition underlying projection for the Lebanese economy respects the Syrian dispute and its spillovers. Current World Bank staff forecasts no longer assume that the end of the Syrian war occurs within the estimated period of 2015 to 2017, but in its place assume that current situations hold, i.e., inhibition of the spillovers lasts but does not prevent occasional safety events from happening. Relative to our Fall 2014 subject of the Lebanon Economic Monitor, real GDP growth for 2014 is predicted to be 0.5 pp higher at 2%, reflecting a spontaneous in economic activity in the second semi of the year as well as constructive effects of declining oil prices. These same optimistic factors will also generate a stronger-than-expected thrust for the first half of 2015, leading to a rising revision of our growth estimates for 2015 by 0.5 pp to 2.5 %. The return to possible output growth critically hinges

on a resolution of the conflict in Syria as well as a marked development in the security and political situations in Lebanon.

Absent important structural reforms on either revenue or expenditure, Lebanon's public finances are expected to remain physically weak and deteriorating. In 2015, condensed transfers to Electricité du Liban from dwindling oil prices along with sustained tax administrative inspection will achieve a projected 1.2 % of GDP in primary investments to be partly offset by 1.5 % of GDP in lower revenues due to the unsustainability of the one-off revenue actions in 2014. As a consequence, the primary balance will remain in surplus, but once again, not due to sustainable policy measures. An expected increase in debt servicing due to the pass-through from higher international interest rates will leave the general.

Fiscal position largely unaffected in 2015 likened to 2014. Assuming political paralysis comforts by 2016, we expect some partial public sector wage rises as well as higher transmissions to municipalities, raising current expenses. This, in adding to larger debt servicing, will lead to a worsening in the overall fiscal deficit.

The behavior of monetary policy is expected to become more interesting due to contradictory objectives. BdL, whose primary objective is to sustain the stability of the peg to the dollar, is predictable to become challenged during 2015 with challenges to its expansionary policies from a number of factors. First, predictable standardization of global interest rates will ultimately require domestic interest rates to increase in order to maintain exchange rate stability. Second, the enthusiastic reply to BdL initiatives (subsidized loans) has helped boost economic activity, but, after numerous years of such lending, more courtesy will need to be paid to the issue of domestic leveraging and repayment capacity. The expanded use of macroprudential tools shows that BdL is watchful to these risks. Henceforth, while monetary policy has been one of the few operative countercyclical policy tools throughout the ongoing period of lethargic development, it will likely become less potent economic tonic going forward.

For short- and medium-term reasons, it is imperative and urgent for policymakers to address Lebanon's longstanding and worsening structural bottlenecks. Lebanon continues to be beset by structural blocks, including in structure such as electricity, water, transport, and

communications. These blockages are becoming even more obligatory, as shown by a worsening of Lebanon's global ranking among key investment environment assessments. While the rise in demand from the Syrian immigrants has worsened these hitches, a deficit in service delivery pre-existed the entry. Hereafter, any reform and/or investment in those areas will go in the direction of alleviating this pre-existing deficit once the immigrants return to their homes. In the interim, while immigrants are present, the much-needed improvements would go a long way in refining the living circumstances and standards of both Lebanese and immigrant communities, mitigating tensions among groups. In the short-term, given the prolonged impact that the Syrian war has had and is predictable to continue having for some time on the Lebanese economy, the option of postponing further any policy choice and action is eventually hurting the economy and its citizens as growth remains weedy, debt is again gathering rapidly, jobs are not created, dishonesty becomes even more prevalent, and services deteriorate at an accelerating pace. Policy inaction is not just tapping on hold Lebanon's development; it is dragging it backward.

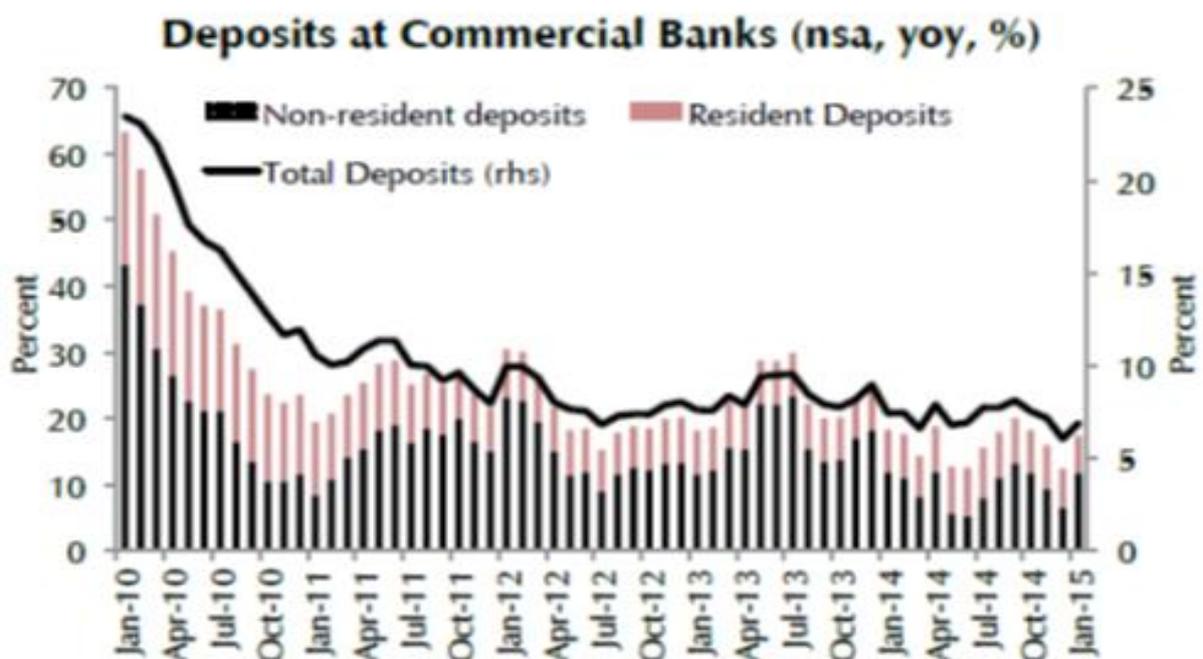


Figure 19 Commercial Banks Deposits/Lebanon economic monitor_spring_2014/Bdl and WB staff calculations

5. Current Crisis

5.1. Start of protest and Resignation of Hariri Government

On Oct 17, 2019, approximately one hundred civil activists were protesting against the new proposed taxes in and around downtown Beirut, blocking essential streets as the Minister of Higher Education and his convoy crossed the area, where protesters gathered across the car. One of his men shot into the air, which further enraged the protesters; no injuries were reported. Walid Joumblatt, who is the leader of the Progressive Socialist Party, announced that he spoke to Chehayeb, who is the minister representing the party in the government, and requested the bodyguards be handed over to the authorities, as all people are "under the law." "A huge number of protesters started appearing in Martyrs Square, Nejme Square, and Hamra Street, as well as many other regions around Lebanon. As the protests grew, Prime Minister Saad Hariri called a snap cabinet meeting at the request of President Michel Aoun for midday on Oct 18. A declaration was also made by Minister of Higher Education, Akram Chehayeb, that schools and universities, either public or private, would remain closed the next day. The Minister of Telecommunications announced that the "WhatsApp tax" idea had been annulled at around 11:00 PM. Protesters saw the "WhatsApp tax" as the spark of demanding reforms in the social, political, and economic situation and against the entire political class, which is believed to be corrupt and in need of immediate ousting. Protests in Martyrs' Square, Beirut on Oct 18, 2019

Protesters in Nabatiyeh and Tripoli, on Oct 18, damaged the workplaces of the main parties in that area, which is represented by Hezbollah, Amal Movement, and Free Patriotic Movement political parties showing dissatisfaction and protesting against the perceived government corruption. Other protesters intended to enter the Serail, which includes the Lebanese Parliament building but was forced to stop by the Internal Security Forces. Protesters shaped roadblocks on the major roads of the country, using burning tires and trash cans to stop access. Civil servants proclaimed a strike with immediate effect through the League of Public Sector Employees, discussing that the suggested reforms would specially destabilize the rights of employees and pensioners. A cabinet meeting was due to be conducted in the afternoon, but it was later canceled since the main parties announced not to attend the meeting due to the bad economic situation and requested for the

resignation of the government due to the "resounding failure to halt the deterioration of the country's economic situation. The protesters were demanding a government of specialists to govern the state in this critical period of Lebanon. However, he criticized the participation of political parties within the protests and argued it should remain something for the citizens to do. In the evening, Prime Minister Saad Hariri addressed the nation, given his "partners in government" 72 hours to support the reforms. If they did not agree, he suggested he would take a "different approach.

