

The Political Economy of Debt Accumulation in Lebanon

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Introduction

Lebanon is grappling with an economic and financial collapse widely recognized as one of the most severe globally since the mid-nineteenth century. Since 2018, the country's real GDP has contracted by approximately 40%, marking one of the steepest peacetime economic declines on record (World Bank, 2025). The Lebanese lira has depreciated by over 98% on parallel markets, severely eroding purchasing power and pushing more than half the population into poverty (World Bank, 2021; IMF, 2022). Amidst hyperinflation and mass unemployment, the government defaulted on its Eurobond debt in March 2020—its first-ever default—while the banking sector became functionally insolvent (Hausmann et al., 2020; IMF, 2022). Public sector debt, including central bank liabilities, has surged to more than seven times the country's GDP (World Bank, 2023). Lebanon is simultaneously confronting a sovereign debt crisis, a banking crisis, a currency crisis, and a profound socio-economic collapse (UN ESCWA, 2022).

Despite the dire situation, a comprehensive resolution remains elusive four years into the crisis, with mounting costs in terms of income losses, service degradation, and human suffering (World Bank, 2023).

This paper critically analyzes the evolution of Lebanon's sovereign debt crisis from the early 1990s through mid-2025. It highlights how a confluence of monetary and fiscal mismanagement, structural weaknesses, and institutional dysfunction contributed to the catastrophe. The analysis traces the historical trajectory of debt accumulation since the post-war reconstruction began in 1992, a period when Lebanon's economy became increasingly reliant on foreign inflows and a rigid currency peg, and identifies the central role of persistent twin deficits in exacerbating vulnerability (Harvard CID, 2022; ERF, 2021). Key policy choices, such as maintaining the currency peg since 1997 and the central bank's financial engineering practices, are examined for their role in deepening systemic risks (IMF, 2022; Hausmann et al., 2020). Governance failures—including entrenched sectarian patronage, elite capture, and chronic resistance to reform—have compounded these economic distortions (World Bank, 2022; ACW, 2023).

This paper delves deeper into the composition and ownership of Lebanon's public debt, assessing pathways to future debt sustainability and fiscal, sectoral, and monetary reforms in the country. It aims to provide well-supported policy recommendations for recovery and debt sustainability, taking into account Lebanon's constrained institutional capacity and complex political economy (World Bank, 2025). The analysis that follows provides the evidence base for these conclusions by first examining how Lebanon arrived at this crisis during the period from independence, with a focus on the period after the civil war (1992–2018), then reviewing the collapse since 2019, and finally outlining the necessary steps forward.

■ Historical Roots of Lebanon's Economic Model

Following its independence, Lebanon's elite pursued a liberal, service-oriented economic model, often referred to as the "Merchant Republic," which prioritized finance, trade, and tourism over productive sectors (Gates, 1998; Traboulsi, 2007). This configuration underscored Lebanon's strategic role as an intermediary for capital, goods, and services between European markets and oil-rich Arab states. Beirut became widely known as the "Bank of the Arab world," with an expanding banking sector and flourishing tourism industry supporting a buoyant services economy (Owen, 1993).

A defining feature of this economic framework was a strong and stable Lebanese pound, which benefited merchants and service exporters but marginalized industrial and agricultural producers (Nasr, 1978). The enactment of the 1956 Bank Secrecy Law further facilitated significant capital inflows, particularly from the Lebanese diaspora and Gulf states. By 1971, bank deposits had surpassed the country's GDP, highlighting Lebanon's emergence as a financial hub (Gates, 1998). The ideological foundation of this model rested on fiscal minimalism, with influential policymaker Michel Chiha famously warning against the "fiscal disease of the West" and the "obsession of taxation" (Chiha, 1964, as cited in Salibi, 1988). This laissez-faire approach limited the redistributive role of the state and contributed to structural imbalances.

