The Financial Recovery Plan: Its Impact on Lebanon's Economic Model, Negotiations with the IMF, and Recession

DR. GHASSAN DIBEH

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FRIEDRICH EBERT STIFTUNG

I. Introduction

The current economic crisis in Lebanon is a manifestation the failure of Lebanese capitalism or the failure of the type of capitalism that was built in Lebanon after 1992.[1] This "failure" has many facets. First, the *World Competitiveness Report* issued in 2019 by the World Economic Forum classified Lebanon as one of the least competitive economies, where Lebanon ranked tenth among 14 Arab countries and ranked 88th globally. Second, the Lebanese economy is dominated by low-productivity sectors. The World Bank's *MILES report* documented that 47.8% of the labor force work in low-productivity services sectors, such as retail and wholesale trade, while only 9.7% work in manufacturing and around 9.4% work in high productivity services sectors, such as information and communication; financial and insurance activities; professional, scientific, and technical activities.[2] Third, the Lebanese economy suffers from a lack of job creation dynamism. Fourth, unemployment is concentrated amongst the youth, especially the educated Lebanese youth, who face three possibilities: unemployment, disguised unemployment, or emigration.[3] Fifth, the economy suffers from high income and wealth inequality, where the top 10% acquire 70% of wealth and around 60% of income.[4] Finally, Lebanon has suffered from persistence of poverty, where around 27% of the population fell below the poverty line before the crisis,[5] only to rise to more than 55% of the population after.[6]

Today, the Lebanese economy is experiencing an unprecedented currency and financial crisis, all the while suffering the negative impact of the Covid-19 lockdown. Amidst such a crisis, the

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[1] The phenomenon of "failure of capitalism" is worldwide. In his book, "Reinventing Capitalism in the Age of Big Data," Victor Meyer Schönberger says that "capitalism is dying, profits soar while inequality rises and innovation stalls. Something has to give." Mark Benioff, in an article in *The New York Times* on October 14, 2019 said, "As a capitalist, I believe it is time to say out loud what we all know as reality: that capitalism as we know it is dead." In "Rethinking Capitalism," Mariana Mazzucato and Michael Jacobs say that capitalism today suffers from weak growth and volatility, stagnation in standards of living and high inequality, and the threat of climate change and the environment.

[2] World Bank, "Lebanon: Good Jobs Needed: MILES Report," World Bank Publications, 2012.

[3] M. Kawar and Z. Tzannatos, *Youth Employment in Lebanon: Skilled and Jobless*, LCPS Policy Paper, Beirut, Lebanon, 2012.

[4] L. Assouad, "Rethinking the Lebanese economic miracle: The extreme concentration of income and wealth in Lebanon 2005-2014," Working Paper 2017/23, World Inequality Lab.

[5] A. Atamanov, D. Jolliffe, M. Mayssaa, and N. Yaacoub, *Snapshot of Poverty and Labor Outcomes in Lebanon Based on Household Budget Survey 2011-2012*, Central Administration for Statistics and World Bank, 2015.

[6] ESCWA, *Poverty in Lebanon: Solidarity is Vital to Address the Impact of Overlapping Shocks*, Policy Brief 15 (2020): 1-3.

Lebanese government produced a rescue plan titled *The Financial Recovery Plan* (hereafter, referred to as "the Plan"), with the aim of containing the current crisis while delineating various reforms to pave the way for a new model for the Lebanese economy.[7] This study analyzes the potential economic and social impact of the government's Plan. Section two tackles the question: Does the Plan signal the end of the Lebanese economic model that has been in place since 1992? It analyzes the Plan's financial system restructuring (BdL and commercial banks), public debt restructuring, and interest rate reduction, as well as their impact on the foundations of the state-BdL-banks relationship that played an important role in the Lebanese economic model and rentier class dominance. In addition, the Plan's ambitious objective of transforming the economy into a productive economy, or what the Plan calls a "New Economic Growth Model," is studied. Section three studies the Plan's adequacy in forming a background for negotiations with the IMF. This section proposes a hypothetical "counter scenario" of a possible governmental stance in the negotiation, taking into account the need to change the economic model that has produced the current crisis and mitigate the social impact of any possible IMF program. Section four argues that the Plan lacks the necessary elements and policies to tackle the recession. Instead, it is overwhelmed by the notion of financial "losses" in the banking sector and at the Central Bank of Lebanon (BdL). In addition, it carries elements of austerity that will exacerbate the current crisis. The section will demonstrate that the Plan does not take advantage of the opportunities for fiscal expansion to fight the Covid-19 recession. It also discusses the social impact of austerity measures and the lack of an effective proposal for a new social contract.

II. Impact on Economic Model

Beginning in 1992, with the advent of the first Hariri government, fiscal and monetary policies changed radically and relied on three pillars. First, in 1993, a stabilization program was enacted that ended the inflationary period of the 1980s and early 1990s. Disinflation was achieved through the stabilization of the Lebanese currency, using the exchange rate as a nominal anchor in a typical exchange rate stabilization program (ERBS). Second, a tax reform was implemented that reduced taxes on capital and wages, or what became to be known as the "tax heaven" policy. Third, significant spending was devoted to state building, reconstruction, and the start of sectarian

[7] Lebanese Government, *The Lebanese Government's Financial Recovery Plan*, April 30, 2020, http://finance.gov.lb/en-us/EventPdfs/English/The%20Lebanese%20Goverment%20Financial%20Recovery%20Plan.pdf.

distribution mechanisms. These policy pillars had fiscal and economic effects, which led to successively large budget deficits and the accumulation of public debt at high interest rates. In addition, the economic cycle became highly dependent on the flow of capital from abroad while the real exchange rate rose, which led to a decrease in Lebanese competitiveness.[8] The continued de facto fixed exchange rate led to persistent stagnation in the Lebanese economy, interrupted by spurts of growth induced by the Paris II bailout in 2002 and in the period following the Paris III conference in 2007. The interest rate policy conducted in defense of the peg caused major shock to the economy, as a result of the high level of real interest rates generated. Berthelemy, et al. showed that Lebanon entered a slow growth trap after 1996 partly because of the real appreciation that harmed Lebanese competitiveness then led to a move towards the production of non-tradables where productivity gains are lower than in the tradable sector.[9]

The Taif State and the Rise of Rentier Capital

Public debt is not only a macroeconomic phenomenon that has an impact economic growth or fluctuations, but it has also a *distributional role*. It can play a role in the redistribution of income and wealth in society.[10] In this respect, in Lebanon, the new state built in the postwar period played such a quintessential role. The Taif Accord in 1989 formed the political and constitutional framework for ending the civil war; additionally, it played a significant role in the political economy of postwar Lebanon. It provided the basis for a political-economic redistributional system between the different sects and their representatives, in what came to be known as the "sharing regime" or *Nazam al Mohasasa*.[11] Moreover, by running successive budget deficits, financed through the issuance of treasury bills at high interest rates subscribed to by commercial banks, a link was formed between the sectarian state and finance capital. In effect, what we can

[8] World Bank, "Using Lebanon's Large Capital Inflows to Foster Sustainable Long – Term Growth," World Bank Publications, January 2012.
[9] J.C. Berthelemy, S. Dessus, and C. Nahas, "Exploring Lebanon's Growth Prospects," Policy Research Working Paper 4332, Washington DC: The World Bank, 2007.
[10] For a discussion of the distributional role of public debt see Marx (1964), Davanzati and Palatano (2018), and Piketty (2012).
[11] Hartzell (1999) studied negotiated settlements in 38 civil wars in the post-WWII era and showed that the security dilemma presented by civil conflict necessitates power-sharing institutions that solve such problems through the use of coercive force, the distribution of political power, and the distribution of resources.

call a "grand bargain" after the war between capital and sects amounted to determining the rate of return on building the sectarian "state" through public debt.[12]

This political economic organization, with which the treasury deficits and public debt led to the rise of rentier capital, ended the hopes for the possibility of establishing advanced or modern capitalism after the war. The system produced on the one hand sporadic economic growth and stagnant productivity growth and on the other hand huge disparities in wealth and income. In this respect, the sectarian power reallocation created an Olson-type[13] distributive coalition that impeded economic growth.[14] The 2016 report by the World Bank shows that confessionalism and confessional governance induced an elite capture that led to the failure of the Lebanese economy to generate inclusive growth and jobs.[15] The report estimated that the cost of confessional governance was at 9 percent of the GDP annually.

