AMERICAN UNIVERSITY OF BEIRUT

THE LEBANESE OFFICIAL BUDGETS TOWARD STATE BANKRUPTCY: A COMPARATIVE APPROACH TO 2019, 2020, AND 2021 BUDGETS

by
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ABSTRACT
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The root causes of the Lebanese economic crisis extend beyond a mere financial issue. It is political and sociological, as the formation of sectarian divisions has been deeply marred within the various socio-political systems of the country. Each power is exercised through a particular religious faction, which has enabled the political elites to exploit state apparatuses in their favor, serving their sectarian followers to the detriment of the government and the general populace. Political leaders divert public spending for infrastructure and social services toward intense clientelism. Instead of spending on social welfare programs for citizens, leaders spend on buying loyalty by providing jobs, direct aid, and other benefits to their followers. Such adverse practices by political clients equally drain state apparatus resources, which in turn result in a budget deficit and the imposition of exorbitant taxes on the general population to fund them. This led to regressive tax policies, which, combined with existing wage stagnation, had devastating impacts on lower- to mid-wage earners. At the same time, political elites and their cronies financially enjoyed expensive privileges, resulting in unchecked, skyrocketing economic disparity, which aspect shaved the state's authority.

The Relationship Between the Lebanese Government and the Central Bank: Lebanon and its government had a pre-established relationship with the Central Bank, which held a somewhat autonomous position, playing a pivotal role in the political battlefield between the parties. The Central Bank had different policies for currency issuance and external debt servicing, which were not regulated by law and were thus politically charged.

Before the Collapse - The Lebanese government, along with the central bank, was already in a cycle of accumulating debt, which continued to compound and ultimately led to an economic collapse. Due to administrative inefficiency and corruption, the government was operating with frequent budget deficits, which led it to depend on the central bank to finance its expenditures. The Banque du Liban (BDL) employed engineering monetary policy strategies by engaging in high-interest financial instruments, aiming to attract foreign deposits and maintain the Lebanese lira's peg to the US dollar. Although these policies were able to provide some short-term stabilization to the economy, they created a financial bubble that relied on capital inflows. To sustain their clientelist networks, political parties were able to stabilize the economy and subsidize public sector employment. Even then, this tactic was unfeasible due to a growing dependency on foreign reserves that were not being provided by productive economic activity.

During the Collapse - When the financial crisis struck in 2019, the government was unable to effectively manage the situation and address the structural flaws in the

economy. The central bank's policies of subsidizing essential goods, such as fuel, medicine, and food, have cost the state over $15 billion. This unsustainable spending drained foreign currency reserves, yet the government did not intervene to adjust policies or introduce reforms. Instead, political leaders allowed the economic deterioration to continue, likely because taking corrective action would have exposed their roles in the financial mismanagement. The government's inaction also allowed well-connected elites and businesses to profit from the subsidies, buying subsidized goods in bulk and selling them on the black market at higher prices. This phase of the crisis revealed the complicity of both the government and the central bank in prolonging an unsustainable system at the expense of ordinary citizens.

Post-Collapse (2022-Present) - As Lebanon's financial situation deteriorated, the general public's outrage did not affect the relationship between the government and the banking sector. To such an extent that even when the government declared a state of bankruptcy, the banking sector was not held accountable. At this point, the Association of Banks in Lebanon (Jamiyat al Masaref), a powerful and influential organization representing the interests of banks in Lebanon, had strong relationships with the political dictatorship, ensuring that depositors bore the brunt of the losses rather than the banks themselves. During this period, banks imposed capital controls, which prevented citizens and bank depositors from withdrawing their savings, but not those with influence and power, who could freely move their assets abroad. During this period, no profound changes were made in the banking activity or legal responsibility for embezzlement. The government chose to do nothing by allowing the situation to fade into the background over time, effectively using it as a means to normalize the crisis.

The Elimination of the Lebanese Lira: One of the most significant yet underdiscussed outcomes of the economic collapse is the virtual de facto elimination of the Lebanese pound (LBP) as the country's official currency. In recent years, the LBP has lost nearly all its power and value as a means of trade. Today, actual trade in Lebanon is conducted almost entirely in U.S. dollars. This shift has eliminated the characteristics of Lebanon's official currency, converting the market into a dollar-based system without formal state acknowledgment. The absence of consideration on this matter suggests that political parties would likely prefer to avoid addressing the issue, as it would highlight their responsibilities toward the subject and necessitate restructuring the entire monetary system, as well as introducing reforms that could weaken their grip on economic power.

Conclusion: The Lebanese government's failure to take action in response to the economic crisis is, in itself, a deliberate strategy. By allowing time to pass without implementing reforms, the government is relying on the population's gradual adaptation to the new economic realities. As people become accustomed to financial hardship and the erosion of their purchasing power, their ability to mobilize against those responsible diminishes. The public's growing disinterest in both the government and the banking sector is a result of economic exhaustion, a lack of alternatives, and a fear of further instability. Ultimately, the ruling elites have managed to maintain their influence by ensuring that no structural reforms are implemented, instead relying on external factors, such as foreign aid or regional political shifts, to provide temporary relief. This approach has left Lebanon in a state of prolonged stagnation, where the population continues to

bear the consequences of a crisis engineered by the very leaders who claim to represent them.

This paper documents the chronological events that led to the collapse of the Lebanese economy, it explores how the political, sectarian, and economic dynamics affected Lebanon's fiscal revenues and decision-making related to Lebanon's public budgets by conducting a comprehensive and contextual analysis of political and sectarian influences, as well as other external influences that contributed to the economic collapse of the state, Exploring how the Lebanese government handled state spending and expenditures vis-a-vis the declining economic situation and how this was incorporated into the official budgets for 2019, 2020, and 2021.
What are the central policies that the government adopted or did not adopt to protect the Lebanese pound and the economy, and how do these policies impact the public budget? Do austerity policies do more harm than good, and is cutting public sector wages the best solution for plugging a budget deficit in an economy that has suffered years of low growth?

When analyzing the influence of political sects and parties, such as the Free Patriotic Movement, Amal Movement, and Future Movement, on financial decision-making in Lebanon from 2019 to 2021, it becomes clear that political leadership plays a significant role in Lebanon's economic crisis and decline. The governance model, which is heavily influenced by the concept of sectarianism, prioritizes the interests of sectarian leaders over the nation's public and economic needs. This manipulation of benefits in favor of the ruling class, rather than the people, is a stark illustration of the impact of political influence on financial decision-making.

Lebanon's economic collapse is not a singular event, but a complex and ongoing crisis that has been unfolding over several years. The correlation between political and sectarian leadership and financial decision-making underscores how political mismanagement, sectarianism, and corruption persist as root causes of the collapse of the Lebanese pound, soaring public debt, and widespread poverty. Moreover, external events such as the promises of petroleum revenue, Saad Hariri's resignation, the October 2019 revolution, and the CEDRE conference have only added to the complexity and severity of the crisis.

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INTRODUCTION

1.1. Background: Lebanon's Economic Crisis and Bankruptcy

In 2019, decades of political mismanagement, corruption, and sectarianism had begun unraveling the fate of Lebanon's economy. Its decline continued towards economic collapse due to Lebanon's financial system. There has been a significant accumulation of public debt due to the depreciation of the Lebanese pound (LBP) in value. By the end of that year, Lebanon had reached one of its highest debt-to-GDP ratios in the world, exceeding 150% of its GDP (International Monetary Fund [IMF], 2020). This is due to the collapse of the banking sector, the depreciation of the nation's currency, and the increase in inflation, which contributed to the economic collapse, the rise of unemployment and poverty, and the fall of public sector services.

One of the core root causes is the Lebanese government's failure to reform and design a sustainable economy. The political system is divided among sectarian leaders who aim to maintain their political influence and pursue their interests at the price of Lebanon's economic decline (Makdisi, 2020). Sectarianism and corruption are Lebanon's governance models, which also explain the limited ability of the Lebanese government to act. The prevailing budget mismanagement, uncontrolled public spending, and economic instability were poorly addressed. Over 2019, 2020, and 2021, Lebanon's economic decline went into a downward spiral determined by budget spending. In 2018, the CEDRE conference aimed to provide financial support if and only if the government promised to conduct a reform plan. This was never implemented, frustrating the bank sector and other Lebanese creditors (Leenders, 2020).

In 2019, as Saad Hariri's government failed to conduct reform, he resigned amid the October 2019 protests, which further complicated the country's economic stability. Hassan Diab's plan for reform was as inefficient as his predecessor's; after taking over Hariri's office and government, the economic decline had reached a point where the budget spending in 2020 had led to the failure of addressing the gap between the official exchange rate and the black-market rate for national currency LBP.

By 2021, Najib Mikati superseded Diab's office and tried to address core issues. However, his government could not procure the budget values spent nor address any core issues, which has led to maintaining the existing status of Lebanon and its governance model. The public had become confident in providing their unwavering disgust towards this sectarian-driven governance, which was exacerbated by Lebanon's fiscal failure and bankruptcy. It would be presumptuous to assume that due to a few years of political mismanagement, corruption, and sectarianism, the nation ended up experiencing imminent economic collapse. Rather than that, the decades of these practices violating public policies have led to the impending financial collapse, as a plan for reform and budget control was neglected.