While this model sustained economic growth, it did so without adequately addressing social equity. By the early 1970s, Lebanon faced not a crisis of stagnation, but one of deep-seated inequality and spatial exclusion, a condition described by scholars as the "crisis of Lebanese capitalism," reflecting the limitations of a growth strategy detached from inclusive development (Nasr, 1978; Chaaban, 2010).

■ Historical Evolution of Public Debt (1992–2018)

The roots of Lebanon's sovereign debt crisis are firmly embedded in the policy choices and economic model adopted after the civil war, which concluded in 1990. During the 1990s, the country embarked on an ambitious reconstruction program under Prime Minister Rafik Hariri, primarily financed through extensive borrowing. This approach led to massive budget deficits and a rapid accumulation of public debt (World Bank, 2020; Salti, 2019). Between 1992 and 1997, the fiscal deficit averaged around 20.7% of GDP, with a primary deficit of approximately 10.7% (IMF, 2020). In this period, public debt surged from \$2.9 billion to \$16.5 billion, exceeding 100% of GDP by 1997 (ESCWA, 2020).

Much of this early debt was domestic, borrowed from local banks and the central bank, establishing a tight linkage between the sovereign and the financial sector (IMF, 2021). Interest payments escalated during this time, with average effective interest rates on government debt reaching 18.6% between 1994 and 1997 (Harvard CID, 2022). In response, the Banque du Liban (BdL) pegged the Lebanese lira to the U.S. dollar in 1997 at LL 1,507/USD. While this measure initially curbed inflation and provided some stability, it also locked in an overvalued exchange rate that would later amplify vulnerabilities within the economic system (Hausmann et al., 2020).

By the early 2000s, Lebanon's debt was widely recognized as unsustainable, with the debt-to-GDP ratio surpassing 150% by 2002, and interest payments crowding out essential public spending (World Bank, 2020). This led to international intervention, with France convening the Paris II conference in 2002, where donors pledged \$4.4 billion in soft loans, conditional on reforms (OECD, 2003). The Lebanese government committed to privatization and fiscal consolidation, which temporarily improved the primary fiscal balance from a 7.6% deficit in 2000 to a 2.6% surplus in 2003 (IMF, 2004). However, overall deficits persisted due to high interest payments. Public debt continued to rise, reaching \$38 billion by 2005, equivalent to approximately 180% of GDP (World Bank, 2021). Political instability, including the assassination of Hariri in 2005 and the 2006 war with Israel, further undermined reform momentum (UNDP, 2006). In 2007, Paris III injected another \$7.6 billion in pledges, offering relief through debt rescheduling and soft loans (IMF, 2008).

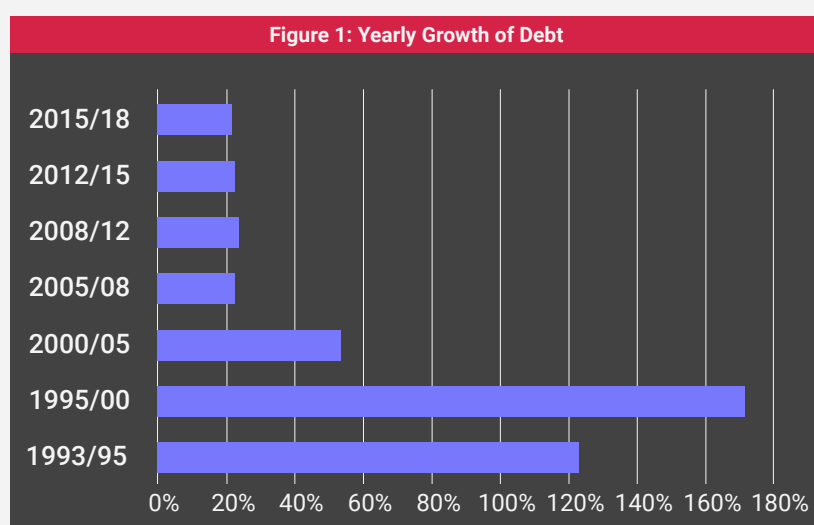
Between 2006 and 2012, a period of robust economic growth (7–9% annually) and capital inflows contributed to a reduction in the debt-to-GDP ratio from 183% to 131% (ERF, 2020). Gulf deposits and remittances played a significant role in stabilizing the macroeconomy (BLOMINVEST, 2011). However, this improvement was primarily attributable to temporary factors, such as high capital inflows, rather than fundamental structural reforms. By the early 2010s, the primary budget balance had stagnated, and the fiscal position remained fragile (Hausmann et al., 2020).