On Oct 21, a general strike was called across the country, demanding immediate reforms and changes to fix the current situations. An urgent cabinet meeting held by Prime Minister Hariri announced in a press conference several economic reforms, including halving the salaries of officials and members of Parliament, lowering the deficit by about US\$3.4 billion in 2020, with the support of the Lebanese central bank and the banking sector, distributing financial aid to families living in poverty and giving US\$160 million in housing loans. Still, his reforms were rejected by the protesters and keep demanding the resignation of the government, which happened on Oct 29.

5.2. Lebanon's banks reopen after two-week of closure amid protests

Experts and bankers expressed their concerns about a rush of the depositors to transfer their savings to outside the country or to withdraw them instead of keeping them in the banks when the banks opened. The bank of Liban promised not to impose capital controls when banks reopen, such measures that deter the currency inflows and investment. After banks have been closed during the protests for two weeks, the Lebanese depositors were surprised by setting limits on withdrawals on both local currency and US dollars. The capital controls are said to be a move to retain liquidity in Lebanon's ailing economy. Even though no formal policy is in place, most have arbitrarily capped withdrawals at around \$1,000 a month.

In contrast, others have imposed tighter restrictions depending on your bank account issued by the Association of Banks in Lebanon. Lenders also stated that the transfer of capital outside the country would be permitted only for urgent personal issues and requested

clients to use their credit cards to meet their requirements. These measures lead to bear the brunt by ordinary depositors who have turned bank branches into areas of conflict.

5.3.Strike of Banks and beginning of Dollar crunch

Relatively to the economy, Lebanon's banking system in the Middle East's biggest -- and one of the biggest in the world. Banks have been shut in the previous month, a period of the first-time disruption even in a nation that's tolerated war and political strife, as anti-government protests took hold national. Urging management to provide them with more security, employees went on a strike to avoid the angry clients who are insisting on withdrawing from their savings. The union said it would finish the strike after asking to protect the banking sector against what it said were daily rumors targeting the industry.

The two main demands -- for security and unified measures -- have now been met, the union's head, George Al-Hajj, said in a televised speech. Banks will now resume work on Tuesday in what will be a short week, closing on Friday for Lebanon's Independence Day. The central bank's governor asked lenders to ease some of the restrictions imposed, meant to avoid capital flight, and prevent a run on the banks. The measures have hindered imports, with suppliers of fuel and medical products cautioning of due to lack of dollar. That's forced suppliers to buy dollars at money changers that were pricing them higher than the official fixed exchange rate.

Salameh also demanded banks to increase their capital by 20% by next June and abstain from allocating dividends for 2019 to boost their liquidity and prepare for possible credit downgrades. In addition to that, S&P downgraded three top banks in Lebanon last week, Bank Audi, Blom Bank, and Bankmed to 'SD,' or selective default status from the riskiest tier of junk, known as CCC. The rating action comes after the Lebanese central bank issued a document warning that the state is draining liquidity from lenders and demanding banks to pay in Lebanese pounds half of the interest due to clients' US dollar-denominated term deposits existing and not matured before Dec 5. The corporation said it would further decrease the ratings there be "additional pressure on banks' liquidity positions or if the banks impose further limitations on specific transfers and operations. The rating agency believes that these measures in Lebanon could become tighter in the future due to

liquidity in the politically turbulent country is diminishing, "causing banks to possibly face near-term mounting pressure on their funding positions

5.4.COVID 19 and its impact

Lebanon is confronting its worst economic crisis since the end of the civil war before even anyone heard about coronavirus. With a critical deficiency of US dollars and depreciated local currency, Lebanon is one of the most indebted countries in the world and defaulted on its loans for the time on the 9th of March 2020. The Prime minister Diab, citing the World Bank, believes that over 40 percent of the population could soon live below the poverty line. The restrictions imposed on the Lebanese economy lead to a decrease in the economic cycle between the households and the rest. In addition to the increase of the black market exchange rate where the Lebanese household was losing the purchasing power day after day, so non-essential commodities demand started to decrease. In addition to that, prices of the commodities, essential as well non-essential, were priced according to the value of the US dollar in the black market. Concerning the healthcare system during the coronavirus, it was functioning properly in the beginning. Still, as the number of cases initiated to increase, hospitals and especially the public sector started to suffer from a lack of resources. The financial crisis being faced by Lebanon has resulted in added difficulties for the medical sector. There is a high scarcity of all the suggested medical supplies which have been deemed necessary to properly deal with the Coronavirus outbreak. Hospital staff, as well as nurses, have all raised concerns regarding the failures of the Lebanese government along with the hospitals to not only adequately staff hospitals but also to protect the staff from the risk of getting infected. The financial crisis has resulted in a dollar shortage: this shortage has restricted the capability of medical supplies importers to order and import these vital medical supplies. The supplies in high demand and low supply currently include- 95 masks, disposable gloves, HazMat suits, and other protective gear, along with the ventilators and their spare parts. For example, protective equipment is not produced in Lebanon. Importing them is very hard due to the economic crisis. The Lebanese government still has to reimburse the public as well as the private hospitals for the bills raised against them, including the payments due from the National Social Security Funds as well as the military health funds (Devi, 2020). Though local distributors reached an agreement with the

authorities that involves the subsidy of their needs similar to the subsidy mechanism applied to the crucial commodities like wheat, petrol, and medicine, which are subsidized up to 85 percent, such a deal seems to be still problematic. The Central Bank has thus commended banks for speeding up their procedures, but in the meantime, stocks are running low. In practice, it needs time for commercial banks and the Central Bank to check the files. Almost 15 million dollars are spent on disposable protection gear used in hospitals every six months. Since October, only \$4 million were spent on these products, "said an importer. The sector which has been the hardest hit by the Corona Virus crisis is the food and beverage sector, which was the mainstay of the Lebanese economy. From September to the December of 2019, almost 800 food and beverage institutions went to close down, which led to 25,000 people (17% of the workers in the food and beverage sector) went on to lose their jobs. In the following January, an additional 200 institutions went on to be closed. The government ordered the closing of the only international airport in Lebanon as well as the closure of all the ports and land crossings for 14 days, subject to extension reviews. Dissimilar to other countries in the lockdown, where all banks have remained open, the Lebanese banking association decided to defy direct government orders. The banking industry closed off for two weeks: this was an apparent effort to preserve their liquidity reserves. Further, with everything shut down, the government will not be able to go ahead and collect taxes, which will further increase the budgetary deficit. The problem of the coronavirus situation can be seen to be particularly worse in the hospitality sectors. Not only are the members of the global travel industry: hotels, airlines, etc. facing reductions or shutdown of activity; so are the smaller neighborhood stores. Beirut is one of the famous tourist destinations; however, all tourist destinations are now deserted; flights are not taking off, all trade shows are also being canceled. Beirut's famous nightlife has come to a complete standstill due to the lockdown. With no tourists to spend and no locals to enjoy, all of the businesses are suffering, and considering the economic crisis, and many owners are tied. They need to lay off their workforce who is further adding to the rising economic crisis and lack of funds in the Lebanese nation. Lebanon boasted a robust tourism sector, which largely contributed to the country's domestic economy as the major source of not only income but also employment. With the currency being low and renowned hospitalities, Lebanon was the ideal place for a quick Middle Eastern authentic vacation for many travelers. This is why in 2016, travel and tourism contributed a staggering 19% to the GDP of

Lebanon. This led to the generation of 338,600 new tourism-related jobs, which in turn invigorated the Lebanese economy by contributing to the GDP of Lebanon in 2016, amounted to the US \$ 9.2 billion.