The Fixed Exchange Rate and the Rise of the Troika

The political economy of stabilization in postwar Lebanon reveals the congruence of interests between the state and commercial banks in maintaining the peg to the dollar through the high interest rate policy enacted by the BdL. Although the role of high interest rates and “financial engineering” by the BdL have come under scrutiny lately for their role in generating profits for commercial banks, this “super profit making” phenomenon, in which banks benefitted from

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[12] In his book, "Debt: The First Five Thousand Years," David Graeber tells the following story: In China, when the son of a merchant learns that an exiled prince lived nearby, he asked his father: "What is the profit on investment that one can expect from plowing field?” “Ten times the investment," replied his father. “And the return on investment in pearls and jades is how much?” “A hundredfold.” "And the return on investment from establishing a ruler and securing the state would be how much?” "It would be incalculable."

[13] M. Olson, *The Rise and Decline of Nations*, New Haven: Yale University Press, 1982.

[14] Mancur Olson has argued that one of the main reasons for rapid economic growth in postwar periods is that wars devastate growth impeding political arrangements. In this respect, distributional conflict can have a negative impact on growth rates in postwar reconstruction periods. A prime example of that is the Weimar Republic in Germany: the weak growth rates experienced in the aftermath of the World War I during the Weimar Republic were attributed to the profit squeeze generated by class conflict. This conflict led to low growth rates and investment rates when compared with both the prewar period and the post-WWII reconstruction period. In Lebanon, sectarian distributional conflict (and cooperation) led to this phenomenon.

[15] World Bank, “Lebanon: Promoting Poverty Reduction and Shared Responsibility,” World Bank Publications, 2016.

proceeds related to subscription in public debt instruments, was evident in the 1990s.[16] In the period 1993-1997, the cumulative premium on Lebanese T-bills over foreign denominated Eurobonds reached around 54%, which to many was seen as the central bank's policy of propping up commercial banks with low adequacy ratios in an overcrowded banking sector.[17] In addition, Urnechelian, et al. has shown that, in the context of the ERBS policy, the average annualized excess returns on short-term T-bills in the mid 1990's were around 16%.[18]

In this respect, throughout the stabilization period and up until its end in 2019, the Lebanese pound withstood severe pressures. This political-economic nexus has defended a currency that otherwise would have been indefensible. An IMF study on the debt-generated financial vulnerabilities in emerging markets concluded that "Lebanon has defied pessimistic predictions, including those of the Fund, and a debt crisis has been avoided. While investor confidence plays a role in any emerging market economy…in Lebanon it has become the linchpin of a unique symbiosis between the public-sector and the banking-sector balance sheets and how the authorities used this to overcome the near roll-over crisis of 2001-2002."[19][20]

The Relationship between Interest Rates (r) and Economic Growth (g)

[16] Central banks can increase rentier income in the economy by raising real interest rates and lowering inflation (Epstein, 2001). In the 1980's and 1990's, there was a secular rise in the GDP share of rentier income in many industrialized countries (Epstein and Power, 2003).

[17] S. Hakim and S. Andary, "The Lebanese Central Bank and the Treasury Bills Market," *Middle East Journal* 51 (1997): 230-248.

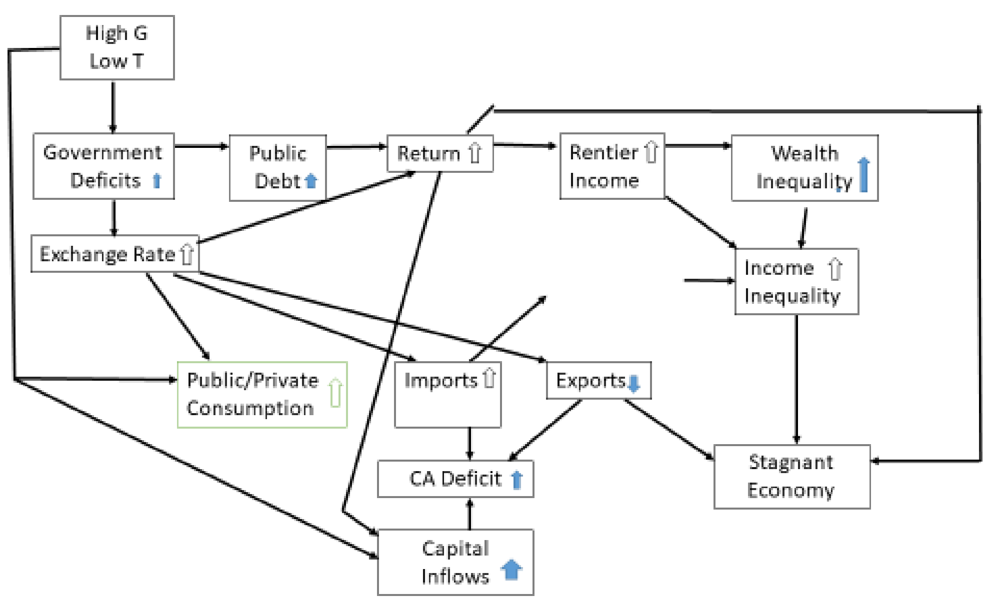
[18] T. Urnechelian, S. Eken, and T. Helbling, "Dynamics of Interest rate Movements: An Empirical Study," In *Back to the Future: Postwar Reconstruction and Stabilization in Lebanon,* edited by S. Eken and T. Helbling, IMF Occasional Paper 176, 1999.

[19] International Monetary Fund, *Debt-Related Vulnerabilities and Financial Crises-An Application of the Balance Sheet Approach to Emerging Market Countries,* July 1, 2004, www.imf.org/external/np/pdr/bal/2004/eng/070104.pdf.

[20] The political economy and political determinants of monetary policy have been discussed and analyzed by various economists and political economists (Alfaro, 2002; Epstein, 1992; Maxfield, 1998; Posen, 1993, 1995; Froyen and Waud, 2002; Eichengreen and Leblang, 2003). Eichengreen and Leblang (2003) discuss political and economic considerations of exchange rate choice and the hierarchy of monetary policy autonomy versus fixed exchange rate policy. In this respect, committing to a fixed exchange rate can lessen the pressure for redistributive policies emanating from interest groups in society. For example, the extension of democratic suffrage in Europe in 1920s and 1930s reduced the ability of governments to defend the currency values at all costs. Alfaro (2002) focuses, on the other hand, on the distributional impact of exchange rate appreciation in temporary stabilization programs and shows that, under certain plausible conditions, the owners of non-tradables gain from real exchange rate appreciation.

In his seminal book, *Capital in the Twenty First Century*, Thomas Piketty discusses the rise of inequality around the world. One driver of inequality as explained by Piketty is the relationship between the rate of return on capital (r) and the rate of growth of the economy (g). If $r > g$, then the income accruing to owners of capital grows faster than the rate of growth of the national income, and hence inequality between capital income and labor income rises. In Lebanon, given the low growth rates in the postwar period and the higher rate of return on capital (profits, interest, rent, dividends, etc.) over time, wealth amassed in the hands of a few, thus explaining the wide wealth inequalities we see today. From 1993 to 2013, the average yearly $r - g$ was 2.5%.[21] The cumulative effect of this positive divergence is increasing inequality between owners of capital and between labor income. In addition, the reduction of taxes on capital benefited the owners of capital, especially rentier capital, and reinforced the r larger than g relationship. In this respect, Milanovic has shown that the rich care more about lowering taxes than income growth.[22] The following sketch shows the channels by which the Lebanese economic model engendered inequality and a stagnant economy.[23]

Sketch of the Relationship Between Economic Model and Inequality



[21] World Bank, "Lebanon: Promoting Poverty Reduction and Shared Responsibility," World Bank Publications, 2016.
[22] B. Milanovic, "The Real Pandemic Danger Is Social Collapse," *Foreign Affairs*, March 19, 2020.
[23] Based on a similar analysis for Germany by Dao (2020), this sketch has been adapted to Lebanon. It is interesting to note that this IMF working paper appeared earlier as a background paper to the IMF periodic consultation with Germany in 2019.