After 2011, economic growth decelerated due to the Syrian conflict and domestic political instability, which curtailed capital inflows and investor confidence. Average GDP growth fell to 1–2% between 2013 and 2018 (IMF, 2021), while interest rates remained elevated to attract deposits. The interest-growth differential turned sharply positive (+3.9%), reigniting debt accumulation (World Bank, 2022). By 2018, public debt reached approximately 155% of GDP in gross terms, or \$85 billion in nominal value, with most of the new debt financed domestically (Salti, 2020). The fiscal deficit exceeded 10% of GDP, driven by inflexible expenditures, including public wages, interest payments, and subsidies to the electricity sector (CEDRE, 2018). Weak tax collection, widespread evasion, and reliance on regressive indirect taxes exacerbated the situation (Arab Reform Initiative, 2021). Despite the \$11 billion pledged at CEDRE in 2018, conditional on reforms, little progress was made. By the eve of the 2019 crisis, Lebanon was caught in a classic debt trap: stagnant growth, persistent twin deficits, and an unsustainable debt burden that necessitated drastic adjustment (IMF, 2020; World Bank, 2021).

Table 1: Lebanon's Public Debt and Key Fiscal Indicators:

Year	Gross Public Debt	Debt-to-GDP	Interest Payments (% of GDP)	Interest Payments (% of Revenue)
1950	0	0	N/A	N/A
1964	1	1%	N/A	N/A
1994	4	6%	N/A	N/A
1993	\$4.2 billion	53%	18.6%	N/A
2000	\$25 billion	151%	17%	75%
2006	\$40 billion	183%	13%	58%
2012	\$57.7 billion	134%	8%	39%
2018	\$85 billion	155%	9%	39%

Source: Multiple Sources, including the IMF, World Bank databases, and economic reports issued by local commercial banks



Source: Blominvest, 2019

Composition and Ownership of Lebanese Public Debt

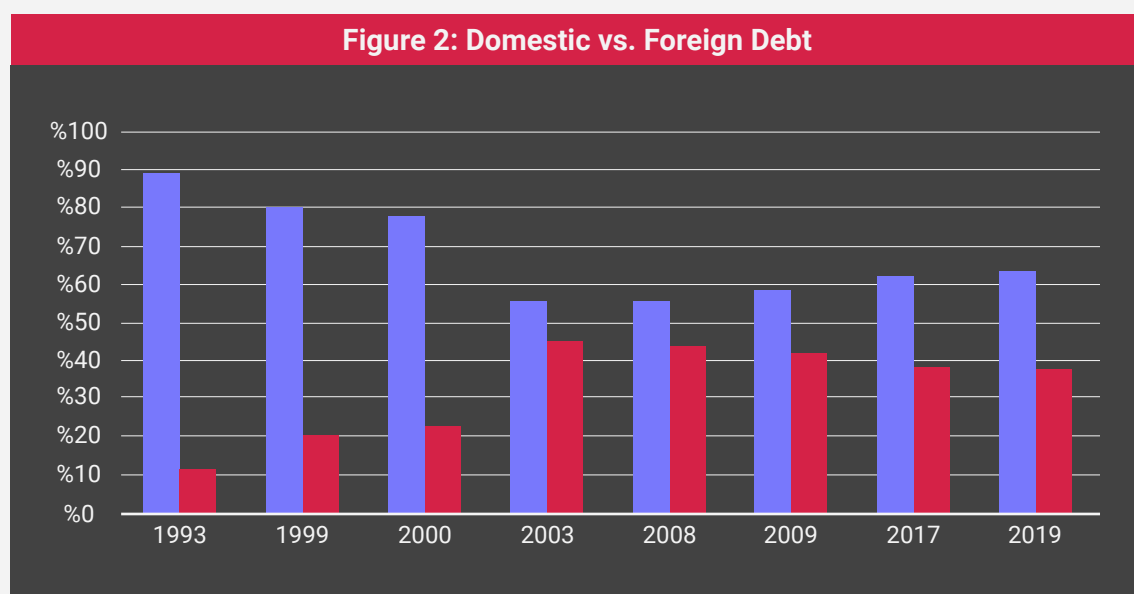
Lebanon's total outstanding public debt stood at 125,760 billion LBP in January 2023 (Moody's Analytics, 2023). However, this figure's real value is significantly impacted by the dramatic depreciation of the Lebanese Pound against the U.S. dollar, which renders the LBP-denominated debt much lower when converted at market rates (Blominvest Bank, 2025). In March 2022, the total public debt was 151.7 trillion LBP, an increase from 131.3 trillion LBP in October 2019, despite the country defaulting on foreign debt and the Ministry of Finance ceasing interest payments on BdL's domestic Treasury Bills (Blominvest Bank, 2025). The general government gross debt was projected at 164.1% of GDP in 2024 by the IMF, underscoring the persistent high debt burden (IMF, 2025).