5.5. Eurobonds

In the current situation, Lebanon has \$28.3 billion of dollar-denominated Eurobonds issued and outstanding, excluding interest and of 15.5 billion US dollar of interest coupons associated with those bonds, making total liability of 43.8 billion US dollar. Besides, Lebanon issued a special treasury bond, which is not technically a Eurobond of an amount of 1.4 billion US dollars, which takes the country's total sovereign dollar-denominated liability to 45.2 billion US dollars. Between April 5, 2016, and May 17, 2018, the Eurobonds were issued in 27 separate transactions with maturity dates on the Eurobonds varies from March 9, 2020, to March 23, 2037. The face value of the bonds ranges from 2.5 billion US dollars (issued in November 2013, with 7.15 percent interest) to 300 million US dollars (issued in April 2031, with 7 percent interest). Various international and local lead managers used to place the bonds. Among the most significant global lead managers were BNP Paribas, Credit Suisse, Citibank, HSBC, Deutsche Bank, Standard Chartered, JPMorgan, and Barclays. The main local placement agents are Bank of Beirut, Byblos Bank, Société Générale de Banque au Liban, BLOM Bank, Bankmed, Bank Audi, and Fransabank. The issuer, which is the Lebanese government, placed 11.1 billion US dollars of the Eurobonds directly, without the services of a lead manager.

The graph beneath shows the maturity structure of principal payments (blue) and coupon payments (red) on the outstanding Lebanese Eurobonds as of April 2019 through 2037. The amounts are represented in millions of U.S. dollars. The timetable of amounts due exceeds 2 billion US dollars per year in each year excluding 2029 and between 2032 and 2037. The years with value due in excess of 3.5 billion US dollars are 2020, 2021, and 2022.

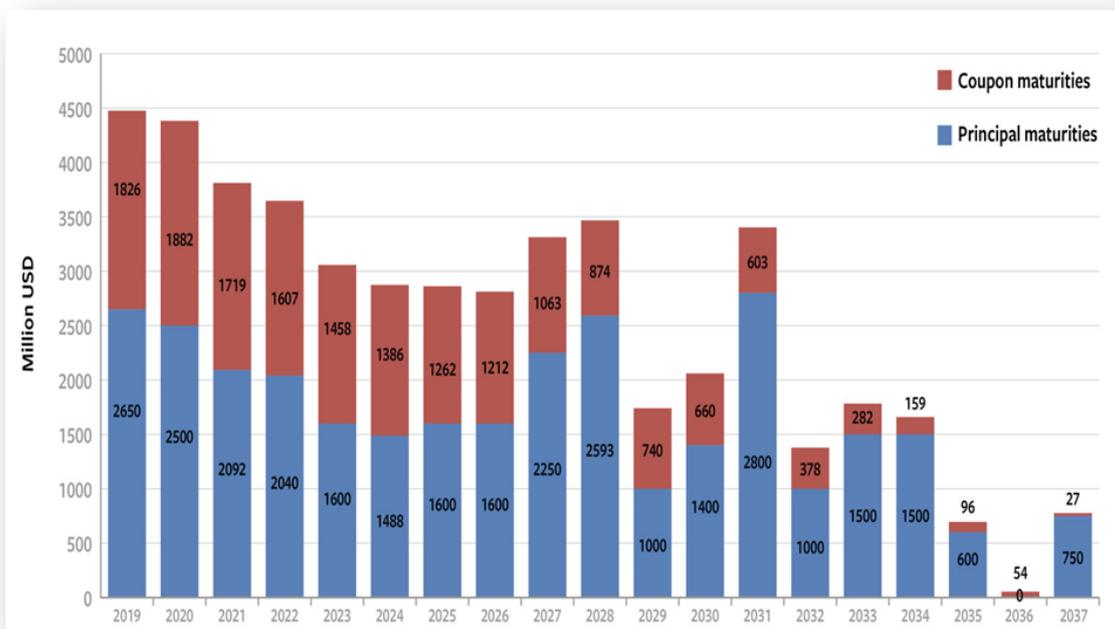


Figure 20 Eurobond Debts Lebanese Ministry of Finance/<https://www.fdd.org/analysis/2020/08/04/crisis-in-lebanon>

Lebanon paid off a Eurobond of \$1.5 billion that was due to mature on Nov 28, plus the coupon, making 2019 maturities paid as agreed. The repayment was regarded as an examination of the government's willingness to encounter its debt responsibilities at a time when Lebanon is struggling with an acute economic crisis. The central bank has previously stated it stands ready to repay the state's maturing dollar-denominated debt to keep the financial credibility of the country. Ahead of the repayment, the bonds were trading near to par, reflecting the market expectations that the administration would meet its responsibilities. On the other hand, many of Lebanon's longer-dated international issues are trading at less than half their face value as investors concern about the danger of distress ahead. The repayment will stack more pressure on the strained reserve, which was insufficient to cover Lebanon's gross financing requirements over the next year. The central bank revealed currently that it had total assets of 38 billion US dollars and usable foreign cash reserves of 30 billion US dollars. The payment of Eurobonds is a drain on FX reserves to the extent that they are held by non-residents, so in this case, the country is looking at around half of the 1.5 billion US dollar redemption. Going more out on the Lebanese bend, foreign holdings drop off significantly, which means external bond repayments would turn less of a burden on reserves. The Lebanese state issued two new bonds on Nov 27,

according to Refinitiv data. These were 1.5 billion US dollars with a maturity of 10 years and a 1.5 billion US dollars of maturity of 16 years. The new issues were a financing mechanism to aid account for the payment of the maturing bond by the central bank.

The cost of insuring Lebanese sovereign debt against the risk of default has more than doubled since the start of civil unrest on Oct 17. On Thursday, Lebanon's 5-year credit default swaps (CDS) stood at 2,602 basis points, IHS Markit data showed. Defaulting on the \$1.5 billion repayments would have been a mistake and set Lebanon on a "hard-landing scenario," said Nasser Saidi, an economist and a former central bank vice-governor. It is crucial at this delicate juncture to rebuild confidence in the banking sector and avoid actions or policy measures that would increase financial vulnerability," he said. Credit default swaps implied a probability of Lebanon defaulting on its debt of 58% within the next year and 78% within the next five years, IHS Markit calculated. On Sunday, Jan 12, Lebanon's central bank has proposed that Lebanese holders of a \$1.2 billion Eurobond due to mature in March swap their holdings for longer-dated notes, senior financial and government sources. Slumps in its global sovereign bonds and soaring credit default trades have proposed Lebanon might be floating towards a default. Such a move, which would require the agreement of the cabinet and law, would provide "breathing space" for Lebanon, but such a swap would need to be "in agreement with the holders of the bonds that mature in March. Last, the year the central bank paid off 2.6 billion US dollars of Eurobonds that were matured. The country has been without a productive government or an economic rescue plan since the resignation of the government of Saad El-Harri in October. The Swap is just a proposition" to the banks, and it was up to the government as to how it would manage Eurobonds due this year, which amount to \$2.5 billion in principal, including the \$1.2 billion due in March

5.6. Lebanon weighs Eurobond debt defaulted on its debt payments

Lebanon's finance minister said Thursday, February 13, 2020, the country's new government is weighing whether to pay or default on its \$1.2 billion Eurobond debt, which matures next month, amid an economic crisis that has sparked months of unrest. Since Lebanon is grappling with its worst financial situation, including a deepening liquidity crunch and a soaring public debt. Lebanese banks raised interest rates in a bid to attract foreign

investments, but now the influx of foreign currencies has dried up, and the central bank's foreign currency reserves are shrinking. Also, on Thursday, February 13, 2020, Lebanon's central bank decreased interest rates on bank deposits of dollars and Lebanese pounds. It set limits of 2% and 4%, correspondingly, on one-month dollar deposits and dollar deposits of one year and above. The bank covered Lebanese pound deposits at between 5.5 percent and 7.5 percent. The central bank decreased the interest rates that were 8 percent and 12 on the dollar previously in the country for the second time in two months trying to solve the liquidity problem. The prime minister Diab appealed to the international community and political opponents to give his government a chance. On Wednesday, Feb 12, the International Monetary Fund said Lebanese authorities had demanded its technical advice on macroeconomic issues facing the country. Any choices on debt are the authorities to be made in discussion with their personal financial and legal experts.