The Dependence on Foreign Bailouts

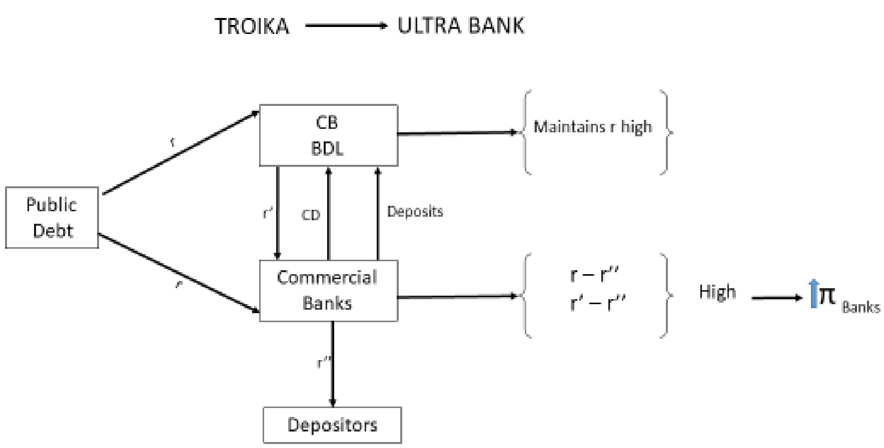
The economic model was maintained through capital inflows that became an essential feature of the model, and growth rates and credit growth in the economy became dependent on such inflows.[24] In addition to such flows, the Lebanese economy necessitated what we can call "financial bailouts," of which Paris II was the largest of such bailouts. Starting in 1997, the necessity of maintaining currency stability and a balance of payments called for the need of such foreign interventions, beginning with foreign currency deposits at the BdL by governments friendly to the Paris II and Paris III international donors' conferences. The international "bailouts" of Paris II and Paris III conferences had a significant impact on the prevention of currency and financial crises that would have signaled the end of the stabilization program. Both came at crucial times in 2002 and 2007, respectively providing Lebanon with both a hard asset (capital inflows) and a soft asset (investor confidence) to withstand pressures to abandon the hard peg. The investor confidence in the standing readiness of countries to help Lebanon with such "bailouts" has led some international traders to dub Lebanon as a "moral hazard" trade, which further attracted foreign liquidity into investing in Lebanese assets.[25] More recently, the convening of the CEDRE conference in Paris in April 2018 and the start of the negotiations with the IMF for a possible program are just the culmination of a long trend in the postwar period.

The Crisis in the Model

As discussed, the economic model withstood pressures for over 25 years. Before the current full blown-crisis, cracks in the model appeared as banks' holdings of public debt, which reached around 70% of total public debt in the 1990s, dwindled as commercial banks became aware of the continued risk of subscription to Lebanese debt. However, due to the internal dynamics of the model which were driven by the peg, high interest rates, and the necessity of foreign inflows of capital and the subsequent growth of deposits, the commercial banks substituted investments in Certificates of Deposits (CDs) issued by the BdL for subscription to public debt. In turn, the BdL increased its financing of the government. This "new mechanism," which in fact still relies on

[24] World Bank, "Using Lebanon's Large Capital Inflows to Foster Sustainable Long – Term Growth," World Bank Publications, January 2012.
[25] A. Schimmelpfennig and E. H. Gardner, "Lebanon—Weathering the Perfect Storms," IMF Working Paper, August 17, 2008.

interest flows from government debt, albeit now practically on an indirect basis, made the financial system more fragile, as the BdL and the commercial banks formed what we call an "Ultra-Bank" with the exposure of banks to the 'Sovereign" (which includes the state and the BdL) intensifying. Hence, all attempts to circumvent the "risks" entailed by the economic model made the system more brittle and fragile. The following sketch shows the relationship between state debt, the BdL and commercial banks.



In September 2019, the establishment of a de facto dual exchange rate with the market rate experiencing large depreciation reaching around 50% by June 2020 declared the end of the currency peg. In addition, due to "dollar scarcity," the commercial banks froze dollar deposits turning to quantity rationing as a means to manage such scarcity. This dual crisis was built up gradually because of the deceleration of foreign capital inflows after 2011. In this respect, it became apparent that the main weakness in the old economic model was not only the peg, but more importantly, the usage of the US dollar since 1993 as if it were a "local currency," particularly for bank loans and economic contracts, which were reflected in the balance sheets of economic agents. In particular, bank lending in dollars meant that there was persistent "money creation" denominated in dollars. This process was supported by capital inflows from abroad. However, once such flows decelerated, and given the fact that the BdL could not print the dollar whenever needed as central banks do in their local currencies when there is a need to inject liquidity in the financial system (after the 2008 crisis and current Covid-19 crisis), the crisis manifested itself in a severe liquidity crisis. In addition, the devaluation of the Lebanese pound in the dual market caused further economic dislocations, wealth and income redistribution, and impoverishment. The dependence of Lebanon on imports led to a significant rise in inflation registering around 17% between September and April 2020. More importantly, in an economy with such a long-term peg and usage of the US dollar in loans and internal transactions, economic relations between classes and economic agents were conducted based on a constant price of the Lebanese pound against the US dollar. This stability provided a stable value environment for determining incomes, storing wealth, writing contracts (for example, loans), and negotiating between different economic agents (for example, between workers and capital on wages). The end of the peg in such an economic environment resulted in winners and losers.[26]

The Plan and the Model

The crisis that besets the Lebanese economy is hence leading to the end of the "old economic model" that depended, as we have seen, on the special relationship between the BdL, commercial banks and the state. The end of the peg, the ensuing inflation, and the debt payment moratorium on the Eurobonds will eventually lead to the end of the rentier income generated by public debt. With high inflation, the real income of the rentier, which depended previously on high nominal interest rates and relatively low inflation, has gone into negative territory. In addition, the freezing of dollar accounts, the stock of previously accumulated wealth in the hands of the few (more than 50% of deposits are owned by 1% of depositors), means that it is threatened by depreciation in value either through a price mechanism (de facto or de jure Lirafication) or through a quantity mechanism (de facto or de jure haircut). Moreover, the crisis rendered an "automatic restart" of such an accumulation regime highly unlikely. In this respect, the government's Plan includes three

[26] John Maynard Keynes said, "a change in prices and rewards, as measured in money, generally affects different classes unequally, transfers wealth from one to another, bestows affluence here and embarrassment there, and redistributes Fortune's favors so as to frustrate design and disappoint expectation" (Keynes, 1930, pp. 80-81). Hence, bond holders in Lebanese pounds, workers and employees, merchants, industrialists, banks, the state, retirees – and even Lebanese workers abroad and others – will experience transfer of wealth and income from A to B, from B to C, and from C to A, etc. For example, wealth will be transferred from holders of government bonds in Lebanese pounds to the Lebanese state (which reverses more than 25 years of transfer from the state to bond holders!), and from banks to debtors in Lebanese pounds, and so on. In the 1980s, banks, speculators, the state, and industrialists gained while workers and employees lost (Dibeh, 2000). See also (Dibeh, 2011) for the postwar period. For example, Epstein and Power (2003) have shown that in many semi-industrialized countries, such as Mexico and Turkey, financial crises caused rentier income to decrease.

pillars that, if implemented, will lead to the end of the old economic model (in addition to the end of the peg). These three pillars are debt restructuring, financial sector restructuring, and the policies of jumpstarting a productive economy.

Debt and Financial Sector Restructuring

The debt restructuring plan entails a reduction of debt to GDP ratio from 175% to 102% in 2020, through significant discounts on the values of outstanding Eurobonds and Lebanese T-bills. The Plan also calls for a reduction of interest rates on both types of debt instruments to 3%. Such debt restructuring and interest rate cuts will certainly necessitate a significant haircut on deposits in the banking sector and will lead to a significant reduction in the incomes generated by the remaining stock of debt. In this respect, the financial restructuring plan includes the restructuring of both the central bank and the banking system. In fact, by initiating the need for restructuring of the BdL and the banking sector and taking stock of financial losses in the financial sector, totaling 186 trillion LBP originating from debt restructuring, private sector loan defaults, and BdL restructuring, the Plan declares unequivocally that the Troika has come to an end. The quasi-Ponzi scheme that underlined the flows in the Troika collapsed, generating such huge losses that need to be addressed through a complete restructuring of the financial sector. The Plan envisages a "bail-in" through commercial banks' capital (31 trillion LBP) and some form of haircut to depositors, albeit according to the Plan, "the authorities are determined to protect the vast majority of depositors, if not all of them, if possible." In order to protect the large deposits, the Plan includes, in this respect, a "Deposits Recovery Fund," where medium and large deposits will be transferred and will be offered to benefit from the revenue stream of the funds "up to a limit." The fund's revenue stream will be generated from recovered "stolen assets" and "potential other future proceeds from state assets."[27] Nevertheless, the Plan is clear, in that the way to address the financial losses is through a "bail-in" by both banks' capital and deposits. This has led the Association of Banks in Lebanon (ABL) to conduct a fierce opposition campaign against the government's Plan.