A thorough understanding of Lebanon's public debt requires a detailed breakdown of its composition and the identity of its holders, particularly given the dramatic shifts observed during the crisis period. Between December 1993 and December 1998, for example, the Lebanese commercial banks held between two-thirds and three-quarters of all Lebanese-pound-denominated debt. (Baumann, 2016).

Domestic and Foreign Debt Composition and Holders

Domestic debt has consistently formed the larger component of Lebanon's public debt. Between 1993 and 2001, for example, domestic debt averaged 81.3% of all debt while foreign borrowing was minimal and was mainly in the form of external loans to finance the reconstruction phase (Baumann, 2016). What is essential is that the ownership structure of this domestic debt underwent a significant transformation during the crisis. The Banque du Liban (BdL) emerged as the primary holder, with its holdings of domestic debt increasing substantially from 44.9 trillion LBP in October 2019 to 58.9 trillion LBP in March 2022 (Blominvest Bank, 2025). This shift reflects a critical aspect of the crisis: as commercial banks, facing severe liquidity constraints and solvency challenges, reduced their exposure to government debt, the central bank stepped in as the predominant buyer. This intervention by BdL, absorbing government debt when other buyers were scarce, represents a clear instance of debt monetization. The central bank effectively financed government deficits by creating money, thereby blurring the traditional lines between monetary and fiscal policy. This quasi-fiscal role of the central bank led to the accumulation of massive losses on BdL's balance sheet, estimated at \$50-60 billion by 2020-2023 (Hausmann et al., 2020; IMF, 2023). These losses, in turn, directly impacted the solvency of the banking sector, which held significant claims on BdL, thus creating a perilous "financial pyramid" and a sovereign-bank doom loop (Hausmann et al., 2020).

From 1999 onwards, the successive Lebanese governments started making a sustained effort to finance debt by issuing foreign-currency bonds termed "Eurobonds" (Baumann, 2016). A crucial aspect of Lebanon's "foreign" debt is its significant domestic ownership. While Eurobonds are classified as foreign debt, a substantial portion was held by domestic entities. In October 2019, Lebanese commercial banks held about \$14.5 billion in Eurobonds, though this figure dropped to \$6.3 billion by March 2022. Additionally, BdL holds \$5 billion in Eurobonds (Blominvest Bank, 2025). This means that approximately 37% of the original \$30.5 billion in Eurobonds were held by local institutions (commercial banks and BdL) (Blominvest Bank, 2025). Foreign investors hold the remaining portion. This blurring of the traditional distinction between domestic and foreign debt has profound implications for negotiation purposes. A default on Eurobonds, while technically an external default, directly impacts the balance sheets of Lebanese banks and the central bank, exacerbating the domestic financial crisis. This interlinkage implies that any debt restructuring plan must simultaneously address both external creditors and the domestic financial system, making negotiations more complex and sensitive to domestic political and economic considerations.