The government said it was consulting specialists to make appropriate decisions before the end of February. The most important question was what to do about a 1.2 billion US dollar Eurobond that matures on March 9 to pay or default. The country has never defaulted on its debt payments before, and defaulting could be costly to the banking system and to the economy; until the recent financial crisis, the banking system was considered the country's profitable and reputable sectors. The government is likely to explore reformation options, but it would need an economic plan supported by the IMF and a domestic consensus. Lebanon's fractious politics, growing popular dissention, and the deepening financial crisis are likely to make it difficult for the current government to make difficult decisions. Under the pressure of public opinion was building against repayment as many argue the priority should be to use shrinking foreign currency to pay for imports of basic needs. Especially because Banks have already imposed informal capital controls on depositors, limiting their withdrawals of foreign and local currencies and transfers abroad.

In fact, Lebanon is waiting to see if foreign bondholders will agree to negotiate new terms on more than \$30 billion of debt as the government attempts to contain the country's worst financial meltdown amid tightening liquidity. The government was seeking to cut its debt load from 170 percent of gross domestic product by defaulting on bonds and putting new parameters with creditors. Local banks, the main holders of Eurobonds, have agreed to start

talks on restructuring and hired Houlihan Lokey Inc. as advisers. Now the Lebanese government is hoping foreign investors will also join the negotiating table and contribute to the voting majority needed to change terms on bonds to avoid a messy default and the lengthy court battles that could keep Lebanon away from international credit markets for years. Lebanon's announcement puts the country on course for the first default in its history as it copes with dwindling foreign-currency reserves and inflation running in double digits. Bonds added to recent declines on Monday 6 th of march, pricing in losses of about 80% of par value on most maturities. Fitch Ratings lowered Lebanon's credit score to C from CC, reflecting an imminent default. The government excuse is that it will prioritize using the 22 billion US dollars in available foreign-currency reserves to pay for the import of essential goods, as opposed to paying back a 1.2 billion US dollar bond that fell due. In its reform program, the government will pursue more than halve debt to between 60% and 80% of output.

5.7.Default and consequences on the banking system

Bonds due on March 9, 2020, of 1.2 billion US dollar principal, April 14, 2020 (\$700 million principal), April 16, 2020 (the \$1.4 billion-principal special treasury bond), and June 19, 2020 (\$600 million principal) are all now in default due to non-payment. Total unpaid bonds to date are \$3.9 billion, while total defaults on all bonds are 45.2 billion US dollar that is subjected to negotiations. As an issue of law and contract, all 45.2 billion US dollars are considered in default for the cross-default clauses in those bond issues and the stated intention of the government. The Lebanese government declared on March 23, 2020, that it is intended to withhold payments on all foreign currency-denominated bonds. Practically, this puts in default all 45.2 billion US dollars of principal and interest due.

The Lebanese state is looking to cut its debt load from 170 percent of gross domestic product by defaulting on bonds and setting new parameters with creditors. Local banks, the largest holders, between \$16 billion to \$23 billion are held by Lebanese banks of Eurobonds, have agreed to start talks on restructuring, and hired Houlihan Lokey Inc. as advisers. However, restructuring Lebanon's Eurobond debt will be highly problematic since it is not a case in which bondholders might be asked to take a 10 to 15 percent haircut (in the form of extended maturities and lower interest rates as part of a restructuring plan. Despite the

problematic fact, the Lebanese state is hoping foreign investors will also join, as the local banks intended to do, the negotiating table, and contribute to the voting majority needed to change terms on bonds. This presents bondholders with an opening position of total default, something unprecedented in the history of sovereign Eurobond issuance. Of course, a debt restructuring could extend the maturities of \$6.6 billion in bonds maturing in 2020, 2021, and 2022 for ten years. That would aid in avoiding a messy default and the long-lasting court clashes that kept Argentina away from international credit markets for years. “They have two options: negotiate as we have said in good faith and as fairly as possible or take the legal route. It’s up to them.”

Lebanon’s declaration sets the country on course for the first default in its history as it copes with dwindling foreign-currency reserves and inflation running in double digits. Bonds added to recent declines on Monday, pricing in losses of about 80% of face value on most maturities. A default on the debt will have far-reaching and long-lasting effects on Lebanon, and with no decision in sight on how authorities will handle the debt liability, many have asked the question as to what will happen next. Credit rating agencies indicated that there would be an additional downgrade of the country due to the default of Eurobonds.

The downgrade and Negative Outlook indicate the very high risk that the Lebanese government will undertake some form of debt restructuring in the near term given the loss of access to capital markets, the ongoing crisis in the domestic banking sector, a weakening international reserve position, and heightened political risk,” In fact, Capital Intelligence Ratings wrote in a note on Friday in which it downgraded the country itch Ratings cut Lebanon’s credit score to C from CC, reflecting an imminent default. However, the government said it would prioritize using the \$22 billion in available foreign-currency reserves to pay for the import of essential goods, as opposed to paying back a \$1.2 billion bond that fell due on Monday, March 9, 2020. In its reform program, the government will seek to more than halve debt to between 60% and 80% of output.

The risk of another downgrade would further affect Lebanon’s ability to ask for money in the future as lenders would request higher interest rates for loans to the state that just defaulted. This dynamic is similar to an individual’s credit score affecting how likely it is for a

bank to fund them a loan and for a country, it is a situation that could take decades to recover.

Local banks are one of the biggest holders of Lebanon's government debt is. The banks have pursued to offload the bonds to opportunistic foreign investors as they are the largest share-holder of the Eurobonds that the Lebanese government might default on the Eurobond. Local lenders traded about 500 million US dollars of the notes from March Eurobond to developing markets, a transfer now under legal evaluation. Treasury bills also make up a significant share of the overall assets of the banks, meaning that in the event of a default, the value of these assets would decline. For clients, this may mean an inability to withdraw their money from the financial system or further borrow from institutions with nothing left to the lender. These difficulties keep going to stem from the years-long scheme that the local banking sector and authorities are involved in to preserve the monetary system that is directed to the country's economic crisis.

Some government officers have acknowledged that the prevailing condition must change. During the statement that Lebanon would not pay the Eurobond, Prime Minister Diab distinguished the country's banking sector is bloated to four times the size it should be and in need of a total overhaul.

Officials are currently searching for the opportunities of a debt restructuring process for the Eurobond. It had been hinted at by authorities that a swap might be the restructuring solution. In this process, the \$1.2 billion Eurobond notes would be swapped for new bond notes that would mature later with a higher interest rate. In this event, the total amount that Lebanon owes would only increase - a painful proposition for a country that is one of the world's most indebted, with its loans totaling around 170 percent of GDP

5.8. Depreciation of the currency and consequences

Since 1997 the Lebanese currency has been pegged to the U.S. dollar at a rate of 1,507.5 LBP per USD s. The peg became unmaintainable, as pegged exchange rates invariably do when the central bank created more money than was consistent with conserving equality between the purchasing power of the Lebanese pound and that of the US dollar at the

pegged rate. Instead of shrinking when necessary to stop an outflow of dollar reserves, the Banque du Liban, after 2016, began desperately to borrow from Lebanon's commercial banks (at high-interest rates) the dollars it needed to maintain the semblance of a peg. The commercial banks attracted dollars, bypassing those high rates on to depositors who presumably hoped to cash out before a devaluation came. This scheme was called the financial engineering by the central bank which leads to an estimated loss of 40 billion dollars in losses

In August 2019, due to different financial hardships, especially the growing probability that the Lebanese government will default on maturing debt obligations, the black-market exchange rate started diverging from the official exchange rate. In the fall of 2019, the black-market exchange rate reached 1,600 LBP per USD. As the protest against the government started and after the opening of the banks, the bank clients were surprised by the ill legal capital control opposed by the banks on the clients on the dollar account, which represents 70 percent of the total accounts in Lebanon as well as on the accounts which are in Lebanese Pound this led to an increase in the demand of the U.S dollar from the black market. The increase in the demand is explained by the fact of the high imports in various sectors like energy, constructions, health care, food and etc.