The ABL Opposition to the Plan

[27] The government Plan is unclear or elusive in this respect. Does "up to a limit," mean a haircut? In addition, the sustainability of the Fund is not clear.

On May 20, 2020, the ABL issued on a counterplan titled "A Contribution to the Government's Financial Recovery Plan" that presented a narrative distinct from the government's Plan. First, the ABL disputed the need for internal debt restructuring, rejected the financial sector restructuring scheme, and proposed what amounts to an outright transfer of public assets, to the order of $40 billion, to a newly created Government Debt Defeasance Fund ("GDDF") in order to settle the government debt to the BdL. In justifying the avoidance of internal debt restructuring, the ABL said, "the fallout of an internal default is likely to lead to a brain drain which will reduce future growth potential, thus leading to a 'lost decade' of depressed economic activity." Such a statement was justified by referencing empirical work that showed that internal defaults would result in significant output loss.[28] The ABL proposed instead an internal debt re-profiling consisting of "significant coupon reductions," which translates into lower interest payments on internally held debt in USD and the Lebanese pound. While there is a broad literature on the output costs of internal debt defaults that corroborate the position of the ABL, the mechanism by which such defaults affect output loss, through balance sheet effects and credit freeze resulting from the default, are already in operation in Lebanon prior to the default. In this respect, commercial banks froze credit provision in the economy and dollar deposits are "locked in" the banks. Hence, the "shock" of an internal default will be at best marginal and, when coupled with bank restructuring as the government Plan suggests, would get rid of the "zombie" state of banks and may return liquidity to the market. In addition, an internal debt restructuring will lower debt service that currently hovers around 10% of the GDP. (In the ABL plan, the debt to GDP ratio will reach around 100% in 2026 in contrast to the year 2020 in the government Plan.) Moreover, deposits as a percentage of the GDP in Lebanon is one of the highest in the world, reaching around 2.5 times (the 3rd globally in 2017), which means that the country is overbanked. Hence, the impact of the internal default on availability or credit will not be as large as in countries where this ratio is much smaller (the average in 2017 was 60%).

The Battle of the Numbers

In the aftermath of the publication of the ABL alternative plan, which represented finance capital's response to the government Plan for various restructuring schema, a controversy ensued publicly concerning the magnitude of financial losses suffered by the banking system and the BdL. Such

[28] Reinhart and Rogoff (2008) and Mallucci (2015).

discrepancies between government officials and BdL officials were reported initially in the negotiations with the IMF; however, this "battle of the numbers" spilled out into the open with the finance committee of the Lebanese parliament weighing in on the matter.[29] This battle was not only a technical one, pitting one estimation of the "financial losses" against another, but also a dispute that reflected vested interests in the Lebanese economy. As discussed earlier, the Plan called for a comprehensive restructuring of public debt, the BdL, and the banking system. The need for this restructuring will entail two actions that would threaten finance capital: the bail-in that would wipe out bank's capital and a "haircut" to large deposits. The counter numbers by the ABL and the parliamentary finance committee aim at reducing these numbers, so as to eliminate the need to for such measures.

Towards a Productive Economy?

The Plan called for the adoption of a "New Economic Growth Model," that would "regenerate the productive economy and promote a new integrated, sustainable and inclusive growth model, that will break with the unsustainable model of the past."[30] The Plan delineates various measures to promote or build such a "productive economy": A reformed legal and fiscal environment, infrastructure investments through CEDRE, the transfer of knowledge from abroad including the Lebanese diaspora, and a set of "comprehensive structural reforms." In addition, the Plan includes some resource requirements for jump-starting some economic sectors like agriculture and the knowledge economy. The resources (to be committed) are largely dependent on foreign aid, such as 1.1 billion USD to support incubators, 6.7 billion USD to loan subsidies for industry, agriculture and tourism, and 2.8 billion USD as credit lines to support the import of raw materials.[31] Hence, the Plan presents a set of procedures and sectoral financial support largely dependent on the availability of foreign aid and loans and it expects that a productive economy will emerge spontaneously. The experience of countries that have industrialized (i.e., built a productive

[29] In a tweet on June 20, the IMF spokesman Gerry Rice said, "There are media reports on IMF staff estimates of financial sector losses in Lebanon. To clarify, our estimates are broadly consistent with those in the government's plan."

[30] There seems to be a consensus amongst various economic and political players in Lebanon on the need to abandon the rentier economy towards building a productive one. Even the ABL, the bastion of the rentier economy, called in its "comments" on the Plan for a transformation of the economy into a productive one!

[31] These measures were mentioned as part of the Plan's "support for the economy during the crisis."

economy) tells otherwise. A structural change in the economy necessitates a degree of planning and industrial policies that guide the economy through the transformation. In this respect, the Lebanese economy today, as a result of old policies and the rentier structure, has a workforce that is largely irregular, operating in low-productivity fields such as the public sector, health, education, and services, and yet also has a minority rentier class possessing a much of the total income and wealth. In effect, the economy lacks a dynamic capitalist class that will produce industries, innovations, and economic development that would move us from the rentier world to the world of production and innovation. In this economic environment, Lebanon needs a comprehensive plan, by way of designing a new economy that would support the transition from a rentier economy to a productive economy, as the latter will not rise in a deus ex machina. The design of such a new economy needs to be comprised of the following five points that are largely left out from the Plan. First, in the current political-economic environment, the productive economy will face significant barriers from established class relations. Hence, it is necessary to weaken the "growth-impeding coalitions" that resulted from confessional governance, as the rentier economy's nexus of vested interests of classes and sectarian groups will impede the transition from rent-seeking activities to productive activities. The transition will also entail ending the dominance of the financial aristocracy and transforming the backward sectarian state.[32]

Second, a clear industrial policy must be implemented that would identify the new sectors for investment and would determine the degree and direction of technological progress. Naturally, the role of the state is pivotal. In her book, *The Entrepreneurial State*, Mariana Mazuccato showed the important role of the state in innovation and technological development in advanced economies. The task of the state rests in fulfilling the fundamental role that "free markets" cannot play. In this context, the state has historically played a role in countries that adopted “late” industrialization, such as South Korea, China, and Russia, as well as played a major role in advanced capitalist economies after World War II by funding research, development, and investment in high-risk areas.[33] As the new technologies are bound to production, we have to change the economy

[32] For example, ending the domination of landowners and of the traditional forces in society required dozens of years of modernist Communist rule, as happened in Poland and China. The predicament of the Venezuelan economy today stems from the inability of the Bolivarian government to build a productive socialist economy. Instead, the state built a redistributive economy dependent on resource rents.
[33] The building of a modern state is of paramount importance, in order to substitute the worn out state of the Taif regime that relies on clientelism, contractual and daily employment, and sectarian quotas for the ruling parties. The current state serves as a fetter to the "transition" process.

structurally and guide it towards increasing the share of the productive sectors, mainly manufacturing.[34] As discussed above, the transformation of class relations away from the dominance of financial interests and towards the rise of a more "enlightened" capitalist class, which would break away from the old dominant structures that have benefited from the state-financial aristocracy alliance, is critical. This could also entail imagining new forms of industrial organization that would mobilize the latent productive potential of the educated and youth sectors of the Lebanese population, who can contribute towards an innovative and dynamic economy through democratically run workplaces and employee-owned cooperatives.[35] This will put Lebanon on the path of economic development and a higher standards of living, as manufacturing growth is tied to rising incomes in developing countries according to many development economists, such as Ha-Joon Chang.[36] In this respect, Lebanon is latently ready for such a structural change, as it has a large pool of educated people in the labor force both internally and in the diaspora who can be utilized in building a technologically advanced industrial sector.

Third, answering the following question: Where will the resources come from to build a productive economy? In Lebanon, an economy dominated by services and rentier economic activities, resources can be transferred to the technologically advanced sector through the tax system. In this context, the state needs to adopt policies that lead to the transfer of the surplus from the rentier sectors towards financing the productive sectors by using the tax system against all forms of rent. In other words, what is required is to transfer resources gradually to the "entrepreneurial state" and from there to the "new economy."[37] The free market alone simply will not do it, and the modern

[34] Korea's industrial policy was comprised three stages. In the first stage from 1961-1973, Korea launched an aggressive export-promotion and home industry protection. The second stage from 1973-1981 was the period of heavy and chemical industries, that concentrated on the creation of large capital-intensive industries such as industrial machinery, shipbuilding, steel, and petrochemicals. The third stage, however, concentrated on functional incentives (Leipziger and Petri, 1993). In the same vein, the industrialization drive in Singapore went through five stages from 1959 to 1990, starting with labor-intensive import-substitution, changing into export-oriented growth in 1966-1973, and ending in technological upgrading and diversification of the manufacturing industry in the 1980's (Soon and Tan, 1993).