Source: Multiple sources (IMF, Ministry of Finance, Blominvest)

The following table provides a detailed overview of Lebanon's public debt composition and holders from October 2019 to March 2022:

Table 2: Lebanese Public Debt Composition and Holders (2019-2022)						
Category	Unit	Oct.2019	Mar.2020	Dec.2020	Dec.2021	Mar.2022
Total Public Debt	Billion LBP	131,303	139,557	144,108	151,309	151,729
Total Domestic Debt	Billion LBP	82,260	87,935	89,762	93,247	92,396
BDL Holdings	Billion LBP	44,967	51,501	55,079	58,002	58,951
Banks Holdings	Billion LBP	26,046	24,916	23,157	21,200	18,925
Others*	Billion LBP	11,247	11,518	11,526	14,045	14,520
Total Foreign Debt	Billion LBP	49,043	51,622	54,346	58,062	59,333
Total Foreign Debt	Million USD	32,530	34,250	36,050	38,520	39,360
Eurobonds	Million USD	30,500	30,500	30,500	30,500	30,500
Eurobonds (incl. arrears)	Million USD	N/A	N/A	N/A	N/A	37,300
IDI**	Million USD	2,059	2,123	2,203	2,215	2,450
FG***	Million USD	1,002	939	880	743	742
Others****	Million USD	45,982	48,560	51,263	55,104	56,141

Source: Blominvest 2025

*Others for Domestic Debt: Likely public institutions, social security funds, and some private individuals/entities.

**IDI: International Development Institutions.

***FG: Foreign Governments.

****Others for Foreign Debt: Other private foreign investors (converted from LBP at 1,507).

*Eurobond figures show original principal; total foreign debt in USD includes accumulated arrears by March 2022—data from (Blominvest Bank, 2025).

Fiscal Policy Failures and Unsustainable Public Finances

Lebanon's fiscal stance since the 1990s has been characterized by persistent deficits, rising debt, and limited public investment. Successive governments consistently failed to adopt credible fiscal consolidation strategies or to broaden the tax base equitably and efficiently (International Monetary Fund, 2020). Instead, public finances were marked by rigid expenditures—particularly on public sector wages, transfers to the inefficient electricity utility *Electricité du Liban* (EDL), and unsustainable debt servicing costs—which crowded out both social spending and capital investment (World Bank, 2020).

The fiscal deficit remained above 9% of GDP for most of the post-war period, while primary surpluses, when achieved, were modest, temporary, and insufficient to stabilize debt dynamics (United Nations Economic and Social Commission for Western Asia, 2021). Budget rigidity was structural: wages, interest payments, and transfers to EDL accounted for over 75% of spending (IMF, 2019). The electricity sector alone absorbed nearly 3–4% of GDP per year in subsidies, an amount exceeding combined spending on health, education, or capital investment (World Bank, 2021).

The structure of revenue collection was regressive and volatile. Despite the introduction of the Value Added Tax (VAT) in 2002, Lebanon's tax system continued to rely heavily on indirect taxes such as VAT and customs duties, which disproportionately affected low- and middle-income households (Salti, 2020). These indirect taxes accounted for more than 65% of total revenues, while direct taxes on income, wealth, and profits remained underutilized (Arab Reform Initiative, 2022). High levels of tax evasion and informality further undermined revenue mobilization (IMF, 2020). Lebanon's ratio of tax revenues to GDP hovered around 14–15%, significantly below the 20%+ average observed in upper-middle-income countries (World Bank, 2020).

Expenditure-side reforms were also notably absent. The government's payroll grew substantially in the 2010s, particularly following the 2017 salary scale adjustment, which raised public wages without adequate compensation measures (IMF, 2018). Social protection spending remained fragmented and insufficient, covering less than 25% of the vulnerable population (ESCWA, 2021). Capital spending averaged less than 2% of GDP, undermining infrastructure quality and service delivery (World Bank, 2020).