1.2. What is a Budget?

Public budgets are considered government tools for policy and economic management planning. This budget estimates and calculates surplus, deficit, revenues, and expenditures, which allow the government to understand the upcoming fiscal year and the spending predictions so that it can take measures to monitor and plan for government income (Morris, Poole, Due, Kay, & Lindbeck, 1998). So, the public budgets can determine the revenue sources like taxes, tariffs, and borrowing needed

from the public sector services such as health, education, etc. (Wildavsky & Caiden, 2004). As a planning tool for the government, public budgets should be well-structured and transparent to stakeholders since they can include policies, programs, financial plans, and/or organizational restructuring. When targeting a year for fiscal plans and initiatives, it is vital for public budgets to be approved because they serve as a communication tool between the government and the public (Khan & Hildreth, 2002). We can expect a healthy public budget when a budget meets revenues or exceeds expenditures. However, achieving this is not ideal, as Lebanon has persistent financial deficits, corruption, and economic struggles (Nahas, 2020).

Moreover, public budgets are tools to shape economic policies and conduct reform, which provide an understanding of the expenditure needed to generate revenue for the government (Blanchard & Leigh, 2013; Auerbach, 2019). These can also help address national problems such as unemployment, debt, and currency devaluation, which public budgets can be used to plan for (El Chami, 2021). In Lebanon's case, in the budgets of 2019, 2020, and 2021, there is a strong correlation between political leadership and financial decision-making, explaining why Lebanon failed to approve its public budgets; this failure could not address the country's economic decline.

1.3. Principles and Objectives of Budgeting

Core budgeting principles navigate around financial management, allocation of funds and resources, promoting transparency and accountability, economic stability, and public trust. Public budgets offer a framework to manage public funds, allocate resources, and invest for both short- and long-term economic sustainability. Moreover, governments need to be responsible, accountable, and transparent about their financial

decision-making, which allows them to gain public trust (Schick, 1998). Transparency can be considered an effective way for Lebanon to counter corruption and economic mismanagement, which the country lacks to support public needs (Leenders, 2019). As such, four main principles for budgeting can be highlighted.

The first principle is about efficiency and effectiveness. This principle guides governments to maximize the efficiency and impact of their resource management. It aims to advise governments that they should try to seek the best outcomes from the minimum resources. These outcomes can be from high-return projects with minimum resources, aiming to maximize the benefits for the public (Musgrave & Musgrave, 1989). In Lebanon, this is not a model aimed to be adopted. Moreover, it can no longer be adopted due to fiscal challenges and the lack of implementation plans with the help of public budgets.

The second principle concerns sustainability. This principle can make budgeting sustainable by balancing revenues and expenditures, avoiding borrowing, prolonging long-term economic sustainability, and minimizing debts (Alesina & Perotti, 1996). However, this principle is underappreciated in Lebanon, which is economically unstable and has an unsustainable debt-to-GDP ratio, and no policies promote this principle (Nahas, 2020).

The third principle concerns equity. Budgeting must be fair regarding allocation and management across different sectors and all populations, so even marginalized groups should be considered, as they also deserve benefits such as social welfare (Bird & Zolt, 2005). However, when it comes to Lebanon, the country follows the tutelage of corruption, which influences the allocation and management of the budget based on sectarian interests, which violates the principle of equity (Dagher, 2021).

The fourth principle is flexibility. It guides governments with a mindset to always be nimble, even during economic crises and disasters. It allows an allocation of budget to solve a short-term problem requiring enormous financial spending while maintaining long-term fiscal health, making budgeting flexible and nimble (Wildavsky & Caiden, 2004). Lebanon could not mitigate the 2019 economic collapse. The budget needed to be flexible towards major financial shocks, and even with Diab's plan to reform the financial crisis in Lebanon, Lebanon's budget was not adaptable to fill the gap between the official exchange rate and the black-market rate for the national currency, LBP.

1.4. Austerity Policies: Impacts and Economic Implications

Most governments that become unable to pay their debts apply a set of political-economic policies and measures with the sole target of decreasing government budget deficits. These policies are known as austerity policies. Some of the main tools used in austerity policies to bring government revenues closer to expenditures are tax increases, spending cuts, or a combination of both.

In most economic cycles presented by macroeconomic models, any decrease in government spending will negatively affect the unemployment level, which means a direct increase in unemployment in the public and private sectors. In addition, increasing taxation as part of the austerity policies will automatically decrease household disposable income, lower consumption, and even decrease investments at the country and individual levels, reducing economic growth (Wesbury, 2010).

During the Great Depression of the 1930s, a controversial debate was taking place on the effectiveness of following austerity strategies. According to the anti-

austerity economist John Maynard Keynes (1937), "The boom, not the slump, is the right time for austerity at the Treasury." Consequently, many contemporary economists argue that budget deficits are most relevant when an economy is in recession to support GDP growth and decrease unemployment. In countries with low economic growth, applying austerity measures can exacerbate the situation and cause deflation, which will inflate existing debt, thus causing credit markets to freeze up and the country to face a liquidity trap. According to economist and scholar Paul Krugman, any decrease in government spending during an economic recession only worsens the crisis. Moreover, Krugman (2013) argues that if the private sector is not capable or unwilling to consume a certain amount or at a level that will increase both employment and GDP sufficiently, then the government becomes responsible for increasing government spending to offset the decline in private expenditure.

That said, we acknowledge that in the economic cycle, one individual's spending is another individual's income. This means that if everyone lowers their spending, we are most likely to result in a fall in GDP and worsen the recession period, which is called, in economic terms, the paradox of thrift (Blyth, 2013).

CHAPTER 2

UNDERSTANDING THE LEBANESE BUDGET PROCESS

2.1. Historical Overview of Budget Implementation

Lebanon's governance, economic, and budgeting systems have shown how expenditures exceed revenues, with public debt reaching over 150% of GDP by 2019 (IMF, 2020). The country keeps failing at doing economic and political reforms due to a lack of public budgets, inefficient spending, a weak economic model, and sectarian influences, which exacerbated the status of Lebanon due to abuse of the budgeting system, resource favoritism, and delaying the reforms (Leenders, 2019; Makdisi, 2020).

Lebanon's governance model has been established since 1990. This historical overview would provide valuable insights into how Lebanon struggled to balance expenditures and revenues and what political interferences thwarted the nation's economic prosperity, contributing to debt and economic decline.

Between 1990 and 2005, this period was marked by Lebanon's reconstruction after the civil war. Many external funds, borrowing, and aid were provided to allow for capital expenditure and rebuild infrastructure. Even though this period symbolized the country's reconstruction, it witnessed political and sectarian influences since the nation's governance model was established. These influences increased debt even after rebuilding infrastructure, allocated funds for sectarian interests, inflated public sector wages, and created inefficiencies, which were the budget implementation plan of this period (Makdisi, 2020). Since 1993, successive governments have been sending draft budgets that violate the text of Articles 83 and 87 of the Constitution. The submission of budget projects can illustrate some violations after the expiration of the constitutional

deadline, and sometimes even after the expiry of the fiscal year in which the budget law is active and valid, the lack of comprehensiveness of budget projects public expenditure, arguing that spending financed from external loans and some grants are excluded from the budget, and the absence of yearly submission of the final financial management accounts to the Council for approval before the publication of the budget for the following year that follows a special law to form the Court of Accounts. ("General Accounting Law," 1963)

After 2005 and the assassination of Prime Minister Rafic Hariri, the political instability led to the violation of budgeting principles. Major political divisions and external conflicts have drained resources and contributed to debt and economic decline. The budget implementation relied on increasing public debt with ineffective budget management and no plans to mitigate economic crises in Lebanon. Political and sectarian influence always delayed the lack of an adequate budget implementation plan (Nahas, 2020). The political conflicts among the main political parties in Lebanon have halted the passage of an official state budget for several years since 2005. This led to unauthorized government spending, and public spending has been subject to little oversight. The absence of an official budget often benefited interest groups within various government factions. It was not until 2017 that the Lebanese parliament passed a state budget. During these 12 years, a few budget propositions were discussed; some have been sent and never addressed, and others have not even been sent to the parliament. (Smith and Bertozzi, 1996)

Between 2010 and 2019, the country reached a budget implementation of borrowing as the primary method to conduct governmental operations. Due to large subsidies, this inefficient method led to economic imbalance and disturbance in the

energy sector, Electricité du Liban (EDL), further contributing to the nation's financial decline (Nahas, 2020). Due to delays or incompleteness from Lebanon's corrupted budgetary system, there has been a failure to receive budget approval for economic reforms.

From 2019 to the present day, Lebanon has entered a major economic collapse. There has been a continued lack of budget reforms, persistent corruption, and political influence. The government had lost the public trust and the creditors' and investors' contribution to Lebanon's economic growth. Lebanon's public debt continued to rise to sovereign debt in 2020, which allowed for budget and policy paralysis to be witnessed with governmental struggles, protests, and a lack of political cohesion (Leenders, 2019).

2.2. Lebanon's Budgetary Format and Structure

Lebanon has a unique political, sectarian, and economic context. Due to political disagreements, coverage of these components can be delayed.

When it comes to revenues, Lebanon has diverse sources. The country uses indirect taxes, such as the Value Added Tax (VAT), customs duties, and excise taxes, as the sources to procure the most significant amount of revenue. Lebanon also adopts smaller revenue procurement sources, such as direct taxes, including income and corporate taxes. These are considered to have more minor revenue procurements due to weak enforcement and tax evasion (International Monetary Fund [IMF], 2020). Another source of revenue is non-tax revenues, which are state services and loans from international donors.

The Lebanese government divides expenditures into two types. Current spending is expenditures for public services such as public sector wages, debt servicing,

etc, and capital expenditures, which are expenditures to promote projects for long-term growth. It is worth noting that capital expenditure is a heavy burden due to debt servicing, public sector wages, and debt obligations (Dagher, 2021). Thus, Lebanon cannot appropriately allocate resources for capital expenditure, as it is resource-intensive to implement projects such as roads and schools.