[35] This new "industrial organization" would prevent the replication of the low-wage economy that has characterized the Lebanese economy and would be incompatible with an economy where collective entrepreneurship would flourish.

[36] Ha-Joon Chang, *23 Things They Don't Tell You About Capitalism*, London: Penguin Books, 2011.

[37] In the 1920s, a debate aptly called the "industrialization debates" erupted in the Soviet Union. The country was still dominated by agriculture and backward industrially, and the question that presented itself was: "How do we industrialize?" One economist who was party to the debate was Evgeny Preobrazhensky. His argument was simple yet complex: the USSR can only industrialize by "exploiting" the agricultural sector for the benefit of the industrial one, i.e. resources must be transferred from one

industrial policy that gradually shifts the economy from a rentier one should rely on taxation of rents and wealth, especially financial wealth that is abundant in Lebanon.[38]

Fourth, establishing a social environment for innovation and growth. In fact, what is needed, in addition to the "entrepreneurial state," is to establish a "social democratic state" that engenders more equality, universal health care, free education, and gender equality. In his book, *Viking Economics*, George Lakey has argued that the Nordic countries have more start-ups than the United States because of the social environment provided by the social democratic state that the US lacks. He cites the work of Hopkin, et al.[39] that shows that lower levels of inequality are associated with greater innovation in economies.[40] In addition, female participation in the labor market is crucial for increases in production, innovation, and productivity. Lebanon is lagging behind tremendously in this respect. In the postwar period, there was no significant increase in female labor participation rates, which hovered around 25%. This shows the failure of postwar economic policies and the economic structure it engendered in mobilizing this segment of the latent labor resource. Gender gaps in labor markets have been shown to reduce income per capita (by 40% if all women are excluded from the labor market). In addition, their exclusion from entrepreneurship causes a drop in output per worker (productivity) by 12%. In the Middle East and North Africa, the gender gap causes a total loss of income by 27%.[41]

Fifth, building a sustainable and productive economy. Today, the world economy and Lebanon suffer from severe environmental damage and the specter of severe climate change. Green Peace estimated that Lebanon suffers a 2% GDP loss from fossil fuel pollution and a rate of four deaths per 10,000 people, which is the highest in the MENA region.[42] Hence, addressing the environment in any new economic model for Lebanon should be a priority.

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sector to another. This argument is still relevant today in developing countries (see Sah and Stiglitz, 1992).

[38] The Plan does mention that "Thought will be given to initiate tax measures to transfer resources from the richer segments."

[39] Hopkin, J., V. Lapuente, and L. Moller. "Lower levels of inequality are linked with greater innovation in economies." LSE US Centre, 2014. https://blogs.lse.ac.uk/usappblog/2014/01/23/lower-levels-of-inequality-are-linked-with-greater-innovation-in-economies/.

[40] Ha Joon Chang (2011) argued, with relevance to Lebanon, that the idea of the heroic entrepreneur is a myth. What is needed is "building institutions and organizations of collective entrepreneurship."

[41] M. Teignier and D. Cuberes, "Aggregate Costs of Gender Gaps in the Labor Market: A Quantitative Estimate," UB Economics Working Papers 2014/308.

[42] "Greenpeace: Lebanon pollution linked death rate highest in MENA," *Middle East Monitor*, June 25, 2020, https://www.middleeastmonitor.com/20200625-greenpeace-lebanon-pollution-linked-death-rate-highest-in-mena/.

III. Can the Plan Form a Good Background for Negotiations with the IMF?

The Plan in its outset proposes for Lebanon to conduct a program with the IMF to provide the necessary liquidity in order to restore or "jump start" the economy. This is driven mainly by the fact that the BdL cannot play the role of lender of last resort in the current crisis, given the immense scale of financial losses, and the fact that much of the liabilities are in US dollars. In the ensuing negotiations that were conducted in June and July 2020, it was reported that the IMF agreed with the estimation of financial losses that were presented in the Plan, rather than the attempted reduction of losses as presented by both the ABL and the Budget and Finance Committee of the Lebanese parliament. On July 13, 2020 the IMF urged the "Lebanese authorities…to unite around a government rescue plan and warned that attempts to lower losses from the financial crisis could only delay recovery."[43] From this angle, the Plan seems to be a good springboard from which to negotiate with the IMF, as the agreement with the Fund on "financial losses" paves the way for negotiating an IMF program with Lebanon. The additional elements in the Plan that would are possibly in congruence with the IMF are the debt restructuring and financial sector restructuring programs. As the IMF would stipulate in its conditionality a sustainable path for public debt, then a restructuring of the debt as presented in the Plan would be welcome. In addition, the restructuring of the financial sector that would rebuild the sector would be a part of any agreement with the IMF. However, the economic and social aspects of any IMF conditionality must be tackled by Lebanon.

A Changed IMF?

According to Stiglitz, the IMF before 2008 used to act "as the creditors' collection agency showing little concern about the effects of its policies on poverty…But in the post-2008 world, the IMF has become a champion for both (sustainability and inclusive growth), arguing that greater equality leads to better economic performance."[44] In the midst of this, there is today in Lebanon a great fear of the IMF and of the potential consequences of its program for the well-being of the middle and

[43] Reuters Staff, "IMF urges Lebanon to unite around government financial rescue plan," *Reuters*, July 13, 2020, https://www.reuters.com/article/us-lebanon-crisis-imf/imf-urges-lebanese-to-unite-around-government-financial-rescue-plan-idUSKCN24E1O5.
[44] J. Stiglitz, "Argentina and the Future of Finance Capitalism," *The Nation*, May 29, 2020, https://www.thenation.com/article/world/argentina-debt-finance-capitalism/.

working classes, which historically have borne the primary burden of fiscal adjustment. The IMF is trying to portray a new image of itself that creates more socially-oriented programs. However, according to many observers of the IMF such as the Bretton Woods Project, the IMF is still imposing austerity as the "new normal."[45]

Historically speaking, the experience of countries that have entered into programs with the International Monetary Fund it is not encouraging. In the 1980s, the IMF became infamous for its programs in Latin America that led to dire results on economic and social levels. In particular, the IMF advanced austerity policies, imposing consumer taxes and lifting subsidies on basic goods. Even in recent times, the IMF policies in some Latin American countries have not changed. In Ecuador, an agreement signed in March 2019 with the IMF calls for tightening the government's budget by about 6% of the GDP in three years.[46] In this respect, many observers have argued that the IMF may have changed its rhetoric through statements or research by its staff regarding equality, poverty and the social impact of its conditionality, but it remains in a practical sense outside the policies of the IMF.[47] A seminal paper by the chief IMF economist and his deputy in 2013 sheds some light on this issue. Blanchard and Leigh concluded that fiscal adjustment in advanced economies in the post-crisis period led to lower growth rates as the forecasters underestimated fiscal multipliers.[48] Hence, the austerity policies that were enacted led to lower output growth than expected. This was considered a scathing criticism of such austerity policies. However, despite being published by IMF's top economists, it was not considered to be an official IMF policy statement.[49] By looking at some of the more recent experiences of countries that dealt with the IMF, we see a more complex picture arise.

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[45] In a recent report, the IMF says that countries can maintain a minimum safety net of last resort if "they scale back wide scale public social insurance schemes, lower the size of social insurance contributions and put greater emphasis on privately managed mandatory and voluntary individuals savings and insurance schemes" (as quoted in BWP, 2020).

[46] M. Weisbrot, "The IMF is hurting countries it claims to help," *The Guardian*, August 27, 2019, https://www.theguardian.com/commentisfree/2019/aug/27/imf-economics-inequality-trump-ecuador.

[47] For example, the new IMF director Kristalina Georgieva has called for the enactment of progressive income taxes to tackle inequality. She said, "At the top of the income distribution, our research shows that marginal tax rates can be raised without sacrificing economic growth." As quoted in https://www.cnbc.com/2020/01/08/imf-chief-calls-for-tax-hikes-on-the-wealthy-to-reduce-inequality.html.