Due to the continuous increase of the dollar, which has reached 4000 Lebanese pound or LBP per one dollar, the Lebanese banks have set an exchange rate of 3,000 pounds per dollar for withdrawals from U.S. dollar accounts and started not to allow their clients to withdraw in U.S dollars, around 50% weaker than the currency's official pegged value which is 1515 pound per dollar. The Lebanese economy depends crucially on the capital inflow sent by the remittance, but the central bank decided to pay off the money sent through Western Union and other transfer money companies in the local currency with an exchange rate of 3200 Lebanese pounds per one U.S dollar in order to keep subsidizing the essential commodities for the Lebanese population as the central bank claims. Indeed, the central bank is using the dollar to subsidize and to cover the shortage of the U.S dollar in the central bank.

Lebanon's pound currency fell to new lows on Tuesday 23 June, trading above 6,000 to the dollar on a parallel market, according to market participants, as a severe dollar crunch

further eroded its value this month that the central bank would begin using limited dollar reserves to support the pound after a sharp fall sparked fresh public protests.

As the value of the local currency continued to lose its value against the dollar, on 23 June, the Lebanese bank's Lebanese banks raised the exchange to 3850 Lebanese pounds or LBP per dollar for withdrawals from the U.S dollar accounts as a liquidity crunch erodes the currency value. With the dollar growing ever scarcer, the Lebanese pound has plunged since the last year 2019 by nearly 80 percent from an official peg 1507, now available only for vital imports. At the new withdrawal rate, depositors would still 50 percent of the value of their savings relative to the informal market where the dollar was traded at 8000 Lebanese pounds.

According to a central bank circular, depositors with dollar accounts in Lebanon will be paid cash in the local currency at a "market rate" within each bank's withdrawal limits. The pound had lost about 75% of its value since October when Lebanon was plunged into a crisis that has led to job losses, price hikes, and capital controls that have severed Lebanese from their hard currency savings. With few sources of fresh dollar inflows, the central bank has looked to stabilize the dollar rate at exchange houses by setting a unified rate with them each day, with legal penalties for dealers that operate above it.

As the Financial crisis in Lebanon accelerates, the current situation is worsening power outages but more largely to Lebanon's continuous economic collapse. This breakdown is due to the disorder of the nation's monetary and banking system. Since October 2019, the Lebanese pound lost more than 80 percent of its value on the black market, with USD1 lately exchanging around LBP8200. Although the Banque du Liban (the Lebanese central bank) continues to declare an official exchange rate of LBP1507.5 per USD, the dollar is exchanged in the black market due to the high demand as long as the banks have frozen the dollar accounts and implemented unofficial capital control. This led to a decrease in the purchasing power of the households by almost 80 percent. Since Lebanon is a country that exports seven times more than imports, the dollar crisis leads to the closure of small and big businesses. So unemployment increased and annual inflation rate soared to 112.39 percent in July of 2020 in details the annual inflation for food & non-alcoholic beverages increased to 336% ,transport 93.4% ,health 14.7% clothing & footwear 408.9% communication 98.6%

furnishing & household equipment 516.6% recreation & culture 142.8% restaurant & hotels 472.9% and miscellaneous goods & services 234%.

5.9.The risk of lifting subsidies

Bank of Lebanon Governor Riad Salameh confirmed in an interview with Arab News, quoted by Reuters a week ago, quoted sources in the bank, saying that the latter will not continue to provide support on wheat, fuel, and medicines. With no doubts that this reality will take a disastrous shadow on the shoulders of the citizens, as the disaster may start with a bread tie and does not end with the most trivial commodity because of the high price of fuel (gasoline, gasoline, gas): the nerve of everything in life, in trade and in industry.

The support provided by the Central Bank of Lebanon under Circular 530 since September 30, 2019, is to secure the dollar at the official price (1507 Lebanese LBPs). Hence, stopping it means that importers and traders will be obliged to secure their "black market" import bill as long as banks refrain from providing them with dollars. All commodities will depend on the dollar price in this market of about 7,500 LP, which also means that every 1500 pounds of the price of each commodity will automatically turn to 7,500 pounds... This is if the exchange rate stops there.

The Central Bank of Lebanon has already revealed months ago its ability to provide support for the drug for about two more years; what has changed today? Maybe it's political pressure or another undisclosed central bank affair.

The Central Bank of Lebanon had already revealed months ago its ability to provide support for the drug for about two more years, but some unknown reasons have changed the situation currently. Perhaps it is political pressure or another undisclosed central bank affair. It may be a warning that Governor Riad Salameh is trying to launch today, but it will certainly be impossible to stop support in this way." "The annual cost of subsidizing medicine is \$1 billion, so the solution is to take gradual steps such as halving it by dispensing some medicines for the benefit of others, but there are drugs that are impossible to stop importing, especially those for chronic and incurable diseases. Otherwise, we are about to destroy the country or to commit suicide, where people will kill each other in the streets."

For instance, a pharmacist who owns a pharmacy in my city, Tyre (Sour), confirmed in a call with "me "that "customers have not yet believed, and they are still acting as usual" he was asked if the demand for medicines increased because of this news: "Most medicines are cut off in the first place, and therefore there is no possibility to notice the difference. We order 5, 10, or 20 cans of femail(medicine), and they send us one can. Where can we perceive the change in demand?"

The lifting of subsidies may be cruel and unjust, but inevitable as long as it is constrained by the size of the Central Bank of Lebanon's modest reserves. The Bank of Lebanon, which has given support since the beginning of the revolution, has given the political power an opportunity to carry out its duties, but has failed to restore the national economy to the path of salvation, but has also failed in its most modest duties, namely to stop the smuggling of these reserves, but "there is no life for those who call for it."

Lifting the subsidies on medicines is very dangerous and threatens the existence of the companies themselves. The lifting of subsidies will force some of the companies to stop work, dismiss employees and withdraw from the Lebanese market because the task of obtaining dollars per month from the black market as much as they import medicine will be impossible."

The disaster will affect patients with chronic and incurable medicines, given their high price. In this case, the agent will be unable to secure it, so many patients will "die from the loss of medicine from the market." In addition to that some drugs can be adopted alternatives (Henrik) in order to shorten the list of subsidized drugs and reduce them, "but this will be a double-edged weapon, because support if one drug instead of 3 or 4 similar drugs is extended, will create a lot of pressure on its import as patients in need turn to one category of them... So the result will be one. Regarding the pharmaceutical sector, lifting the support could be a disaster that will affect the Lebanese population, especially the poor and middle class.

The owner of a mill in the Saida area revealed that "the cost of a ton of wheat imported from Ukraine intended for bread is about 230 dollars, of which the mills pay 15% of the market price or about 550 thousand Lebanese pounds, and if the subsidy is lifted, the price

per ton is going to increase to 1,725,000 LBP and enhances that such a decision will push wheat importers to increase investments in the mills. Merchants will have to increase capital in order to import the same amounts, and this is hard due to the current economic situations.

The subsidy removal may be harsh and not fair, but it is unavoidable as long as it is constrained by the volume of the central bank reserves. The central bank, which, through support, almost since the beginning of the revolution, has given the political authority a chance to satisfy its obligations, but it has not achieved to restore the national economy to the track of recovery. It has also not succeeded in its most humble obligation, which is to stop the depleted smuggling of these reserves, but “there is no life for those you call.” This reality created the logical argument or “legal excuse” that would enable the Central Bank to stop subsidies with a clear conscience ... Until that time, the authority and the covenant should bear their responsibilities and face the people’s anger and anger.

