The explosion at the Beirut port added to Lebanon's financial and political problems.

Lebanon's financial crisis deepens as political class defer difficult decisions

Two years into the Lebanese financial crisis, the country's political class is still refusing to take the hard decisions that will enable a recovery to begin. *Arab Banker's* Editor, Andrew Cunningham, considers how the crisis has evolved in recent months and the steps that will need to be taken for Lebanon to emerge from its crisis.

On 27 March 2020, Lebanon's Ministry of Finance delivered a presentation to bondholders, setting out the process by which it hoped to renegotiate the obligations on which it had defaulted a few weeks before.

A month later, the Ministry published a detailed Economic Reform Plan, comprising a new long-term economic strategy, fundamental adjustments to budgetary revenues and expenditures, and a restructuring of the banking system.

But as *Arab Banker* was going to press in August 2021, none of these ambitious goals had been achieved; key advisors who had drafted the Reform Plan had resigned; and no support package from the IMF had been agreed, despite the Plan citing such a package as a pre-requisite for its success.

One reason for the lack of progress has been the sheer depth of the problems that Lebanon is facing. The country has lived for decades on borrowed money (often borrowed from itself through complex financial-engineering operations between the central bank and commercial banks) and an overvalued exchange rate. Any move to a sustainable budgetary profile will entail huge reductions in subsidies and in the volume of government salaries and pensions, and a long-awaited restructuring of the state electricity authority. But implementing those reforms will bring yet greater hardship to the most vulnerable sectors of society, who have been most affected by the financial collapse.

The World Bank has estimated that Lebanon's financial crisis is among the most profound of any since the mid-19th century and possibly among the worst three. Gross domestic product fell by 40% from 2018–2020, the World Bank said. In 2020, 40% of households were having difficulties accessing food and other basic needs, according to the World Food Programme. Sporadic electricity production will be made possible only as a result of fuel oil imports from Iraq, for which Lebanon will pay with vaguely defined 'medical and consultancy' services. (In mid-August the agreement was still be to implemented.) As for the banking system, former advisors to the Ministry of Finance estimate that three-quarters of banks' assets – about $80 bn – comprise exposure to the Banque du Liban, far exceeding the central bank's reserves.

In response to the crisis, the central bank has been introducing multiple exchange rates. These supposedly cushion certain industries and certain people from the full effects of exchange-rate devaluation. The need to re-unify such multiple exchange rates as part of any reform package only complicates an already-difficult monetary landscape.

The explosion at the port of Beirut, in August 2020, added to Lebanon's problems. The explosion killed more than 200 people, injured thousands and left tens of thousands homeless. Public anger at the incompetence and apparent corruption that enabled the explosion to happen forced Prime Minister Hassan Diab to announce his government's resignation, deepening the country's political paralysis.

But perhaps the most fundamental challenge that Lebanon faces lies in the inability of its political elite to agree a common position on the way forward. It is important to note that the April 2020 Reform Plan was prepared by technocrats in the Ministry of Finance, and only published after considerable haggling among political figures and the banking community.

For decades, Lebanon has been run by community leaders, often acting through formal political structures, such as the Presidency or the Parliament, but sometimes not. One of the factors that typically delays government formation is the equitable distribution of ministries, some of which confer greater powers of patronage than others. Smooth political process has also been hampered in recent years by the changing balance of economic and demographic power in Lebanon, and in particular between the previously dominant Maronite community and the previously marginal Shi'ites. It is a changing balance that some find hard to accept.

In the weeks following the explosion, French President Emanuel Macron made two visits to Beirut and urged lawmakers to form a government by mid-September as a precursor to agreeing a support package with the IMF in October. Of course, no such government was formed.

In July 2021, France's ambassador to Lebanon delivered an extraordinary rebuke to Hassan Diab, still acting as caretaker prime minister, who had said that a "siege" had been imposed on Lebanon and that it would lead to social unrest. Ambassador Anne Grillo replied that Lebanon's troubles were not the result of an external siege but rather, "It is the result of your own responsibilities, all of you, for years, of the political class."

It is not only in the political sphere that the same faces continue to dominate.

At the time of writing, Riad Salamé retained his position as Governor of the Banque du Liban. Over the past few months, authorities in France and Switzerland have opened investigations into the sources of Mr Salamé's wealth; but he remains in place, having been appointed for a further six-year term in 2017. (Mr Salamé denies any wrongdoing.)

Mr Salamé has been at the centre of Lebanon's economic and banking activities for nearly 20 years, including those of economic growth under former Prime Minister Rafic Hariri (who first appointed him, in 1993). He oversaw the complex financial engineering that enabled the banks to show profits in recent years, and he has been a trusted interlocutor with US authorities investigating the financing of terrorist organisations. If Mr Salamé does leave his post before his term expires in mid-2023, what he does with his accumulated knowledge of the Lebanese financial system will be a key part of any agreement that he reaches with the authorities.

In June, the Association of Banks in Lebanon re-elected Salim Sfeir as its Chairman for a further two years. The Association's Vice President and Secretary remain unchanged, while a new Treasurer was chosen from among the previous Board members. Speaking after his re-election, Mr Sfeir commented that no bank had gone bankrupt during the current crisis, and that no deposit had been lost. While legally true (for example, no bank has been declared bankrupt), these statements will appear odd to the owners of banks in which liabilities far exceed any reasonable valuation of their assets; and to bank customers who are only able to withdraw foreign currency deposits in local currency, at heavily discounted exchange rates, and in small month-by-month instalments.

Against the background of political paralysis, the situation in Lebanon remains volatile. In late July, Najeeb Mikati, was asked to form a new government. Mr Mikati has served as prime minister twice before and is a billionaire who made much of his money in telecommunications. As the summer drew to a close, France was said to be deepening its efforts to arrange a multinational financial-support package.

Lebanon has faced many crises before, including a 15-year civil war that wrecked much of Beirut, killed tens of thousands and temporarily divided the country into religiously based cantonments. The settlement of the civil war came partly when the warring parties were too exhausted to continue but, more significantly, when Saudi Arabia provided sufficient incentives for all parties to set aside their differences.

This time, with Saudi Arabia lacking the clout it once had in Lebanon, a settlement will require Lebanese political and business leaders to accept huge financial losses on their investments and, if the government's finances are to be reformed, a reduction in their powers of patronage. For some people in Lebanon, there is much to lose, as well as much to gain, in a viable settlement of the country's economic and financial problems. ■