[48] O. Blanchard and D. Leigh, "Growth Forecast Errors and Fiscal Multipliers," *American Economic Review: Papers & Proceedings* 103, no. 3 (2013): 117–120, http://dx.doi.org/10.1257/aer.103.3.117.

[49] According to some observers, the IMF did soften its stance on fiscal adjustment, as evidenced by its divergence of views concerning Greece from the other members of the Troika.

The IMF Imposes Austerity in Arab Spring Countries

The IMF's experience in Arab countries, such as Tunisia and Egypt, in the aftermath of the Arab Spring, was also disappointing. Instead of helping these countries in the transition phase towards economic recovery, the Fund came with its ready-made recipes, which in the case of Tunisia, led to a conflict between the IMF conditionality and the consolidation of democracy.[50] Sherry studied the various IMF programs (or policy recommendations, in the case of Lebanon) in the Arab region in the post-spring period and argued that, in this context, the rhetoric of a changed IMF was just a myth. In the IMF's various dealings with Tunisia, Egypt, Jordan, and Lebanon, the IMF has mainly advocated fiscal and monetary and exchange rate policies that prioritized macroeconomic stabilization at the expense of clear social objectives, despite appealing to the importance of social safety and nets and targets.[51] Sherry concludes "that the stability-focused macroeconomic policies are essentially in collision with a longer-term development-oriented agenda.[52] While little room for social policy in IMF discourse and documents does exist, it remains insignificant, inadequate, and incapable of advancing inclusive growth."[53] According to an article published in *The Wall Street Journal*, a wave of austerity has hit the Arab Spring countries, which resulted from the IMF requiring "borrowers to reduce state spending and balance budgets to spur economic growth, which led to cuts in government payrolls and reduced subsidies for food, energy and other everyday goods."[54]

While Iceland Negotiates a Good Deal

[50] B. Daragahi, "Belt-Tightening Demands Put Tunisia's Democracy at Risk," *New York Times*, May 3, 2018, https://www.nytimes.com/2018/05/03/world/middleeast/tunisia-democracy-economy-reform.html.
[51] H. Sherry, "Debunking the Myth of a Changing IMF: Unpacking Conditionality in the Arab Region Post-Uprisings," Arab NGO Network for Development, September 2017, http://www.annd.org/data/file/files/IMF-Debunking%20the%20Myth%20of%20a%20Changing%20IMF.pdf.
[52] H. Sherry, "Debunking the Myth of a Changing IMF: Unpacking Conditionality in the Arab Region Post-Uprisings," Arab NGO Network for Development, September 2017, http://www.annd.org/data/file/files/IMF-Debunking%20the%20Myth%20of%20a%20Changing%20IMF.pdf.
[53] H. Sherry, "Debunking the Myth of a Changing IMF: Unpacking Conditionality in the Arab Region Post-Uprisings," Arab NGO Network for Development, September 2017, p. 49, http://www.annd.org/data/file/files/IMF-Debunking%20the%20Myth%20of%20a%20Changing%20IMF.pdf.
[54] A. El-Fekki and J. Malsin, "Tightened Belts in Mideast Stir Memories of Arab Spring," *Wall Street Journal*, December 5, 2018, https://www.wsj.com/articles/second-jobs-and-tightened-belts-the-arab-middle-class-cuts-back-1544005801.

In many ways, the experience of Iceland in the aftermath of the 2008 financial crisis has many similarities to the current situation of Lebanon. Iceland is a small country with a population of around 330,000 people. Following neoliberal reforms that began in 1995, an enlarged banking sector flourished, attracting not only local depositors but depositors from abroad, mainly from the UK and the Netherlands. The banking sector's assets grew to several times the GDP. In October 2008, the sector collapsed, causing a severe crisis and currency collapse. The crisis also caused political upheaval, leading to the election of a left-wing government after popular protests besieged the parliament for around three months. The new leftist government tackled the crisis through a "bank restructuring scheme" that allowed the largest three banks to go bankrupt and through the nationalization of banks. Similarly to Lebanon, the government entered into negotiations with the IMF, as a program for restructuring the financial system was deemed necessary. In the course of the negotiations, the IMF initially tried to impose austerity through reduction of expenditures on health and education, which was refused by the government, and then finally agreed not to impose austerity and instead to raise taxes on the wealthy, rather than on the middle and working classes. In response, George Lakey observed: "The Icelanders wanted to reduce the taxes on the working and middle classes and increase taxes on the rich. The IMF is famous for urging the opposite, as countries that continue to suffer from IMF-inspired austerity policies can tell us….In 2009, Iceland won the argument with the austerity crowd."[55][56] Gylfason said that the rescue operation with the IMF rested on three pillars.[57] First, the IMF lent support for the government not to bailout the banks and allowed losses, which were equivalent to an unprecedented seven times the national income, to be borne by foreign creditors, banks' shareholders and some depositors. This allowed Iceland to shield the real economy from the financial collapse. Second, a strict capital control regime was established that prevented the usage of local currency to obtain foreign currencies except for imported goods and services. Third, a countercyclical fiscal policy was enacted. This "patient fiscal policy" was "patient in that government expenditures were not cut and taxes weren't

[55] G. Lakey, *Viking Economics*, Mellville House Publishing, 2016, p. 165.
[56] George Lakey says that, according to the famous Icelandic economist Thorvaldur Gylfason, the IMF wanted a public relations win. He stated, "Being cuddly with Iceland could provide a welcome change in image"(p. 47). One exception to this "cuddly" relationship with the IMF was the treatment of the so-called IceSave accounts that were held primarily by British citizens. The IMF insisted that Iceland pay such depositors, and the Icelandic government finally yielded.
[57] T. Gylfason, "Iceland, Rising from the Ashes," The Legatum Institute, 2012.

raised immediately in order to avoid deepening the recession that followed the financial meltdown."[58][59]

And Portugal Abandons Austerity

Since 2015, the government in Portugal has managed to stop the deterioration of the Portuguese economy that resulted from the austerity imposed by the Troika (IMF, the European Commission, and European Central Bank). Portugal entered into a program the IMF in 2011 and suffered subsequently from an economic recession. As a result, unemployment rose dramatically and at its peak 40% of youth were unemployed and more than 485,000 people left the country between 2011 and 2014.[60] Only when economic policy moved against austerity, as a result of the agreement between the left-wing parties since 2015 which included increasing the minimum wage by 20%, unfreezing of pensions, and halting privatization, did Portugal recover.[61] Similar to the Icelandic case, the countercyclical measures had a multiplier effect on consumer spending and confidence.[62] David Lipton, Deputy Executive Director of the IMF, admitted to the successes of the Portuguese experience in a March 2019 speech: "Consider these three sets of numbers: Unemployment peaked at 16 percent in 2013, with the young particularly hard hit. Now joblessness is at 7 percent, its lowest level since 2004….Yields on Portugal's bonds were in double-digit territory during 2011-2012. By contrast, the yield on the 10-year bond is currently around 1.3 percent, showing a remarkable improvement. The overall fiscal deficit in 2010 was about 11 percent of the GDP. The government is targeting a small deficit this year, and the primary balance is expected to hit its

[58] T. Gylfason, "Iceland, Rising from the Ashes," The Legatum Institute, 2012, p. 6.
[59] Iceland did raise taxes, especially on higher incomes, and did enact some cuts to education and health expenditures and to the public wage bill. However, Iceland maintained its social benefits (Tan, 2018). An interesting fact reported by Tan (2018) tells of the objective of policy in Iceland in the post-crash period. Inequality, which was rising during the financial liberalization period, went down after ten years, post-crisis.
[60] T. Lorenz, "As Europe Moves Right, Portugal's Government Veers Left—and Thrives," *World Politics Review*, 2018, https://www.worldpoliticsreview.com/insights/23899/as-europe-moves-right-portugals-government-veers-left-and-thrives.
[61] Germany urged the new left coalition to stay the course designed by the Troika. The foreign minister Wolfgang Shauble warned, "Portugal is making a major mistake if they no longer stick to what they have committed to. They will have to request a new programme. And they will get it. But the terms would be severe, and it is not in Portugal's interests." As quoted in Newell (2019).
[62] H. Wainwright, *Remain and Reform: The Portuguese experience of being 'in and against' the European Union*, May 29, 2019, https://www.anothereurope.org/portugal-report-pr/.

highest level since 1992… In addition, exports and tourism have boomed, and the current account has been nearly balanced for the last several years."[63]

What Can Lebanon Wrestle from the IMF?