In Lebanon, the budgetary system undergoes stages for approval from stakeholders such as the Ministry of Finance, the Cabinet, and the Parliament. According to Leenders, the Ministry of Finance first drafts the budget proposal; after that, the Cabinet must review, reflect, debate, and amend the proposal to consider the political priorities. Once the Cabinet finishes, it submits the proposal to the Parliament for approval (Leenders, 2019).

2.3. Overview of Political, Economic, and Sectarian Influences

Sectarianism in Lebanon is inscribed in its constitution; it has been legalized and formalized within the official and non-official state organizations and institutions. Sectarian preference and discrimination can be traced back to the mid-19th century during Ottoman rule. Four significant events in Lebanon reinforced it: the creation of the Republic of Lebanon in 1920, the constitution in 1926, the National Pact of 1943, and the Taif Agreement of 1989 (Bahout, 2013). As Lebanese sectarianism's nature and dynamics are a form of divorce, religious communities and subdivisions constituted its political and constitutional existence, and it was referred to as "the sectarian state *par excellence*" (Hirst, 2011). The sectarian dimension was mixed between Muslims and Christians, which are constituted of Sunnis, Shias, Maronites, Orthodox, and other minorities. (Malik, 2008). This model aimed to provide each sect its fair share of political power to

guarantee peace and no conflict among the different sects in Lebanon. It also aimed to foster a sense of unity and inclusivity among the sects so that all Lebanese could be under one common nation. However, this governance model entrenched sectarian divisions and fostered clientelism. It encouraged political leaders to consider their sectarian interests and undermine the nation's needs. The leaders wanted to maintain sectarian loyalty among their people by distributing resources to them, even if it meant weakening the state and contributing to the economic decline of Lebanon (Makdisi & El Khoury, 2020).

The World Bank (2017) pointed out in its systematic report that sectarianism is one of the reasons that led to the collapse of the electricity sector. The World Bank has also recently informed the Lebanese government that, in light of the disruption of the legislation, it will not commit to new development projects for Lebanon. The source of these foreign interventions is not limited to the World Bank or the UN but also includes the European Union and many other Western and Arab governments with influence in Lebanon.

At the economic level, Lebanon has used the rentier model, in which the banks were the center gatekeepers of its economy. The operation involved external inflows, i.e., receiving money from Lebanese living abroad and other foreign aid; this model gave Lebanon long-term sustainability to some extent. Nevertheless, this reflected how Lebanon relies on this economic model, which shows the nation's lack of manufacturing and local production, unsupervised trading, and excessive public borrowing due to the weak state of Lebanon's economy and governance (Atallah, 2020). By 2019, this deceptive long-term sustainability had been unmasked as the banking sector collapsed with no more external inflows. The government failed to advance and diversify

Lebanon’s economic model, mainly due to the sectarian influence, and to address this issue.

Lebanon’s governance model is the direct cause of these economic challenges. The sectarian influence allowed the sects to become competitive for resources and continue their operation of interest by undermining and delaying reform. This has contributed to national and public inefficiency, underfunded social services, and inadequate infrastructure due to corruption and the economic status of Lebanon, which affects the nation’s economic growth and governance for the country’s long-term sustainability (Leenders, 2019). In 2019, the imminent economic collapse was exacerbated in 2020 and 2021. Lebanon's governance and economic model has reflected just economic mismanagement and corruption. The government led by Hariri in 2019 offered hope for critical reform, mainly due to the CEDRE conference, which aimed to provide financial support to the country if Hariri’s government implemented a reform plan. His government, which consists of sectarian political parties such as the Free Patriotic Movement, Amal Movement, and Future Movement, and others, did not agree on a reform plan and kept delaying any discussion regarding the fiscal crisis, which led to policy paralysis for reform (Dagher, 2021). They were more interested in rewarding their allies and promoting their influence in the country.

CHAPTER 3

THE 2019 BUDGET: CRISIS ON THE HORIZON

After decades of budget mismanagement from Lebanon's governance, economic, and budget systems, Lebanon's financial system, under the supervision of Prime Minister Saad Hariri and Central Bank Governor Riad Salame, was in crisis. The 2019 national budget has failed to stop the nation's preexisting fiscal imbalances. This chapter will discuss key events of 2019, examining how these events, such as political influence and policies, culminated in the complete collapse of the Lebanese financial system, leading to economic collapse.

3.1. The Formation of Lebanon's 2019 Budget and Political Challenges

Even after the 2018 parliamentary elections, there were few resolutions and reforms to the country's political system. Prime Minister Saad Hariri's government symbolized a sense of national unity as it included a mix of political/sectarian factions. Nevertheless, the political system remained the same due to the impact of Lebanon's governance model, which allows political parties to always focus on their sectarian interests, disregarding the means for political reform (Makdisi, 2020). The 2019 national budget has awaited its approval since April 2019 to address Lebanon's economic decline and fiscal deficit, which has reached 11.5% of GDP. Nevertheless, no comprehensive solution was discussed even though, in 2019, the public debt had ballooned to over 150% of GDP, which shows political neglect of the nation's needs. However, they still planned a way to gain revenue with austerity measures. They aimed to appease both domestic and international stakeholders, including the International Monetary Fund

(IMF) and donor countries, by proposing a mix of new taxes and cutting public spending, public sector wages, and pensions, which were all part of the country's economic model that was mentioned earlier (El Chami, 2021). These austerity measures from Lebanon's economic model were inefficient and insufficient to address the fiscal deficit, the country's growing public debt, corruption, the need to reform Lebanon's state-owned enterprises, and ways to procure the 2019 national budget. The 2019 national budget was passed in July 2019 with the delusion that the country is still stable, even though the economic state is deteriorating due to the failure to implement measures to mitigate economic collapse.

3.2. The Introduction of WhatsApp Tax: A Catalyst for Protests

Even with the hope of procuring the 2019 national budget, no major event occurred in July 2019. However, on October 17, 2019, a protest ignited after introducing the "WhatsApp tax" and other internet application taxes. The $6 per month was a revenue needed for the Lebanese government to face the economic struggles and the rising public debt. Nevertheless, the Lebanese already lived in high unemployment, inflation, and worsening conditions. Not to mention the country's high public debt. 30% of Lebanese live below the poverty line, and this tax was seen as an unjustified financial burden and a symbol of the government's continued corruption, which led to a protest being ignited (Makdisi, 2020; Nahas, 2020). The October 17, 2019, protest revealed the Lebanese citizens' anger toward the country's state regarding its governance and economic and political corruption. This protest also symbolized Lebanese unity, where all religious and political sects came together to revolt against this corruption, political mismanagement, and economic decline. This protest became a revolution growing in

scale to demand change to Lebanon's governance, economic, political, and budgeting models (Leenders, 2019).

3.3. The Role of Riad Salame and the Central Bank's Monetary Policies

Riad Salame, the governor of the Central Bank of Lebanon (Banque du Liban), is considered an important figure who played a role in the 2019 economic crisis. He was appointed governor in 1993 and managed the budget and financial management of the country. He stabilized the Lebanese pound and attracted foreign capital from his policies, deploying the fixed exchange rate between the Lebanese pound (LBP) and the U.S. dollar since 1997 (Makdisi, 2020). Although this policy was transformational and attractive, it contributed to Lebanon's economic decline and collapse. Salame's policy favored the maintenance of the Lebanese pound and the U.S. dollar, but it was delusional to convince everyone that it could maintain a sustainable financial system. Lebanon first had a volatile political environment; the country also relied on foreign currency inflows, as seen from its economic model. As these inflows reduced due to the volatile political environment, the country's economy became sluggish with depleting foreign exchange reserves. Salame remained confident in his peg, convincing the government that it had enough reserves to maintain the exchange rate. Still, by 2019 and 2020, the reserves diminished to a point where there was a failure to address the gap between the official exchange rate and the black-market rate for the national currency LBP (Nahas, 2020).

Salame's leadership in managing Lebanon's debt turned the tables on the advantageous use of the financial concept called liquidity. Since 2016, the Central Bank has tried to use high-interest schemes to attract foreign currency from commercial

banks. These schemes aimed to gather funds to purchase government bonds, which take advantage of liquidity (Makdisi, 2020). This has caused the country to become highly dependent on government debt. By 2019, the bank sector had faced sovereign risk liquidity problems, which caused the Lebanese to withdraw their demanded cash.

Overall, Salame's leadership in managing the financial system was somewhat stable, but it failed to mitigate the economic crisis due to inefficient financial strategies, leading to debt. Not to mention corruption and political influence in every financial decision (Leenders, 2019).

3.4. The Growing Protests and Political Pressure on Saad Hariri

In late October 2019, as the protest continued and grew, the Lebanese citizens demanded that Prime Minister Saad Hariri and his government resign, which he had led since 2016. The public's anger over the economic decline, corruption, and financial mismanagement has pushed them to demand a new government. Hariri issued an ultimatum to make a reform plan on October 18, 2019. Still, due to the inability of all factions to agree on a reform plan for a new government, the public's demands, and their implementation on October 29, Hariri announced his resignation. His resignation was a victory for the revolution but had little to no beneficial impact as the country remained fragmented, corrupted, and economically unstable (Dagher, 2021).