5.10. Beirut Port blast and its economic consequence

On the 4th of August, a blast at the port of Beirut happened, destroying the port and partially the area of a diameter of 15 km. The port was responsible for covering 80 percent of Lebanon’s maritime shipping traffic. It is considered to be the country’s main entry point for goods imported through the sea. Lebanon is currently on the edge of collapse, and this blast showed immediate negative consequences on both social and economic aspects, which is accelerating the collapse of the system.

- The cost of rebuilding the port is estimated between 8 to 15 US billion dollars,
- Spiraling food inflation rates combined with strong currency depreciation are the main risk factors of the households purchasing power
- The shelters of around 300 thousand inhabitants have been damaged partially
- the Lebanese economy and supply chains are seen to worsen an already deteriorating socio-economic situation, which is likely to result in a further increase in the number of the poor and extreme poor

6. Current economic indicator

6.1. GDP annual growth rate

In Lebanon, the GDP Annual Growth Rate is averaged 3.36 percent from 1971 until 2019, attaining 83.28 percent in the final quarter of 1977, the highest ever and the lowest of -56.99 percent in the final quarter of 1976. In the second quarter of 2019, the GDP in Lebanon contracted 5 percent over a similar quarter of the past year. According to analysts, Lebanon's GDP Annual Growth Rate is expected to be at -10 percent by the end of this quarter.

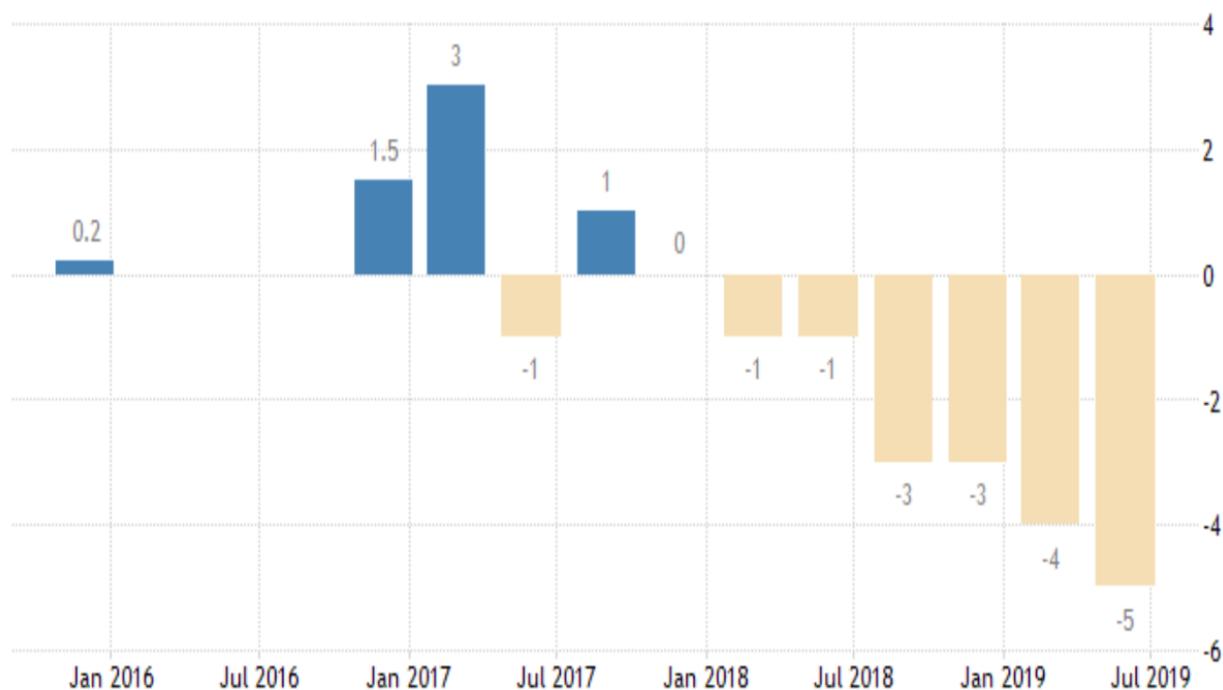


Figure 21 GPD ANNUAL GROWTH RATE-LEBANON-<https://tradingeconomics.com/lebanon/gdp-growth-annual>

6.2. GDP Per CAPITA

The GDP per capita in Lebanon averaged 5782.07 USD from 1988 until 2019, reaching an all-time high of 7761.60 USD in 2010 and a record low of 2442.70 USD in 1989. Lebanon's GDP per capita was last updated in September of 2020. GDP per Capita of value 5858 USD.



Figure 22 GDP per CAPITA-<https://tradingeconomics.com/lebanon/government-gdp-per-capita>

6.3. Lebanon Government Debt to GDP

The Lebanese government recorded a government debt that is equivalent to 151 percent of the GDP of the country in 2018. From 2000-2018 the Government Debt to GDP averaged 152.96 percent, recording in 2006 an all-time high of 183 percent and a record low of 131 percent in 2012. It is predictable that the debt to GDP ratio will increase since Lebanon needs to borrow capital to solve the current financial crisis and to do reforms in the essential sectors

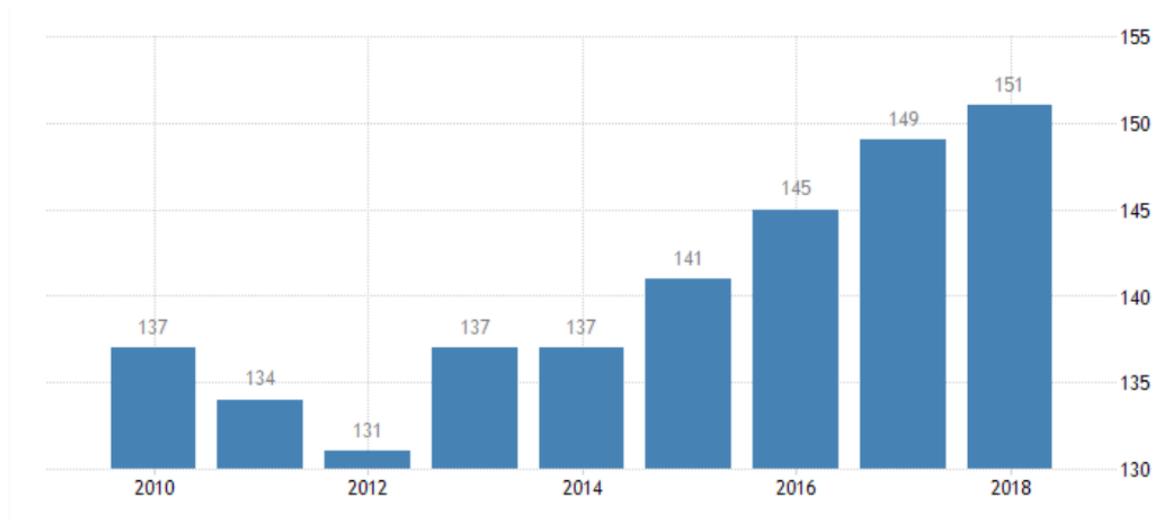


Figure 23 Debt to GDP-<https://tradingeconomics.com/lebanon/government-debt-to-gdp>

6.4. Interest Rate

The Interest rate in Lebanon has recorded an average value of 6.47 percent from 2011-2020. In October 2019, the interest rate reached the highest value of 10.29 and recorded the lowest interest rate value in June 2020 of a value of 4.53 percent during the last decade. It is expected that the interest rate at the end of this quarter would be 4.5 percent.