Long-standing procedural and institutional weaknesses severely compromised fiscal governance. Lebanon operated without an official budget between 2005 and 2016, relying instead on extra-budgetary spending and treasury advances (ESCWA, 2021). Even after the reintroduction of annual budgets in 2017, their credibility was limited due

to unrealistic revenue projections, frequent off-budget spending, and weak execution (ARI, 2022). The General Directorate of Public Finance lacked effective forecasting tools, and its procurement processes were opaque and politicized (Arab Center, Washington, D.C., 2022). Oversight and accountability mechanisms were eroded. Key institutions, such as the Court of Accounts and the Central Inspection Board, were either politically captured or underfunded, and budget transparency ranked among the lowest in the MENA region, according to Open Budget Index assessments (IMF, 2020). External audits were rare, and public access to fiscal data or performance monitoring was minimal (World Bank, 2021).

As a result, Lebanon entered the 2019 crisis with one of the highest debt service burdens in the world. Interest payments consumed nearly 50% of total revenues and approximately 10–12% of GDP annually (IMF, 2020). This severely narrowed fiscal space left the government unable to adopt countercyclical measures or invest in critical infrastructure and human capital (ESCWA, 2021). Attempts at reform failed to gain traction amid political fragmentation, public distrust, and entrenched elite interests (ARI, 2022). Ultimately, Lebanon's fiscal trajectory proved unsustainable. A toxic combination of rigid spending, regressive taxation, poor governance, and debt overhang left the country highly vulnerable to external shocks. When capital inflows dried up in 2019, the fiscal crisis merged with a balance of payments and banking crisis, precipitating the sovereign default in 2020 (World Bank, 2020).

Table 3: Lebanon's Fiscal Realities

Year	Total Revenues (%of GDP)	Total Expenditures (%of GDP)	Overall Deficit %of GDP)
1949-1951	N/A	N/A	Surplus
1964-1966	N/A	N/A	2%
1974	15.6%	15%	0.6
1990	9.7%	39.4%	-29.8%
1992	12%	23.4%	-11.1%
2000	N/A	N/A	-23.7%
2006	24.8%	35.9%	-11.1%
2018	20.5%	31%	11%
2022	6.5%	11.5%	-5.2%

Source: Multiple Sources (IMF, World Bank, ESCWA Databases)

■ Monetary Policy, the Dollar Peg, and Financial Engineering

Lebanon's monetary policy has been profoundly shaped by the fixed exchange rate regime adopted in 1997, which pegged the Lebanese pound to the U.S. dollar at a rate of LL 1,507.5/USD. While initially successful in reducing inflation and stabilizing expectations following the civil war, the peg became increasingly misaligned with economic fundamentals, and its long-term costs began to outweigh its benefits (International Monetary Fund, 2020; Hausmann, 2020). For over two decades, the Banque du Liban (BdL) maintained this regime by offering high interest rates to attract inflows, particularly remittances and bank deposits from the diaspora (World Bank, 2020). This hard peg created a perception of macroeconomic and financial stability that encouraged financial inflows but masked profound structural weaknesses. Real exchange rate appreciation eroded export competitiveness, and Lebanon's economy became overly reliant on consumption and imports, financed by foreign capital rather than productive exports (Economic Research Forum, 2020). The current account deficit consistently exceeded 20% of GDP between 2007 and 2019, one of the highest globally, exposing the country to mounting external vulnerabilities (World Bank, 2020).

The BdL operated as both a monetary and fiscal agent, using its foreign currency reserves to finance public sector deficits and ensure debt rollover, thereby undermining its operational independence (ESCWA, 2021). Over time, it became a primary buyer of government debt and assumed a quasi-fiscal role in funding budget shortfalls, further blurring the line between monetary policy and public finance (IMF, 2020).