3.5. The Collapse of Lebanon's Financial System

Hariri's resignation had little to no beneficial impact as the economic decline worsened into a collapse. Not to mention the liquidity issue caused by Salame's leadership. For the bank sector to protect its prosperity and survival from bankruptcy, internal policies

were implemented to impose informal capital controls, restricting withdrawals and freezing accounts. This delusional safety from Salame's policy offered no long-term sustainability for the bank sector, government, and citizens, which debunked this confidence in Lebanon's financial system (Leenders, 2019). The Lebanese pound started to be devalued, with the black market governing the exchange rate with the U.S. dollar. The two decades of stability shifted into hyperinflation in a short period. Food, medicine, and fuel became increasingly scarce and expensive. Not to mention the rise in unemployment and poverty. By the end of 2019, the imminent economic collapse was approaching, and there were no solutions to reverse it (Nahas, 2020).

3.6. The 2019 Lebanese Budget Highlights

July 19, 2019, marked the negligence of more than 7 months past towards reaching the fiscal year's deadline, but the 2019 budget was approved and the year 2018 had been superseded by the 2019 budget and its optimism with a deficit of 7.6% of GDP, down from 11.4% in 2018, and with an increase of $1.8 billion in revenue as opposed to 2018. However, with the GDP of public debt reaching more than 150%, there has been further concern about closing accounts from previous years that violate deadlines and other requirements. There has also been spending in funds, which the revenue could not tackle significant deficit drivers, such as inflation and persistent deficits at Electricité du Liban (EDL). Reducing social expenditure was one of the techniques to address the deficit. They halted public sector recruitment, cut wages, increased the taxes on higher-income brackets and movable capital, nullified fee exemptions and privileges, and introduced more fees on public sector activities such as advertising, imported goods, and other activities.

In the end, the decades of financial, political, and governmental mismanagement have led to Lebanon's failure to mitigate the imminent economic collapse. The monetary system collapsed due to the failure to mitigate this crisis under Riad Salame's leadership, vision, and Lebanon's economic model. The 2019 budget also failed to be appropriately procured to address the country's financial deficit and the WhatsApp tax, which led to the protest. Prime Minister Saad Hariri resigned, which had little to no beneficial impact. Hariri's resignation was also signaled as he was discontent with the political culture within his government, leaving the country in political and economic turmoil.

CHAPTER 4

THE 2020 BUDGET: CRISIS DEEPENS

4.1. Lebanon's Political and Economic Crisis Deepens

Since 2019 and 2020, Lebanon's situation has worsened with economic collapse, political paralysis, and social unrest. In early 2020, public debt had reached $90 billion, more than 150% of the country's GDP. The surge of inflation and public debt has allowed the Lebanese pound (LBP) to continue to lose its value exponentially due to little to no initiatives for reform, due to political negligence and corruption in the country's ongoing crises (Sibai, 2020). After Hariri's resignation, the protest continued to pursue this and demand reform for corruption, mismanagement, and this sectarian-driven political system. Amid the need to re-establish Lebanon's governance, Hassan Diab was elected prime minister in January 2020, aiming to form a new government and resolve the country's crises.

This chapter will explore Diab's government, which tried to break from Lebanon's traditional political system. It will also explore their operation on the 2020 budget, as well as the political influence on this budget, its management, its austerity policies and decisions, and other external factors further impacting the economic crisis and the Lebanese pound's devaluation during this critical year.

4.2. The Political Composition of Hassan Diab's Government

In January 2020, Prime Minister Hassan Diab was elected. He was considered a technocrat to steer the country from its current crisis. His operations aimed to go beyond the tradition of Lebanon's political system to tackle the country's problems

independently. His cabinet had several technocrats and non-politicians, who could not impact the political and economic levels. Lebanon's political system was mainly dominated by the sectarian influence of its governance model. The power-sharing of sectarian influence from Hezbollah, the Free Patriotic Movement (FPM), and the Amal Movement made Diab's government negligible due to their influence and sectarian interest. For example, the FPM, led by President Michel Aoun, was considered to have control and decision-making to manage the energy sector, including control over Electricité du Liban (EDL). Implementing solutions from Diab's recommendations for EDL's inefficiency and financial strain had to be studied and approved by FPM, making Diab's governmental impact negligible (Makdisi, 2020). Another example is Hezbollah, which controls Lebanon's foreign policy and security affairs. Hezbollah was not part of Diab's cabinet; however, they were very well involved in influencing the 2020 budget and Diab's financial decisions (Leenders, 2019). Hassan Diab and his government resigned on August 10, 2020, in the aftermath of the devastating Beirut Port explosion on August 4, 2020.

4.3. The 2020 Budget: Economic Austerity and the Revolution's Impact

The 2020 budget was presented between January and February of the same year. Still, it was not an easy process conducted by Diab's government as they had to balance an agreement between international creditors and the political influence that had brought Diab to power. The International Monetary Fund (IMF) and other global financial institutions were key stakeholders, resources, and external financial support, which needed to be included in the budget to address Lebanon's financial deficit and economic crisis. The budget still cuts public sector wages, public services, and EDL

(Sibai, 2020). This budget burdened the Lebanese public, which was considered insufficient and unfair. Triggered by the existence of patronage and corruption, the Lebanese public forcefully rejected the policies to implement this budget because it could place further burdens on the citizens. The protest continued its journey to influence the situation made for reform, demanding the resignation of all political leaders, including Diab and his government, which also aimed to disintegrate this sectarian-driven governance model. The sectarian influence cannot provide tangible solutions, and this budget is intangible to make fiscal measures, so the protest neutralized the political decisions and prevented the implementation of this budget (El Chami, 2021).

4.4. The Black Market and the Continuous Support of the Lebanese Pound

Through the 2019 and 2020 events, the Lebanese pound continued its devaluation. Set from 1,507.5 LBP to the US dollar, the Lebanese pound was increasingly disconnected from this exchange rate, and by mid-2020, the black-market rate had reached a value of over 5,000 LBP to the US dollar. Lebanon's financial system and the central bank continued to put and use foreign reserves to support the official exchange rate, which exacerbated the devaluation of the Lebanese pound as the country’s reserves were draining. The central bank failed to stabilize the currency and support the official exchange rate, which caused the black market to cause a disparity between official and market exchange rates and imposed consequences on Lebanon’s economy, such as rising inflation and diminishing purchasing power (Dagher, 2021). The 2020 budget was unable to address the Lebanese pound’s devaluation due to unimplemented measures and macroeconomic instability. There has been no mention of

the role of the central bank in supporting the official exchange rate, and the black-market economy became the nation's economic system, which caused frustration among the public and nullified any governmental operation to address Lebanon's financial deficit and economic crisis. Not to mention the exacerbated devaluation of the Lebanese pound due to these events.

4.5. The Cedre Conference and International Involvement

In April 2018, France and other international actors and donors pledged billions of dollars in loans and grants to be provided to Lebanon as part of the CEDRE (Conférence économique pour le développement, par les réformes et avec les entreprises) conference if proper reforms were implemented in the country to address its economic state.

In 2020, President Emmanuel Macron visited Lebanon. It urged the existing government again to continue their pursuit of national unity and implement the reforms, reminding them of the CEDRE conference's pledge after the failure of the 2020 budget to implement reforms and the worsening of the situation after the Beirut port explosion. Nevertheless, this external pressure undermined Lebanon's sectarian political system, which continued to influence the government's failure to meet this simple condition. The political, sectarian system had isolated the country from these funds and from the international community that aimed to support Lebanon's

4.6. The 2020 Lebanese Budget Highlights

The 2020 budget highlighted the trend towards failure with imminent economic collapse. There is no strategic planning for this critical year, where persistent financial

mismanagement and inadequate solutions fail to tackle the root causes of the economic decline and to conduct reform plans. On January 27, 2020, the Lebanese Parliament approved the budget through Resolution No. 2 of April 9, 2020. The 2020 budget overestimated with optimism that there would be a deficit reduction of 0.6% of GDP, a sharp drop from 7.6% in 2019, which neglected the existence of the continuing economic decline. There have been initiatives leading to inequalities, such as significant disparities. Old public plates, valued at $50000, are now valued at lower prices, reaching just 55 million Lebanese pounds due to Article 22, Paragraph 2. There have been governance concerns about consistently adjusting taxes and exchange rates, violating the Monetary and Credit Law. There have been inconsistent and multiple exchange rates for revenue and expenditure estimates, which led to further instability. There have also been inefficiencies and corruption, costing over $135 million annually in state rental expenditures. Not to mention the persisting public debt mismanagement with no attempts at restructuring or rescheduling debt, straining the economy. The public budget had 4% of its investment allocation, while 96% was allocated to consumer expenditures, hindering economic reform. No recovery plan was even considered, with data estimating spending at the official exchange rate of 1,507 Lebanese pounds per USD in 2019, so inevitably speaking, the budget lacked the necessary measures to tackle the financial deficit of the critical year of 2020, leaving the country with imminent economic collapse.

To conclude, 2020 has been considered a continuing crisis for Lebanon, with Diab's government trying to break into the traditional political system, which ended up plaguing the 2020 budget. Diab's government aimed to navigate the political and economic challenges with the 2020 budget, which was proposed with its measures. The

2020 budget was deemed insufficient, inadequate, and unfair in addressing Lebanon's fiscal deficit and economic crisis, as it also burdened the Lebanese public. Moreover, the central bank's role in supporting the official exchange was not transparently mentioned, which drained foreign reserves and exacerbated the devaluation of the Lebanese pound.

Due to Lebanon's sectarian-driven governance model, the government and political system have failed to implement impactful and tangible reforms. Moreover, protests and sectarian politics have caused political and policy paralysis, which has prevented any progress on reforms to subsidize Lebanon's crises.

The 2020 budget appeared to be a failure to implement reforms in the national interest, and even with external pressure and the CEDRE conference to promote national unity and the implementation of meaningful reforms, the government has failed to continue its operation due to sectarianism and corruption. The events also highlight how the country would remain unstable and uncertain due to continued political influence, economic mismanagement, and failure to act in the national interest.