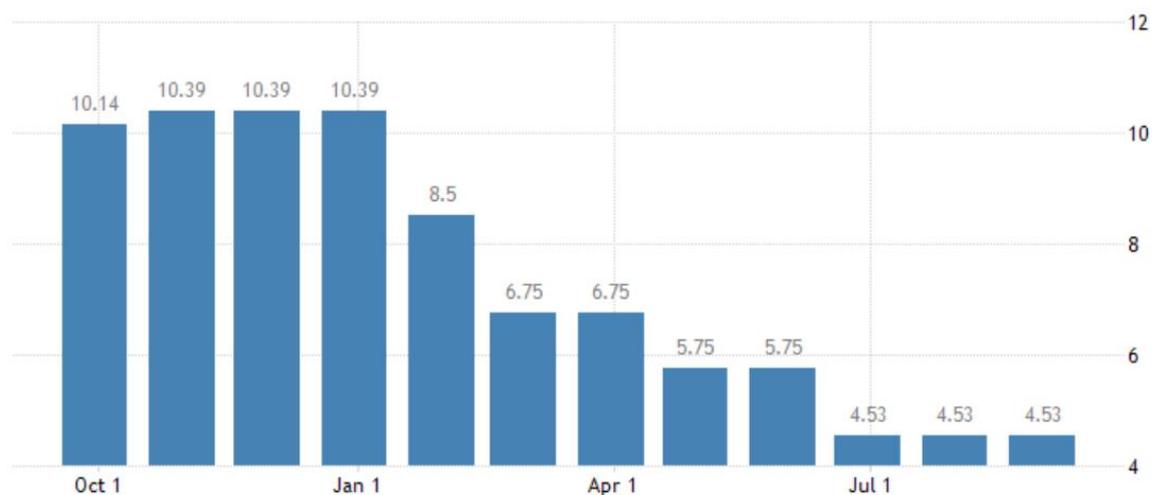


Figure 24 Interest Rate lebanon-<https://tradingeconomics.com>

6.1. Inflation Rate

Lebanon's annual inflation rate flowed to 120.0 % in August of 2020 from 112.39 % in the previous month, due to the rising economic and financial crisis and the ongoing devaluation in the Lebanese pound amid political crisis. It was the highest inflation since the aftermath of the country's civil war. Prices increased quicker for housing and utilities 12.2% and 11.6% in July respectively; non-alcoholic beverages and food 336% vs. 367.2%; transport 105% while clothing and footwear 413.4% vs. 408.9% respectively. With respect t to furnishing & household equipment, prices increased 663.9% vs. 516.6% accordingly. Also, recreation and culture have recorded increases that 154.3% vs. 142.8%, respectively. In addition, the tourism sector represented by restaurants and hotels their prices increased by 506.5% for restaurants and 472.9% for hotels while miscellaneous goods and services their prices increased respectively 253.5% and 234%. Consistently, consumer prices rose 3.16 percent, the smallest since February, after increasing 11.4 percent in the previous month.

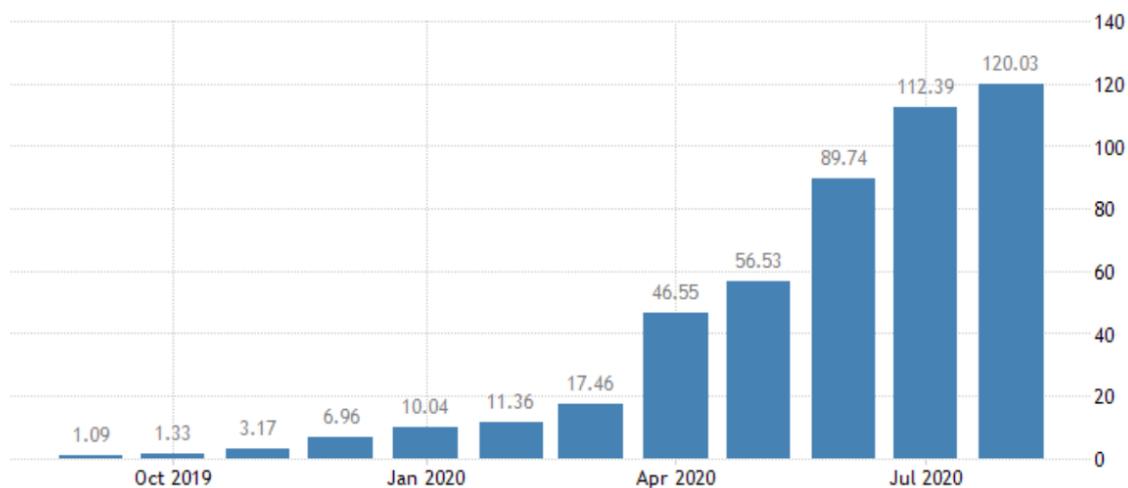


Figure 25 Inflation Rate Lebanon-<https://tradingeconomics.com/lebanon/inflation-cpi>

6.2. Unemployment Rate

The unemployment rate in Lebanon is around 6,23 percent, but the unemployment rate in Lebanon is predictable to reach 6.90 percent by the end of 2020, according to the global trading economist, and this can be explained due to the current situation the country is passing through.

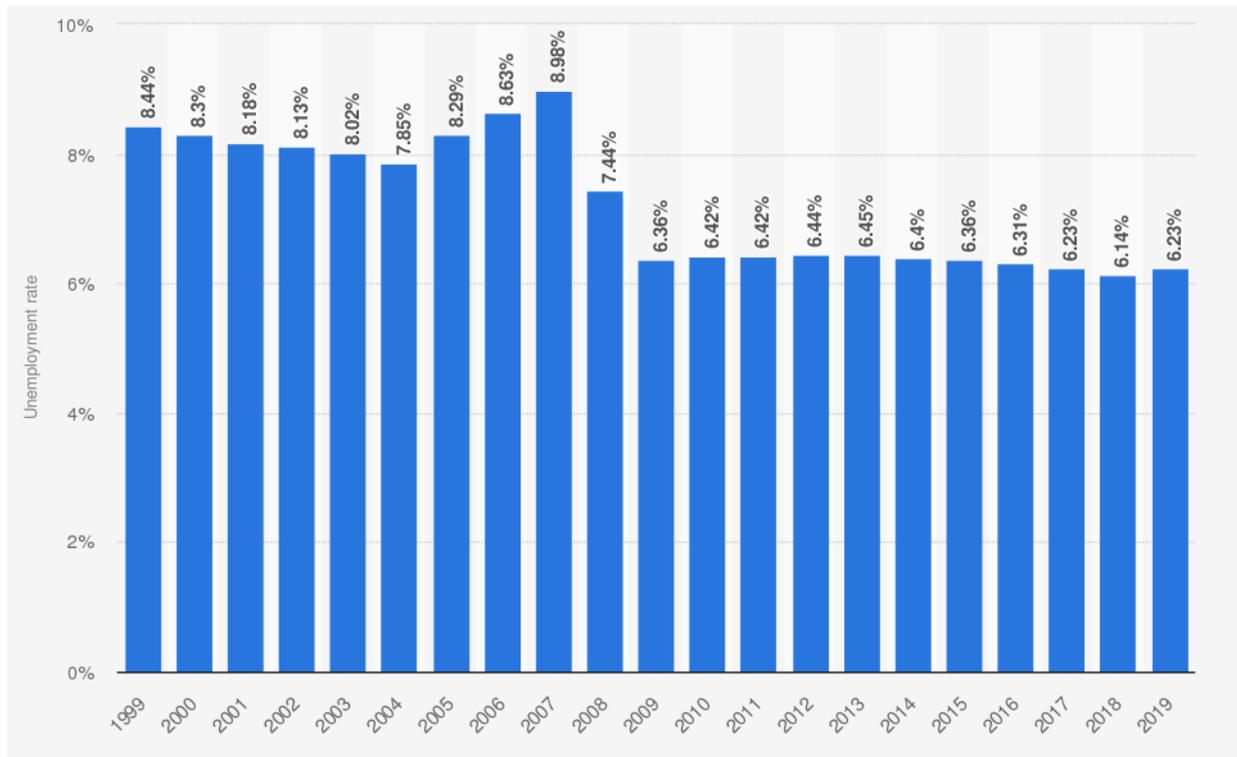


Figure 26 Unemployment Rate-<https://www.statista.com>

6.3. Food inflation

Food Inflation in Lebanon, as shown in the figure below, shows that the food inflation in October 2019 was 1.18 started to increase until it reached the peak value, which is the current inflation food rate of 367. This large increase is explained by the shortage of the US dollar in the market and disability of suppliers to use their dollars deposited in the bank for import purposes.