Starting in 2016, faced with declining foreign inflows, BdL introduced what it termed "financial engineering" operations. These involved offering Lebanese commercial banks attractive returns in U.S. dollars in exchange for new dollar deposits, which BdL then used to replenish its reserves (Harvard Center for International Development, 2022). Banks would place dollars at the central bank in return for LBP-denominated instruments or deposits at high interest rates, generating significant returns. Critics argued that these operations functioned similarly to a Ponzi scheme, requiring ever-increasing new inflows to meet existing obligations (Hausmann, 2020).

The Ponzi scheme comparison suggests that the returns offered were unsustainably high, exceeding what could be generated from productive investments, and the system relied on attracting new deposits to pay off existing ones. This mechanism artificially inflated BdL's foreign currency reserves, creating an illusion of stability while accumulating massive quasi-fiscal losses on its balance sheet, estimated at \$50-60 billion by 2020-2023 (Hausmann et al., 2020; IMF, 2023). It deepened the banking sector's exposure to sovereign risk, as banks became reliant on BdL's operations rather

than private sector lending (IMF, 2021). These operations transferred the risk from the commercial banks, who were attracting deposits, to the central bank, effectively delaying an inevitable adjustment and creating a highly fragile financial pyramid (Hausmann, 2020). When confidence eroded, these operations collapsed, leading to the currency's freefall and hyperinflation, demonstrating the profound systemic fragility built into the pre-crisis monetary system. Moreover, these operations heavily favored large depositors and banks, contributing to regressive redistribution and increasing systemic fragility (Hausmann, 2020).

Compounding the problem was the central bank's lack of transparency. BdL did not publish audited financial statements in accordance with international standards, and losses were often concealed through unconventional accounting practices, such as the reclassification of liabilities as "seigniorage advances" and the overvaluation of illiquid assets (ESCWA, 2021; Arab Center, Washington, DC, 2022).

The IMF and other external actors repeatedly emphasized the need for a full forensic audit of BdL's accounts as a prerequisite for financial stabilization and international support (IMF, 2021). Ultimately, the collapse of confidence in the peg in late 2019 led to a sharp depreciation of the Lebanese pound on parallel markets. The exchange rate spiraled out of control, losing over 90% of its value by mid-2021, resulting in hyperinflation, the erosion of real incomes, and a near-total breakdown of monetary transmission mechanisms (World Bank, 2020; IMF, 2021). In February 2023, Lebanon officially adjusted the exchange rate to LL 15,000/USD—an overdue move that nonetheless fell short of true unification and did not restore credibility to monetary policy (IMF, 2023).

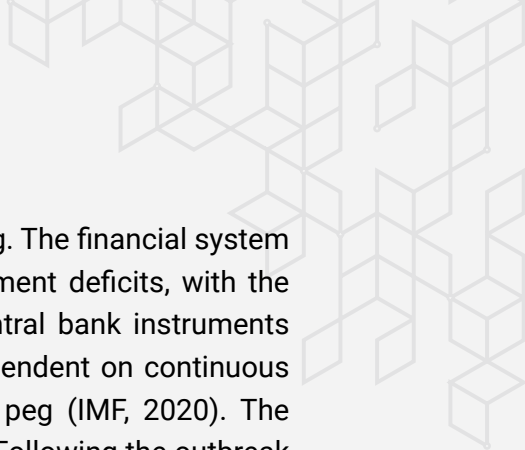
Structural Economic Weaknesses and External Imbalances

Lebanon's post-war economic model has been primarily driven by consumption, imports, and external capital inflows, rather than by productive investment or export-oriented growth (International Monetary Fund, 2020). Since the 1990s, economic policy has prioritized short-term financial stability and capital attraction, particularly through banking and real estate, at the expense of long-term structural development (World Bank, 2020). This resulted in a dual economy: a financially liberalized, dollarized, service-oriented sector coexisting with weak, underdeveloped, and informal productive sectors such as agriculture and industry (Economic Research Forum, 2020). The share of industry in GDP declined from over 14% in the early 1990s to less than 8% by 2018, while agriculture dropped to under 4%, despite Lebanon's potential in agro-food value chains (ERF, 2020). The service sector dominated the economy, accounting for more than 75% of GDP, but offered limited formal employment or innovation spillovers. Real estate, retail trade, and the financial sector absorbed the majority of investment, generating cyclical booms rather than sustainable productivity gains (Hausmann, 2020).