CHAPTER 5

THE 2021 BUDGET: POLITICAL CAMOUFLAGE

After almost a year of operating under the management of Hassan Diab's caretaker government since his resignation in August 2020, the parliament assigned Najib Mikati as the new Lebanese Prime Minister on July 26th, 2021, after Saad Hariri stepped down from his nomination in July 2021 after nine months of unsuccessful negotiations. However, Mikati's government failed to pass a budget in 2021, regardless of the highly worsening situation in the country, the deepening financial deficit, and the economic crisis. There has also been political paralysis thwarting other possible economic reforms as the government has reached its most severe economic downturn since the 1975–1990 civil war. This chapter will explore the 2021 budget or the situation without an official budget, reflecting on the political benefits gained as a tool used to address sectarian needs. Minimal aims of financial recovery were tackled as key political figures and advisors, such as Faysal Salman, Ali Hassan Khalil, and Lazard, will be discussed to understand their roles in shaping and negotiating the country's fiscal strategies in 2021.

5.1. The Mikati Government's Budget Strategy: Denial and Political Camouflage

The 2021 budget has been proposed by Mikati's government, which was ignored and undermined. It could address Lebanon's deep financial crisis and economic collapse. Nevertheless, the budget has been undervalued, with optimistic assumptions and no intervention strategy. Mikati's government denied the truth behind the black market's control over the Lebanese pound. They continued to address and support the

official exchange rate, which skyrocketed to more than 20,000 LBP per dollar (Makdessi, 2020). His government continued to support Salame's leadership and assumptions regarding the Lebanese pound, which aimed to shield the country from hyperinflation and gain public trust. Nevertheless, the budget's revenue projections cannot match the black market's exchange rate. The government relied on the assumption and projection that there would be a modest increase in revenue during the financial and economic crisis. The bank sector says otherwise because of a broad economic collapse (Dagher, 2021). Relying on this optimistic assumption did not impress the bank sector, as they continued to impose their internal policies of capital controls and restricted access to foreign currency and withdrawal. There have been no considered strategies for a financial plan, and the government has relied on using unsustainable financial practices, such as borrowing. All of these can foreshadow a similar result, as the governmental operations seen earlier were typical, so Mikati's government failed to address the financial deficits and economic crisis as they relied on assumptions, negligence, and unnecessary decisions instead of planning for well-suited reforms. They also neglected to consider the long-term impact of Lebanon's ballooning public debt (El Chami, 2021).

5.2. Structural Reform Deficiencies and Lack of Political Will

The draft budget was submitted to the cabinet on January 26, 2021, nearly five months after the legal deadline. However, the budget was neither approved by Parliament nor officially implemented. Consequently, the government operated without an official budget for 2021, relying instead on provisional spending measures to manage state affairs. The 2021 budget ended up being a failure with no reform implementation.

Mikati's government and negligence have undermined the International Monetary Fund (IMF) and the World Bank from helping them with their reform plans. International organizations have kept calling and advocating fiscal consolidation, recovery of the bank sector, and privatization of industries, causing a massive drain on public resources. Mikati chose small and superficial strategies, which had little to no impact on addressing the complexities of Lebanon's issues. EDL has been proven corrupt and inefficient in the Lebanese electricity sector, and the government had no reform plans to stabilize EDL's enormous debts. Instead, the government continued to subsidize the industry, which failed to reduce the fiscal deficit and continued to spread its inefficiencies. EDL is a sectarian-owned sector, meaning Mikati is not at fault. The failure to consider and reform EDL is strictly due to political influence. EDL is considered their property as it tends to reward loyalists and would be used to maintain power and control. There is just continued sectarian interest, even with the economic collapse of the country, the abuse of EDL, and its enormous debts.

5.3. Overview of Political, Economic, and Sectarian Influences

Mikati's attempted operations were largely symbolic and ineffective. There have been modest tax increases on luxury goods and cuts on public sector wages. The 2021 reforms were underutilized, with just token gestures meant to placate international donors and critics. They gave the illusion that these minor reforms would reduce the fiscal deficit. Still, in reality, public sector wages have been decimated by inflation, with a rise in poverty rates (Dagher, 2021). The 2021 budget has been delayed to plan for impactful solutions. Political posturing is meant to delay the budget so that political factions avoid making regrettable decisions. Political leaders must maintain a support

base, which has postponed the budget submission until 2022. The Lebanese public already felt the burden of Lebanon’s widespread poverty and unemployment, so this delay was conducted in favor of sectarian interests and political control over the country’s economic decline and financial instability (El Chami, 2021).

5.4. Debt Restructuring and Political Manipulations: Lazard, Eurobonds, and Sectarian Factions

Lebanon defaulted on its Eurobond debt in March 2020, which affected the 2021 budget and isolated it from international capital markets. So, they had to resolve the public debt (Makdisi, 2020). Lazard is a global financial advisory firm that aims to help guide Lebanon's restructuring negotiations for its debt. Lazard aimed for significant debt reduction and financial consolidation, which must be done for Lebanon's economic recovery. Nevertheless, political factions, such as Hezbollah and Amal, resisted and neglected Lazard’s plan and recommendations. They were also reluctant to accept the terms to maintain their supporters (El Chami, 2021). An example is former Finance Minister Ali Hassan Khalil, who rejected a deal to restructure Lebanon's debt with international standards (Leenders, 2019). Khalil and other political elites feared losing control of the country's patronage networks as these terms could jeopardize public sector jobs and state subsidies, impacting their supporters. On the other hand, Faysal Salman is an economic technocratic advisor who advocated for restructuring Lebanon's debt as it aligns with the IMF and the World Bank to stabilize the currency and the economy, which was thwarted by this political system (El Chami, 2021). Part of the terms was to cut subsidies, which political leaders feared would impact their supporters' access to state resources for survival. Public sector employees are a key support base for these political leaders, so these leaders had to prioritize sectarian loyalty over the

economic crisis of Lebanon by preventing the reduction in the size of the public sector (Leenders, 2019).

5.5. The 2021 Lebanese Budget Highlights

With the ongoing governance failures and economic collapse, political paralysis and administrative dysfunction were evident as spending measures continued to be referenced under Article 86 of the Constitution. There has been a continued lack of transparency and accountability, multiple exchange rates of distorted governmental transactions, and the inability to tackle hyperinflation with a GDP contraction of over 20%. The previous onslaught of 2020's impact on the cost of living allowed compounding inefficiencies in subsidy programs with severe shortages of essential goods like fuel, medicine, and wheat. The devaluation continued, enabling public sector services such as healthcare, education, and other infrastructure to be underfunded. With neglect to form an economic reform plan as advised by the IMF, the government lost its opportunity to receive funds for economic recovery and future opportunities to stabilize and diversify the economy through key sectors like tourism, agriculture, and renewable energy. As seen by the public and international agencies, a growing distress epitomizes Lebanon's inability to manage its financial and political system. So, in all, with the absence of the 2021 public budget, there has been reliance on provisional spending with waste and corruption, alienation of Lebanon from international financial institutions and donor countries, and lost opportunities for economic plans, reform, recovery, and growth.

Ultimately, the 2021 Lebanese budget missed a critical opportunity to address the nation's financial deficit and economic crisis. The Mikati government denied

reasonable reforms due to denial, delay, and assumptions. Their political posturing depends on dissolving any viable pathway to recovery if it impacts their supporters. The budget relied on unrealistic revenue projections and ignored access to international support, which allowed the country to remain in financial limbo.

Lebanon’s crises are deepening, and budgets are being used as a tool for corruption. Sectarian interests always prioritize political posturing over economic recovery, aiming to maintain sectarian supporters and patronage networks to maintain control. This governance model, which aimed to bring peace from sectarian violence, has brought chaos and corruption to Lebanon's financial system.

The political system severely ignored international recommendations, which indirectly affected political posturing. They devalued Lazard and Faysal Salman’s advocacy, fearing the terms would impact their supporters. Political leaders must maintain sectarian loyalty over solutions impacting their political posturing and influence.

CHAPTER 6

LEBANON'S ECONOMIC AND POLITICAL LANDSCAPE DURING THE CRISIS

6.1. The Collapse of the Lebanese Pound: Official vs. Black Market Rates

Salame's consistency in defending the official exchange rate proved to be an unviable and illusory strategy as he drained the country of foreign reserves, which weakened the financial system of Lebanon to collapse (Dagher, 2021). By late 2019, the black market emerged, with market exchange rates far exceeding the official national exchange rate, negatively affecting consumers and investors with imports, debt servicing, and savings protection. By 2020, the exchange rate reached over 4,000 LBP per dollar, widening the gap between the official and black-market rates (Makdisi, 2020). A progressive increase in the black-market rate has exceeded 20,000 LBP per U.S. dollar by mid-2021. Without a doubt, the Central Bank had finally admitted that it could not sustain and defend the official exchange, highlighting the complexity and losses of the national reserves to overcome this crisis. The currency crisis offered a wide gap between the official and black-market rates, which they utilized the official exchange to subsidize the import of essential goods using dollars from foreign reserves. Regardless of its intention to serve the Lebanese in the short term and defend the official exchange rate, this strategy offered no long-term benefit to the Lebanese or the national currency, as it did not stabilize the economic situation (El Chami, 2021). So, Salame's leadership in managing the financial system during the crisis proved to be a failure in the long term, which was criticized due to depleting the foreign reserves, thwarting the government from taking more essential steps for long-term stability and reforms. Salame intended to unify the exchange rate system but failed, causing severe

consequences and a widened gap between official and black-market rates (Makdisi, 2020). His actions destroyed the currency's value, leading to millions of losses for Lebanese savings and the collapse of the banking sector, an essential industry for Lebanon's revenue stream.