We have seen that the IMF in the Arab region has been a largely "unchanged IMF," in that its conditionality was harmful and led to social unrest and the impoverishment of the middle classes, which according to *The Wall Street Journal* was "pushing a segment of society that is key to growth and stability into making painful cutbacks and fueling discontent."[64] Therefore, in negotiating or designing a program with the IMF, Lebanon must stress the need for an "alternative" or heterodox program that eschews austerity and its harmful effects on the economy and society. The experiences of Iceland and Portugal are guiding experiences for Lebanon to imitate. The Lebanese government should negotiate a program that would help Lebanon transition to a new economic model, and that plan must include the following four elements.

First, a significant debt restructuring that would allow Lebanon to grow inclusively and sustainably without the need for significant fiscal consolidation (i.e. indirect tax increases and subsidies reforms). This would be in line with what Stiglitz has noted regarding the Argentinian case where the IMF has calculated what a sustainable debt restructuring would be, hence pitting Argentina against its creditors, or what Stiglitz called "finance capitalism."[65] Hence, the IMF can help Lebanon in standing up to "finance capital," that is demanding that no debt restructuring occurs.[66]

Second, a radical restructuring of the banking system along the lines of the Icelandic experience that primarily protects small depositors and future generations from being burdened with a bailout of the banking sector, as proposed by the bloc of the ABL and the parliament, in effect preventing the "privatization of profits and socialization of losses."[67] In addition, a strict capital control regime

[63] D. Lipton, "Lessons from Portugal's Recovery," International Monetary Fund, March 25, 2019, https://www.imf.org/en/News/Articles/2019/03/25/sp-032519-lessons-from-portugal-recovery.

[64] A. El-Fekki and J. Malsin, "Tightened Belts in Mideast Stir Memories of Arab Spring," *Wall Street Journal*, December 5, 2018, https://www.wsj.com/articles/second-jobs-and-tightened-belts-the-arab-middle-class-cuts-back-1544005801.

[65] J. Stiglitz, "Argentina and the Future of Finance Capitalism," *The Nation*, May 29, 2020, https://www.thenation.com/article/world/argentina-debt-finance-capitalism/.

[66] In the case of Argentina, the IMF calculated what Argentina can sustainably pay its foreign creditors. Stiglitz (2020) called this "an inconvenient truth that the country's creditors would like to ignore."

[67] Lakey cites two Nobel winning economists regarding the experience of Iceland with much relevance to Lebanon today. Paul Krugman said, "Where everyone else bailed out the bankers and made the public pay the price, Iceland let the banks go bust and actually expanded its social safety net" (p. 49). Joseph Stiglitz

must be imposed. In this respect, since the 1997-1998 Asian crisis in which the IMF opposed capital controls, it has relaxed its position on the matter. With the IMF's blessing, Iceland maintained capital controls for more than eight years. The experience of Argentina in the period after the 2018 program with IMF is important in this respect. According to observers, most of the funds disbursed by the IMF (about $44 billion) "immediately left the country enabling investors to cash out of Argentina at little or no cost."[68]

Third, a new tax system that would ensure both fiscal consolidation and social justice. The tax reform should be comprehensive, should include taxes on wealth, and should revise the progressive income tax system that currently exists. The taxes on wealth, especially financial wealth which according the 2019 Global Wealth Report totals 232 billion dollars, will play a major role in fiscal consolidation with no effect on the real economy, as much of this wealth is not used for investment or consumption, but has benefited from high interest rates in the old economic model.[69]

Fourth, it must be clear that any program with the IMF must eschew austerity measures. The reform of the tax system along the above lines and the de facto devaluation of the Lebanese pound, in addition to debt restructuring, would help in fiscal and current accounts adjustments, which would be stipulated in any IMF program. As the talks with the IMF are occurring amidst an unprecedented recession in Lebanon, the non-imposition of austerity on the middle and working classes is urgent.

IV. The Plan in the Context of Recession and Social Impact

Lebanon has been on a low-growth path akin to secular stagnation since 2011. However, the financial crisis and the Covid-lockdown that lasted 2.5 months have caused a severe downturn in

said, "What Iceland did was right. It would have been wrong to burden future generations with the mistakes of the financial system" (p.51).

[68] L. Merling, "Without an economic recovery, Argentina cannot repay its Debt," Center for Economic and Policy Research, 2020, https://cepr.net/without-an-economic-recovery-argentina-cannot-repay-its-debt/.

[69] Taxes on wealth have become a major element of the calls for effective and just tax systems around the world – see B. Casselman and J. Tankserley, 2020. For the Arab world, see K. Abu-Ismail and V. Hlasny, "Wealth inequality and the cost of poverty reduction in Arab countries: the case for a solidarity wealth tax," UNESCWA, https://www.unescwa.org/publications/wealth-inequality-closing-poverty-gap-arab-countries. An example of a wealth tax that can be imposed in Lebanon is a 2% tax on net wealth over $1 million, which according to Global Wealth Report would reach around 21 thousand adult individuals. In addition, inheritance taxes on wealth should be high (~50%) over 1 million USD. This will dilute the financial dynasties that persist through time and would exempt the middle and lower classes from inheritance tax.

economic activity, a rise in unemployment, and an increase in poverty rates. In this economic context, the Plan must be analyzed. It has concentrated more on tackling the banking and currency crisis (in addition to moving to a new growth model) and does not adequately tackle the recession that hit the Lebanese economy, intensifying since 2019 with a projected reduction in the GDP in 2020 by 11% according to the World Bank. Moreover, the GDP per capita will register a -12.8% decline and per capita consumption -14.1 %, and the population below the national poverty line will jump from 500,000 to 900,000 in 2020.[70] Although the Plan projected growth to resume in 2021 and included a vision for a social safety net that disburses 5.5 billion across five years (depending on international support), it does not address the recession and the negative social impact of the crisis in any meaningful way for various reasons.

First, the Plan is fiscally conservative. It imposes austerity at the time of recession while what is actually needed is countercyclical policies. The total expenditures will be reduced from 22.4% of the GDP in 2019 to 17.1% of the GDP in 2024. The primary balance is projected to increase from -0.9% in 2019 to 1.6% in 2024.[71] Austerity is partly imposed through the reduction in public wages from 13.1% of GDP to 9.1% and the reduction of pension payments from 4.7% of the GDP to 2.2% of the GDP in 2024. Moreover, the Plan lacks the specific mechanisms for the projected growth rates. There are no estimates of fiscal multipliers that study the effects of reducing government expenditures on output. The Plan, additionally, does not "exploit" the opportunity provided by the expanded "fiscal space" allowed by interest rates reduction and debt restructuring. The public debt reduction from around 170% to around 100% in 2020 and the planned reduction of interest rates to 3% should allow the government to expand expenditures during the recession. Instead, in addition to austerity measures, it includes unnecessary extra-expenditures support for an economy adversely shocked by the Covid-19. The Plan's short-term measures to address the Covid-19 crisis allocates around $1 billion of support to companies that are in need of cash and especially foreign currencies. In addition to the measures being mostly guarantees, assistance in paying dues to NSSF and potential foreign loans that do not have an immediate multiplier effect on the economy, the measures constitute less than 2% of the GDP yearly while many countries in

[70] K. Abu-Ismail, *Impact of COVID-19 on Money Metric Poverty in Arab Countries*, UN-ESCWA, 2020, https://www.un.org/unispal/wp-content/uploads/2020/07/I2000216.pdf.