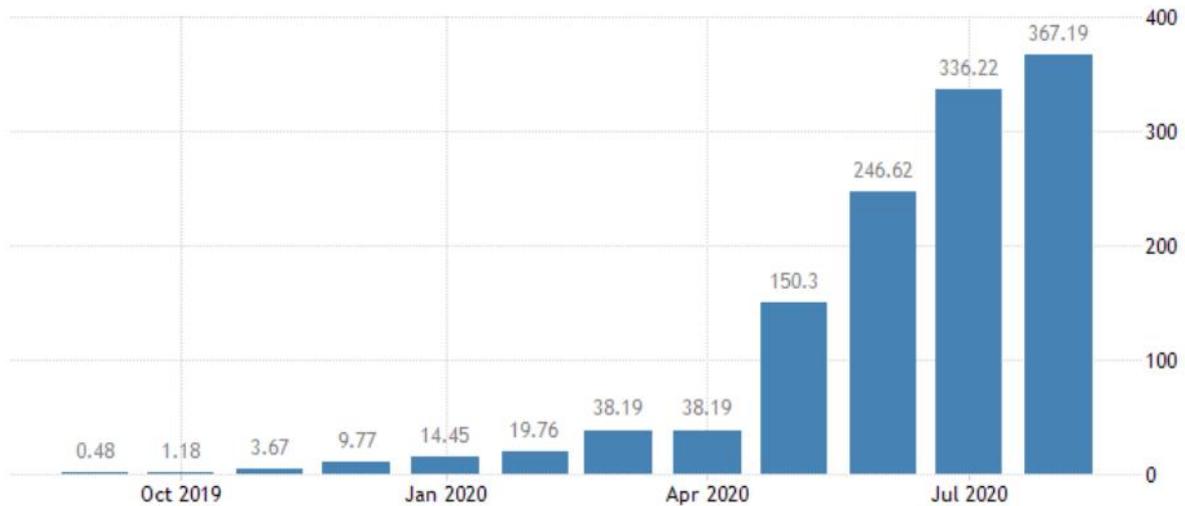


Figure 27 Food Inflation-<https://tradingeconomics.com/lebanon/food-inflation>

6.4. Lebanon Remittances

Due to the difficult situation that Lebanon has endured, the Lebanese population migrated seeking to have a better future. Thus, a lot of families depend in Lebanon on the money transferred from their relatives. Remittances in Lebanon increased from 756.2 USD million in April 2019 to 836.80 USD Million in October 2019.



Figure 28 Lebanon Remittances-<https://tradingeconomics.com/lebanon/remittances>

6.5. Lebanon Electricity Production

Lebanon has not the ability to source 24-hour electricity since its 1975-1990 civil war, leaving many households dependent on their own generators or private neighborhood providers who charge expensive fees to have electrical power during regular daily electrical cuts that can last for 12 hours. The government's net transfers to state power firm Electricite du Liban (EdL) sum to 1 billion-1.5 billion US dollars yearly, most of it spent on fuel oil, which is equal to about a quarter of last year's budget deficit of \$4.8 billion. The accumulated cost of subsidizing EDL amounts to about 40 percent of Lebanon's entire debt. The following chart shows the Electricity Production in Lebanon at an averaged 876.45 Gigawatt-hour from 1993 until 2020, reaching an all-time high of 1528 Gigawatt-hour in July of 2017 and a record low of 277 Gigawatt-hour in September of 1994.

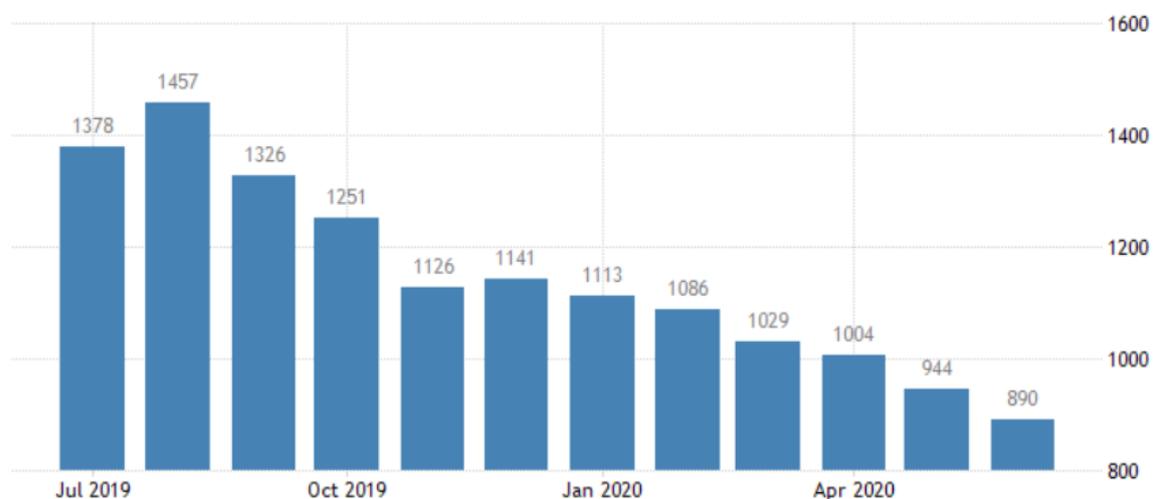


Figure 29 Lebanon Electricity Production-<https://tradingeconomics.com/lebanon/electricity-production>

7. Conclusion and recommendations

Lebanon passed through many difficult situations after independence that turned Lebanon from Switzerland of the middle east to a nation that is currently on the brink of collapsing. The present economic crisis is, at its core, a governance crisis originating from a dysfunctional sectarian system that hindered rational policymaking and permitted a culture of corruption and waste. Decades of following this model left the economy with high debt

and a bloated banking sector. The purchasing power of the Lebanese household has decreased by 80 percent due to a constant increase in the exchange rate of the dollar to the Lebanese pound, which reached 8000 LBP per dollar and illegal capital control of the banks on the depositors on withdrawals. The current shortage in dollar supply in the market has worsened the energy production crisis and inflation rate, especially the food inflation rate. This prevail situation leaves the country with three simultaneous crises.

1. The first crisis is the balance of payments and currency crises. For 2020 the estimated gap between USD supply and USD demand is at \$8 billion. This gap is not filled, the economy experienced difficulties, including servicing of external debt, imported goods' shortages, currency devaluation, and economic contraction.

2. The second one is that of public finance. Starting with 10 percent of GDP deficit in 2019, government revenues are now collapsing under the weight of the recession and the banking crisis. An estimate of a \$3 billion primary budget deficit (excluding interest payments) for 2020.

3. The third crisis is that of the banking system. With nearly 50 percent of banks' assets invested in Lebanese sovereign risk, including with the central bank and another quarter representing risky private sector claims, banks are effectively insolvent and illiquid. Despite the loose and inefficient capital and banking controls recently put in place, the sector is experiencing a deposit run. In similar international experiences, the central bank usually steps in and provides the liquidity that banks need. However, the BdL is constrained by its limited USD reserves and by fears that an oversupply of LBP would lead to further currency weakening

Lebanon needs to take immediate action; otherwise, the country will experience further the economic crisis. The country needs to stay neutral in the regional conflict and to rebuild and strengthen its relations with the Arabic world who play a crucial role in the strengthening economy of Lebanon. The Lebanese authority needs to rebuild the external and internal confidence state by imposing reforms on the political and economic system. The current system is based on sects that must be changed to a civil state. In addition to that, the

stability with the region is essential in the current situation to solve the current disputes as to the maritime border that could put Lebanon on the map of gas-producing countries.

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