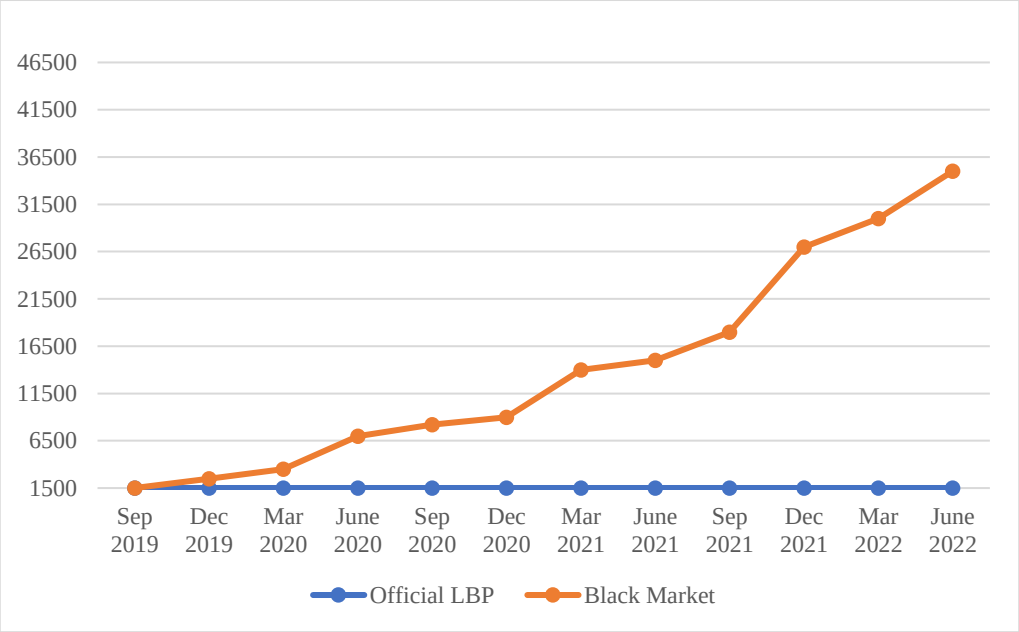

Figure 1. Official LBP Rate vs Black Market Rate.

6.2. The Illusion of Petroleum Wealth and Promises of Future Revenue

The government pretended that Lebanon was not a sectarian-driven state, and they put faith in the political leadership to fulfill a promise of political wealth. Nevertheless, relying on this illusion is useless as it offers no direct result and actualization, undermining tangible actions capable of stabilizing Lebanon's economic challenges for 2019 and forward. Salame's actions and influence can be described as a short-term, illusory display, aiming to give a sense of safety to Lebanon's financial system. The concept of petroleum wealth follows a similar illusory archetype, aiming to expect and rely on its actualization to promote economic growth and recovery in

Lebanon, which raises concerns about how illusion plays a role in determining the confidence and decision-making of the government.

Lebanon hoped for petroleum wealth, as in the early 2010s, seismic surveys offered insight into significant offshore oil and gas reserves in the Levant Basin. It marked a new market share in the Eastern Mediterranean region, where Lebanon can contribute to the oil and gas industry. Lebanon benchmarked its neighboring countries and found optimism to be part of this market share, significantly since this can help reduce Lebanon's massive public debt, fund infrastructure projects, and create jobs and a new revenue stream beyond the overreliance on foreign remittances and borrowing (El Chami, 2021). In 2017, the government assigned international companies, including Total, Eni, and Novatek, to find traces of oil and gas in Lebanon's offshore blocks and consented to drill and search (Dagher, 2021).

The political system was highly interested in this project; they promoted the illusion that petroleum wealth was the only solution to resolve Lebanon's economic issues. From President Michel Aoun to Prime Minister Saad Hariri, many had seen the potential of petroleum wealth for Lebanon's economic recovery, which the Free Patriotic Movement (FPM) advocated. They showed high interest since they control the Ministry of Energy and Water (Nahas, 2020). Nevertheless, the government and the political leaders failed to develop comprehensive energy policies to create a flow for the oil and gas sector. They kept delaying the actualization and repeatedly used this illusory promise of petroleum wealth to distract the people from their ongoing failure in forming these policies (Makdisi, 2020).

The first attempt to extract oil and gas happened offshore in Block 4, led by Total in 2020, and failed to conduct viable extractions for the market. The COVID-19

pandemic has paralyzed operations and drilling procedures in the oil and gas sector. Moreover, there has been a regional dispute with Israel thwarting Lebanon from fully exploring its offshore blocks due to the need to resolve its maritime boundaries with Lebanon, which delayed this project with uncertainty for the investors (El Chami, 2021). These events debunk the Government's credibility and illusory promises of petroleum wealth. The economic crisis was worsened by the lack of actual improvement in Lebanon's economy and its massive public debt. There has been no realism in measuring the feasibility of creating the oil and gas sector, and they did not consider the constraints that thwart them from exploring the offshore and developing the industry. The petroleum wealth was not a promise but an excuse to distract the public from uncertainty, an illusory attempt reflecting how the government is unable to address the actualization of this project and to conduct the reforms recommended by the CEDRE conference and international organizations (Dagher, 2021).

When correlating this project to Salame's leadership, a pattern can be seen where the political mismanagement had practiced the same techniques for years, which is related to focusing on the sectarian interest of a project and offering short-term impact for the public to distract them from reality. Much like the borrowing and financial engineering, which were inefficient in managing the economic system, the promises of future oil and gas provide little to no impact on improving Lebanon's economy due to constraints and no specific actualization of creating the oil and gas sector. In all, it cannot resolve public debt, restructure the banking sector, or address the fiscal crisis seen in the country (Nahas, 2020). Still, this concept has revealed how political leaders fail to optimize for their lies and provide alternatives to what they promised the public. Their trust and frustration in this government reached a level

where a protest could ignite at any uncouth decision. It is inevitable to mention that there will not be any economic recovery and no opportunity to address Lebanon's fiscal issues and improve its economy, since short-term petroleum wealth is unrealistic (Makdisi, 2020).

6.3. External Influences: Saudi Arabia, France, and International Relations

Between 2019 and 2021, Lebanon's economic and political crisis was shaped by corruption, internal mismanagement, and, most importantly, significant external influences. Lebanon's economic and political scenery during this period was shaped by two external influences: Saudi Arabia and France. When it came to Saudi Arabia, it had a well-established political tie with the Sunni leader in Lebanon, former Prime Minister Saad Al Hariri, while France was taking a leading role in diplomatic affairs to secure political reforms and financial aid to Lebanon under President Emmanuel Macron. Moreover, Lebanon's crisis remained unresolved through the complexity of international relations, geopolitical entanglements, and Lebanon's sectarian divisions, which made it hard for external countries to intervene and have an effect. The involvement of external countries highlights the connection between Lebanon's internal issues and regional and international politics. (Dagher, 2021)

6.3.1. Saudi Arabia's Role and the Hariri Resignation

Saudi Arabia has always had ties to Lebanon's economic and political growth. During the period of Prime Minister Saad Hariri, he was considered a key factor in communicating with this country with his Sunni leadership and relationship with them. He is also a beneficiary of Riyadh's support. However, during his stay in Saudi Arabia,

Hariri unexpectedly announced his resignation from his role as prime minister. There has been no rationale behind this controversial debate. However, he revealed that the reason for his resignation is due to Iran and Hezbollah's influence on Lebanon and his life. Saudi Arabia's influence over Lebanon disappeared after Hariri's incident in 2017; the kingdom started detaching itself from Lebanon's political affairs after the economic crisis escalated in 2019. Therefore, it led to Saudi Arabia's elimination of the political and financial support for Lebanon, particularly for Hariri, which left him without a sponsor during the political instability in Lebanon. Eventually, Hariri officially resigned in October 2019 regarding the nation's revolution over government corruption and economic mismanagement, which significantly impacted the Lebanese crisis. Hariri could not claim his influence over the Sunni Party since he lost credibility with Saudi support. (El Chami, 2021)

6.3.2. France's Role: Macron's Diplomatic Efforts and the CEDRE Conference

France was considered Lebanon's long-time ally and former colonial power, and tried to stabilize the country's economic and political situation during the crisis. The French President led diplomatic initiatives to address the crisis in Lebanon, especially during the Beirut Port incident in August 2020. Macron visited and met with the Lebanese political leaders, insisting on forming a technocratic government to implement the needed reforms and address the country's political dysfunction and deep-rooted issues of corruption.

During the CEDRE conference, held in Paris in 2018, France was involved and played a huge role. International donors also guaranteed more than $11 billion in aid to Lebanon. This financial assistance was subject to the Lebanese government applying a

series of economic reforms, including anticorruption measures, infrastructure development, and fiscal consolidation. However, the Lebanese government failed to meet the required conditions to receive such financial aid. The French diplomatic efforts to make such reforms were obstructed by the Lebanese deep sectarian political system, where the opposition, in particular, the Free Patriotic Movement and Hezbollah, were against such changes since it would threaten their control over some state institutions. (Dagher, 2021)

Despite Macron's repeated interventions, particularly his proposal for a "roadmap" for economic and political reform, the Lebanese political parties remained unable or unwilling to implement meaningful changes. Therefore, it became more evident that Macron was frustrated with the Lebanese political paralysis since his efforts to bring peace within the rival factions and secure international financial aid were almost impossible. The French failure in diplomatic strategies emphasized the challenges of communicating Lebanon's crisis through external pressure, especially given the deep-rooted nature of Lebanon's internal divisions (El Chami, 2021).