[71] The reduction in expenditures and primary balance adjustment includes CEDRE expenditures. Without CEDRE, the austerity is even more severe with expenditures being 14.8% of the GDP in 2024 and the primary balance registering 3.8% in 2024.

the world have spent their GDP many times over to fight the negative effects on output engendered by the pandemic.[72]

Second, the Plan does not tackle inequality although it includes slight increases in taxes on capital income. Despite the need for fiscal consolidation as advocated by the Plan, the consolidation comes solely from the expenditures side, as the ratio of taxes to GDP remains constant at around 15%. In this respect, the Plan does not use the "tax space" available for Lebanon to raise taxes on wealth and capital income by five to ten percent of the GDP. Moreover, the planned increases in electricity and gasoline prices will be regressive in nature. The necessary overhaul of the tax system is also needed to finance Keynesian countercyclical policies, for which international calls have been increasing due to the pandemic crisis.[73]

Third, the Plan includes the establishment of a Public Asset Management Corporation (PAMC) and a Deposits Recovery Fund. The first consists of all state assets, except oil and gas resources, and aims at allocating its profits to the financing of BdL capital "so as to allow it to pay its commitments to commercial banks." The second will include transferred deposits from the banking sector and will benefit "from future potential returns from state assets." These two funds do mimic the proposal by the ABL and amount to the "socialization of losses" of the financial sector through a state bailout of large deposits. This "socialization of losses" will entail a transfer of resources from the public sector and hence a reduction in government expenditures on social and public capital, in effect substituting financial wealth, largely idle, for social and public capital. Fourth, the Plan relies on social targeting financed by international agencies as discussed above. In the current crisis, what is needed is a comprehensive strategy amounting to a new social contract or New Deal, rather than a targeted approach. In this respect, the provision of universal health coverage, expanded public education, and unemployment benefits needs to be at the top of the

[72] The Plan calls for international partners to finance such expenditures. For actual measures by Lebanon and other countries in response to Covid-19, see https://www.imf.org/en/Topics/imf-and-covid19/Policy-Responses-to-COVID-19#L. For example, Latvia has dedicated a fiscal support package equivalent to 12% of the GDP. Lebanon, in contrast, dedicated 1200 billion LBP for a social safety net (still not clear on disbursement mechanisms), which is a paltry 1.5% of the GDP (pre-crisis nominal GDP and package valued at the official exchange rate of 1500 LBP/USD).

[73] Independent Commission for the Reform of International Corporate Taxation, "The Global Pandemic, Sustainable Economic Recovery, and International Taxation," May 2020, https://www.icrict.com/press-release/2020/6/14/icrict-report-the-global-pandemic-sustainable-economic-recovery-and-international-taxation.

public agenda to enhance the social wage in the economy, at a time when money wages are losing value because of currency depreciation and inflation. The social wage will provide these basic commodities to supplement the dwindling real wages. In this respect, Lebanon needs a new wages policy that includes the social wage. Finally, a "wage restraint" in low productivity sectors and a "high wages" policy in the high productive and new sectors will be critical. These new wage policies will ensure monetary stability and a comprehensive social provision, in addition to enhancing competitiveness to create a virtuous cycle of production, consumption, and innovation in the Lebanese economy.

Fifth, by imposing austerity and "socialization of losses," the Plan undermines the establishment of a modern state in Lebanon, which is pivotal to the maintenance of social cohesiveness, solidarity, and fairness. Paul Collier said that in advanced capitalist countries between 1945 and 1970, "we experienced the rapidly rising prosperity achieved states that purposively harnessed capitalism for the benefit of society."[74] In the Plan, the opposite is proposed, that is to say, using society for the benefit of capital. The transfer of state assets and their returns to the two funds will complete phase two of capitals gain at the expense of the public (the first being the accumulation of financial capital through investment in state debt). Now, state assets are at stake. More than that, the nature of the state itself will be composed of the "worst" in the Taif state and the worst in the "neoliberal state," with dire social consequences. Today, amidst the uprisings' demands to abolish the sectarian system, a social democratic state must be built with the goal of "turn[ing] each nation into a gigantic community, a society with a strong sense of shared identity, obligation and reciprocity."[75]

Social Unrest and Politics

According to the UN World Economic Situation and Prospects 2020, "the leading cause of social unrest, as witnessed in Iraq and Lebanon in 2019, is the lack of decent employment opportunities."[76] The current crisis will definitely persist in its impact on social and political unrest; hence, addressing the crisis through fiscal measures to alleviate the recession and provide a "new

[74] P. Collier, *The Future of Capitalism*, Penguin, 2019, p. 47.
[75] P. Collier, *The Future of Capitalism*, Penguin, 2019, p. 49.
[76] United Nations, *World Economic Situation and Prospects 2020*, New York, 2020, p. 151, https://www.un.org/development/desa/dpad/wp-content/uploads/sites/45/WESP2020_FullReport.pdf.

social contract" is essential. This is also a worldwide phenomenon, as societies are caving under the pressures of economic crises. Milanovic warns of a societal collapse as result of the supply and demand shocks from the pandemic: "the human toll of the disease will be the most important cost and the one that could lead to societal disintegration. Those who are left hopeless, jobless, and without assets could easily turn against those who are better off….Thus the main (perhaps even the sole) objective of economic policy today should be to prevent social breakdown."[77] The Plan is silent on this issue. There is a need to conduct an economic policy to prevent social breakdown in Lebanon that includes fiscal countercyclical measures and the building of the social democratic state as outlined above.

In the case of Lebanon, social collapse may lead to national disintegration as confessional politics and the confessional system of governance collapse under the weight of the crisis. The first sign of this is how the current government is regarded as governing by proxy, under the guise of "technocratic government." Hence, a new form of politics must arise that stresses the need for a secular state, which will form the political and constitutional foundation for the social democratic state and do away with confessional politics, thus building a new system of politics that will ensure political, economic, and social progress for Lebanon.[78]

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[77] B. Milanovic, "The Real Pandemic Danger Is Social Collapse," *Foreign Affairs*, March 19, 2020.

[78] The confessional system in Lebanon is similar to political systems that have been dominated by "identity politics," such as race or ethnicity (Fukuyama, 2018). However, such systems can move to a more traditional class-based politics as the evolving experience of South Africa shows, where more and more class cleavages are affecting electoral outcomes (Gethin, 2020).

Appendix

The August 4th Explosion and its Aftermath

On August 4, 2020, Beirut was rocked by a huge explosion that occurred in its port. The explosion was estimated to be the equivalent of one thousand tons of TNT. It caused around 200 casualties and thousands were injured, in addition to the devastation of surrounding neighborhoods. On August 31, the World Bank issued an estimate of the Rapid Damage and Needs Assessment (RDNA), which was conducted in the aftermath of the explosion and reported that the damage caused to the physical stock was between $3.8 billion and $4.6 billion while losses and decline in output was estimated between $2.9 billion and $3.5 billion. Additionally, critical recovery needs amounted to between $35 and $40 million in immediate cash transfer in order to meet the basic needs of 90,000 individuals and to create short-term jobs for 15,000. Moreover, housing needs were estimated in the range of $30-45 million and in 2021 in the range of $190-230 million. Finally, $225 to $275 was needed in financial support for 5,200 microbusinesses and 4,800 small businesses. Apart from quantifying the economic costs of the explosion, this tragic event needs to be situated within the general crisis that Lebanon is facing with the following notable points.

First, notwithstanding its immediate cause, the explosion is the result of the disintegration of the state and its of foundations, as the Taif regime turned the state into a space for distributional sectarian consensus and conflict and into a source of rent income for the financial aristocracy with no regard for building functional state institutions that could have prevented the incident in the first place. *The Economist* magazine commented in this respect: “What kind of government leaves a mountain of explosive chemicals lying around unsafely for the better part of a decade? The same kind that cannot agree on a budget for 11 years and that let its central bank run a Ponzi scheme to defend its unrealistic currency peg. The kind, which is so deluded that it relies on aid, loans and remittances, spending far more than it collects in taxes. The kind that is controlled by an out-of-touch elite who fiddle and extort while the economy burns.”[79]

[79] “No way to run a country: A big blast should lead to big change in Lebanon,” *The Economist*, August 6, 2020, https://www.economist.com/leaders/2020/08/06/a-big-blast-should-lead-to-big-change-in-lebanon.

Second, the explosion, the ensuing destruction, and the loss of output and jobs can be seen as "inequality enhancing shock," as the work lost was mainly by low-wage workers, and the resulting crisis has had an asymmetric impact on the poorer sections of the population that suffered housing damage.

Third, the type of aid that ensued in the aftermath of the explosion was mainly run by NGOs in the form of food and shelter aid. The government did not respond with any kind of a relief program. Of course, the explosion should have prompted the government to enact social work programs that would have provided both reconstruction work and income for the unemployed. In addition, the government also could have enacted an "emergence basic income" scheme to provide income for those who lost jobs and property. However, the rentier state again had nothing to do with such programs and waited, as usual, for foreign aid to pour into the country.

Fourth, the areas mostly hit by the explosion, namely Gemayzeh and Mar Mikhael, are now in danger of being exploited by big capital that may intensify its efforts to buy up destroyed houses and property to construct future developments. This would intensify the trend that was dominant in the period before the explosion.[80] Hence, proper relief and regulatory measures should be undertaken to help the residents in these areas to remain in their homes and to prevent exploitation by financiers and developers.

[80] M. Fawaz, "A People Centered Recovery," American University of Beirut, Beirut Urban Lab, 2020.

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