6.3.3. Geopolitical Tensions and Regional Dynamics

The Lebanese crisis was also caused by a broader geopolitical dynamic since there was a rivalry between Saudi Arabia and Iran. The Saudi disconnection from Lebanon occurred with the growing influence of Hezbollah, which Iran supports. Hezbollah's role was critical in the Lebanese political system, as it has a political party and an armed group. There has been a dispute between Gulf and Western countries, which view it as a destabilizing force in the region. Through this dispute, it was

complicated for Lebanon to secure international support, especially from Saudi Arabia, since Hezbollah is part of the government. (El Chami, 2021)

Saudi Arabia and Iran's regional rivalry, along with Lebanon's internal sectarian divisions, left the country in a risky position. International countries, including the United States, the European Union, and the Gulf states, were unwilling to invest in Lebanon's recovery without any guarantees of political reform. The geopolitical complexities around Lebanon highlighted the struggles to achieve a solution, as international countries had made their strategies with the need to address Lebanon's financial and humanitarian collapse (Nahas, 2020).

CHAPTER 7

THE CONNECTION BETWEEN POLITICAL LEADERSHIP AND ECONOMIC COLLAPSE

The Lebanese economic and financial collapse is deeply connected to decades of policy paralysis, political mismanagement, and systemic corruption. Politicians are known for their connection in a sectarian power-sharing system that prioritizes their interests by using resources and state institutions to consolidate power and maintain patronage networks. These actions eliminated public trust, undermined governance, and left Lebanon deeper into financial challenges. This chapter reveals the connection between economic dysfunction and political leadership within the country, highlighting specific mismanagement, corruption, and policy failures that led to the country's financial collapse.

7.1. Political Patronage and Economic Mismanagement

Political leaders have long exploited Lebanon's sectarian political system to benefit their interests. By diverting public resources to their sectarian communities, they secured their own people's loyalty while neglecting national priorities. This strategy created inefficiencies across public sectors, especially in the bloated public administration. Wages in the public sector, which are often directed to politically affiliated employees, absorbed shares of the national budget, leaving almost nothing for essential services or development (Nahas, 2020).

The manipulation of public procurement processes is another example of political mismanagement. Road construction and waste management, considered part of major infrastructure projects, were usually granted to companies linked to politicians,

such as former Prime Ministers Najib Mikati and Saad Al Hariri. For example, allegations surfaced that firms linked to Hariri were advantageous in bidding processes, leading to substandard work and inflated costs. Such practices undermined service quality and drained public resources, deepening public dissatisfaction (Dagher, 2021).

7.2. Resistance to Reform and Political Paralysis

Lebanese politicians consistently abstained from reforms threatening their control over public institutions. International organizations and donors, including the World Bank and International Monetary Fund (IMF), conditioned financial aid on implementing measures such as privatization of state-owned enterprises, fiscal consolidation, and anti-corruption initiatives. So far, these demands have gone unobserved, as politicians prioritized and maintained their interests over securing the Lebanese economic stability (Makdisi, 2020).

The National Anti-Corruption Commission has tried to establish anti-corruption mechanisms but has also faced political resistance. Many politicians feared vigorous oversight could undermine their power and expose illicit activities. For example, judicial authorities that political parties controlled have stalled investigations into illicit enrichment by politicians; most were controlled by parties, including Hezbollah and the Amal Movement, further entrenching corruption (Dagher, 2021).

7.3. Financial Engineering and the Illusion of Stability

Under Riad Salame's control, the Lebanese Central Bank implemented financial engineering plans to attract foreign deposits and maintain the currency peg. Such policies, supported by high interest rates, provided a mask of stability while the

structural economy weakened. Politicians supported these plans, as they delayed the need for reforms (Makdisi, 2020).

The Lebanese banking sector was deeply connected with the politicians, with many holding remarkable stakes in major banks. For example, banks linked to known figures such as Marwan Kheireddine (Chairman of Al-Mawarid Bank) and Salim Sfeir (Chairman of Bank of Beirut) played key roles in financing the government's unsupported debt. Such banks profited from high-interest loans to the state, effectually enabling the fiscal mismanagement that led to the crisis. Therefore, when the financial system collapsed, such institutions resisted reforms, including haircuts on large deposits, to protect the interests of their fellow politicians (El Chami, 2021).

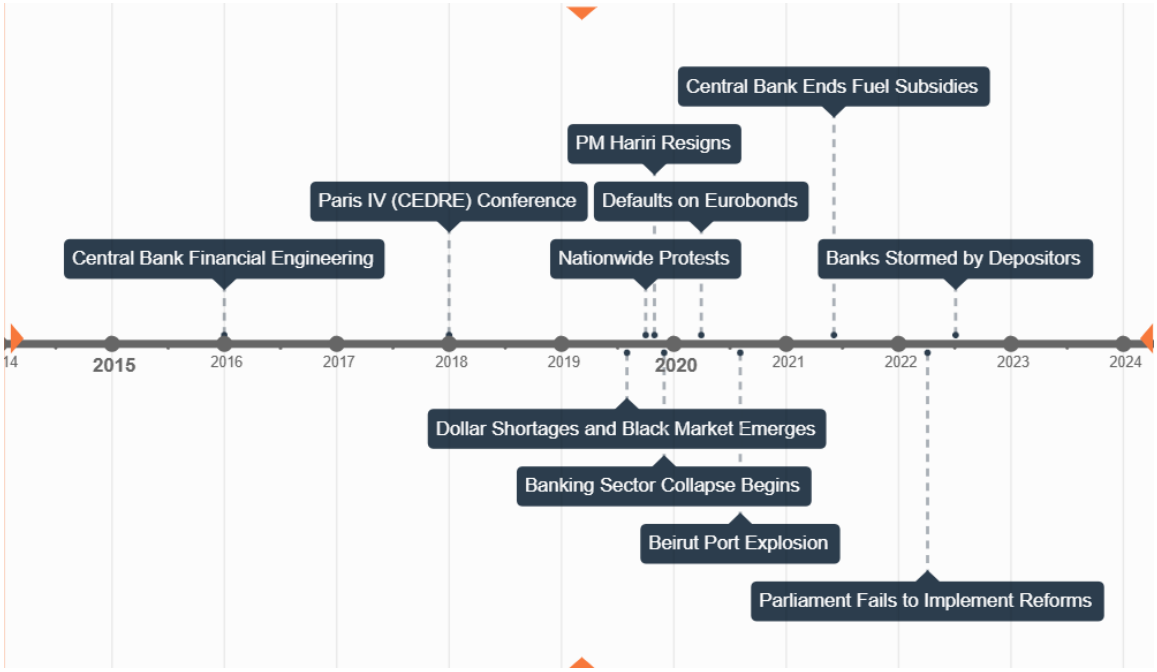

Figure 2. The Path to Bankruptcy: Timeline of Key Events.

CHAPTER 8

CONCLUSION

8.1. Summary of Findings: The Role of Sectarianism, Political Mismanagement, and Corruption

When it comes to sectarianism, Lebanon's governance model shapes the economic policy under the divided power along religious lines. This model has been under the National Pact and the Taif Agreement, aiming to reduce sectarian violence and conflict by allocating each sect a key position and ownership in the government. However, this framework has allowed sectarian interests to dominate political and economic decision-making.

Political leaders have abused their positions and assets for patronage, distributing jobs, contracts, and services to their supporters so that they maintain sectarian loyalty and influence. Not to mention that governmental tools such as economic policies, public resources, and public budgets were also used for sectarian benefits, such as delaying public budgets to avoid accountability (Makdisi, 2020). Ministries and state institutions are assets for these political leaders.

Political mismanagement is a direct factor that caused Lebanon's economic collapse. The protest, the International Monetary Fund (IMF), external agents, and other international organizations have advocated and warned Lebanon's political system of the importance of reforms and what can be done to reduce corruption, cut public spending, or improve governance. Nevertheless, these solutions offer fear to political leaders as they can lose control over key state institutions and sectarian loyalty, threatening political posturing (Nahas, 2020). There is ample evidence for political mismanagement, such as the successive governments failing to pass timely and

effective budgets in 2019, 2020, and 2021, which utilized the same reform methods with no orientation towards significant issues. There is a lack of fiscal discipline and the willingness to reform many sectors that are mismanaged and have financial burdens on the country, such as the energy, banking, and public administration sectors. The government's decision to default on its Eurobond debt in March 2020 is an act of ignorance to seek unsustainable financial practices, which was consistently done for sectarian interests. They had ignored a critical opportunity in 2021 to address the nation's financial deficit and economic crisis, which Lazard and Faysal Salman advocated with good-fit reforms. Moreover, even with the continuing crises, they will never agree on the necessary reforms to stabilize Lebanon's economy (El Chami, 2021).

When it comes to corruption, it is a work culture in the political system in Lebanon. A destructive force that aims to exercise Lebanon's governance model to embezzle public funds, misuse state resources, and engage in illicit practices. They mask and use the governmental revenue streams to enrich themselves and their allies and undermine the country's financial stability. Corruption facilitates political mismanagement, as this work culture can only be effective through chaos and sectarian interest. With Lebanon's economic collapse, the October 2019 protests were triggered not just by the WhatsApp Tax and financial crisis but by the decades of frustration over the corruption, which they aimed to forcefully engage the resignation of the entire political system of Lebanon (Dagher, 2021).

When connecting these three factors, we can confidently state that Lebanon's political leaders use sectarianism to maintain control of power, assets, and influence through corrupt practices, favoring their interests and support. The culture of corruption in the workplace encourages political mismanagement, where leaders prioritize

sectarian benefits over the country's long-term economic sustainability. The government can never compete with Lebanon's governance model, made of a sectarian-driven system with a work culture of corruption. It can never successfully implement reforms nor use external influence to suggest reform to the political system seen in the country, leaving Lebanon in a state of prolonged economic collapse (El Chami, 2021).

8.2. The Future of Lebanon's Economic Situation

The future of Lebanon's economic state is undoubtedly uncertain, as there is a complex set of challenges stemming from the history of Lebanon's governance, financial, and budget models, fueling economic collapse, political mismanagement, and corruption. Since 2021, there have been no reforms to predict Lebanon's economic progress and future. There is a need to address public sector inefficiency, corruption, and overwhelming public debts. IMF and other international organizations advocated for a pathway toward recovery, which political leaders have historically resisted with no implementation till a unanimous agreement is met, satisfying all sectarian terms and interests (Makdisi, 2020). This section must discuss and contemplate the needs, solutions, and requirements that should have been agreed upon and implemented. Doing so would provide a framework to understand how the future of Lebanon could have gone if the aforementioned were addressed and implemented.

8.2.1. The Need for Comprehensive Economic Reforms

The ability to implement comprehensive economic reforms is one of the most essential factors in understanding the future of Lebanon's economy. There is a need to address the financial burden generated in the public sector, which the government

spends a significant amount on to maintain. In other words, there is a financial loss from the unsustainable operations done in some industries; the government is spending ample money to maintain them. A solution is to reduce the size of the public sector, improve tax collection, and reform state-owned enterprises such as EDL. Nevertheless, these reforms cannot be easily implemented without a strong political leadership oriented to national needs, not sectarian ones. In addition, there is also a need to implement anti-corruption measures as they lead to political mismanagement and satisfy sectarian needs (Nahas, 2020). By doing these reforms, Lebanon can depart from its infamous governance model and attract the international financial support necessary for economic recovery (El Chami, 2021).

8.2.2. The Role of International Financial Assistance

After implementing these reforms, Lebanon's economic recovery can be imminent as international financial assistance can be made possible per the CEDRE conference. Lebanon is just heavily reliant on financial aid. Due to the extensively mentioned political factors, the country has failed to implement reforms, leading to the inability to meet the IMF's conditions. This isolates Lebanon from international financial markets and deprives it of much-needed liquidity, which is something the country does not need to do since there is already an economic crisis (Makdisi, 2020). By implementing the reforms, international actors, such as France, can help stabilize the economy, which pledged in the 2018 CEDRE conference over $11 billion in financial aid to allow Lebanon to recover economically (Dagher, 2021).

8.2.3. Addressing The Public Debt Crisis

A critical issue to focus on is the public debt exceeding 150% of GDP. There is a need to address these, as a debt restructuring process needs coherent fiscal policies. When Lebanon implements these, it can negotiate with international creditors to facilitate the restructuring process, which can help maintain the public service of goods and the economy (El Chami, 2021). Addressing public debt can eliminate inefficient subsidies and plan efficient and fair tax reforms to increase government revenue. It also requires a comprehensive debt strategy to consider the currency devaluation and decline of public services (Makdisi, 2020).

8.2.4. The Importance of Restoring Public Trust

With all this corruption and chaos, undoubtedly, public trust has plummeted, which can affect the economic behavior of the citizens and investors and neglect Lebanon's need for economic growth. When addressing the reforms, the government must show transparency, accountability, and corruption-free governance for public trust to be restored, which was the opposite of what was seen igniting the October 2019 protests. The banking sector is part of this issue, as public trust is necessary for its operation to contribute to prosperity and the country's economic growth. The bank sector in Lebanon is the country's primary source of income. By tackling currency collapse, economic decline, and the reduction in public services, it is inevitable for the public to understand the role of government in creating the conditions for economic and personal growth, which can also help restore public trust. The public can heavily value reforms to tackle electricity, healthcare, and education issues (Dagher, 2021).

8.3. Policy Recommendations

Regardless of everything mentioned so far, policy recommendations need to be provided. These can help lay the foundations for reform with specificity related to Lebanon's context. They can provide a roadmap to address the economic crisis, the need for multi-level reform, and the socio-economic poverty seen in the Lebanese public.

The policies are the following:

8.3.1. Fiscal Consolidation and Public Sector Reform

The country must reduce its ballooning public debt and restore its fiscal balance. The government must reduce public spending, which consumes a substantial portion of the national budget. They should find a balance between public sector wages, streamlining public administration, and reducing the reliance on state jobs. The government can craft a revenue stream by broadening the tax base, pursuing tax evaders, and ensuring that high-income earners and corporations pay their taxes (Makdisi, 2020).

This policy also recommends privatizing or restructuring public sectors such as Electricité du Liban (EDL). EDL has been known to cause Lebanon's fiscal deficit. Still, by improving the delivery of essential services and reforming the anarchy seen in EDL, the government can establish public-private partnerships to strengthen EDL’s efficiency and ensure that it is held accountable for its actions (El Chami, 2021).

8.3.2. Corruption Measures and Improved Governance

Corruption is a work culture seen in Lebanon’s governance model, not to mention the sectarianism present. This policy should take measures against corruption

because it can restore public trust and rebuild confidence in Lebanon's economic growth. There is a need to build an independent anti-corruption commission to hold public officials accountable for their actions. They can investigate and prosecute any political mismanagement conducted, which can be punished by labeling their action as a betrayal of the nation's sovereignty. By acknowledging the corruption seen, the government can take measures to prevent misconduct and utilize tools, such as government accounts, procurement contracts, and public spending reports, to track any deviations caused by political mismanagement (Dagher, 2021). The judiciary system must also be empowered and reformed with an archetype of independence to reduce political interference. The judiciary system should be able to appropriately handle corruption cases and implement laws to restrict and punish corruption. Public reporting of corrupt activities can also be a tool of evidence to hold the perpetrator accountable, and the law can fully protect the witness as a whistleblower if the evidence is plausible. Calling for international partners, including the European Union and the International Monetary Fund (IMF), can help the judiciary system to be efficiently reformed and competent to deal with cases of corruption; they can also provide technical assistance and offer monitoring of the progress of a case (Nahas, 2020).

8.3.3. Restructuring the Banking Sector, Debt Management, and Economy

The policy should also tackle the banking sectors, which require urgent restructuring. Lebanon's banks have huge sovereign debt, which must be subdued. The government needs to collaborate with international financial institutions, including the IMF and the World Bank, to reimburse and balance the losses between small depositors, large depositors, and bank shareholders, so that small depositors need to have minimal

losses. Implementing a process to restructure bank liabilities would result in well-studied management of bank debts and the handling of non-performing loans. Meaningful negotiations with international creditors should exist to restructure Lebanon's sovereign debt. The government defaulted on its Eurobond debt in March 2020, aiming to establish talks, but the political posturing thwarted its progress. For Lebanon to enforce fiscal discipline and economic reform, there should be a comprehensive debt restructuring plan satisfying IMF recommendations, which will allow the feasibility of reducing the debt burden and create the fiscal space needed for public investment and social protection (El Chami, 2021). So, when aligning with the IMF recommendations, Lebanon will be provided the liquidity it needs to stabilize its economy, and the government must show a strong commitment to implementing the reforms. Not to mention the CEDRE conference pledge. Also, the government should think about capital investments where they can collaborate with Gulf countries and other regional actors to secure funds for economic growth and job creation (El Chami, 2021).

8.3.4. Social Protection and Poverty Alleviation Programs

The policy should consider Lebanon's economic and social crisis and risky measures. Over half of Lebanon's population went into poverty, so there is a need to design social protection programs. Vulnerable populations need to be protected and supported with cash transfers, food assistance, and subsidies for essential services such as healthcare and education, which the economic crisis has severely impacted due to their low socio-economic status. These programs should define their audience and their vulnerable socio-economic background to support them without the need for political

interest (Dagher, 2021). One of the best practices governments should consider is their expenditures, i.e., current and capital. Investing in human capital can be essential in equipping Lebanese to participate in a future economic recovery. By investing in education and job training programs in rural and underserved areas, the potential for growth in human capital can unlock international partnerships and job opportunities, which can facilitate economic recovery and empower sectors such as technology, renewable energy, and tourism (Nahas, 2020).

8.3.5. Political Consensus and Constitutional Reform

Finally, there is a need to reform the political system in Lebanon. The governance model had impeded economic and political progress by thwarting and delaying governmental operations for reasonable reforms. There is a need to raise awareness that political leaders must prioritize national interests over sectarian interests, which can be implemented in the constitution. The government and the political system must be stable and held accountable for any damage done to the country. This can be done by eliminating political sectarianism, promoting inclusivity, and strengthening democratic institutions (Dagher, 2021).

The October 2019 protests are a demand from the Lebanese people's desire for political change due to the corruption and sectarianism present. Political leaders can no longer evade public needs. They need to be transparent and accountable about their actions; they need to engage with civil society and opposition groups to build a sense of unity and reform the country out of its current crisis, which they brought into (Nahas, 2020).

In conclusion, Lebanon's economic recovery requires a multi-faceted, comprehensive approach to resolve its governance model, biased decision-making, the financial system's collapse, corruption, and the need to take advantage of international financial support. These policies would have to depend on Lebanon's political leadership to form a governance model aiming to serve the nation and its people with transparency and technocratic approaches. Without changes in the governance model, there can never be considerable changes in Lebanon's corrupted and financially disrupted sectors, which can thwart the country from recovering its economy as it continues its path to total economic collapse.

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