The country's infrastructure gap exacerbated these challenges. Chronic underinvestment in energy, water, transport, and digital infrastructure led to high production costs, supply bottlenecks, and diminished competitiveness (World Bank, 2020). Electricity shortages, in particular, raised operational costs for businesses and discouraged industrial growth. Poor transport logistics and high port fees further hampered exports (ESCWA, 2021). Lebanon consistently ranked poorly in the World Economic Forum's Global Competitiveness Index and the World Bank's Doing Business indicators throughout the 2010s (World Bank, 2021).

The weakness of the productive economy manifested in chronic external imbalances. Lebanon has consistently run persistent current account deficits since the 1990s, averaging 22% of GDP between 2011 and 2019, one of the highest in the world (IMF, 2020). This was driven by a large trade deficit, with imports exceeding exports by a ratio of nearly five to one. The country imported over 80% of its consumption needs, including food, fuel, and medicine (World Bank, 2020). Meanwhile, export performance was limited by low competitiveness, a small industrial base, and regional instability. Exports of goods averaged only 12–15% of GDP during the 2010s, compared to 25–30% in peer economies (ERF, 2020).

These imbalances were financed through capital inflows—mainly bank deposits from the diaspora, remittances, tourism receipts, and real estate investments (IMF, 2019). However, these flows were largely speculative or consumption-driven, rather than being



channeled into productive investment or technological upgrading. The financial system acted as an intermediary between foreign inflows and government deficits, with the banking sector recycling deposits into sovereign debt and central bank instruments (Hausmann, 2020). This cycle created a fragile equilibrium dependent on continuous inflows and confidence in the financial system and currency peg (IMF, 2020). The economy's vulnerability to external shocks increased over time. Following the outbreak of the Syrian war in 2011, capital inflows began to slow, weakening reserve buffers and increasing reliance on financial engineering (World Bank, 2020). Between 2016 and 2019, the central bank's net foreign assets declined steadily. The current account deficit remained high, while foreign exchange reserves became increasingly illiquid due to the central bank's quasi-fiscal operations (ESCWA, 2021).

Compounding these issues was Lebanon's high degree of dollarization. By 2019, over 70% of bank deposits were denominated in U.S. dollars, and both public and private transactions were conducted extensively in foreign currency. This reduced the effectiveness of monetary policy and increased the economy's exposure to exchange rate shocks (IMF, 2020). At the same time, Lebanon lacked capital controls or macroprudential tools to manage volatility, allowing for rapid outflows when confidence eroded (ESCWA, 2021). The structural distortions of the Lebanese economy—namely, a narrow productive base, excessive dependence on non-resident inflows, large trade deficits, weak export capacity, and underdeveloped infrastructure—meant that any external shock could destabilize the entire macro-financial framework. These underlying vulnerabilities were masked by temporary financial inflows and the illusion of currency stability but were never addressed through serious reform (Arab Reform Initiative, 2022). When confidence broke in 2019, the result was a sudden halt in capital flows, a collapse of the currency, and a deep recession, exposing the structural frailty of the pre-crisis economic model (World Bank, 2021; IMF, 2020).

Institutional Constraints and Governance Failures

Lebanon's sovereign debt crisis cannot be explained solely by macroeconomic indicators; it is deeply rooted in structural and institutional dysfunctions that have compromised state capacity, policy effectiveness, and reform credibility for decades (International Monetary Fund, 2020). Lebanon's post-Taif governance system, which relies on sectarian power-sharing, has led to elite capture, clientelism, and weak accountability mechanisms (Arab Reform Initiative, 2022; Salti, 2020). The Lebanese political system allocates power and public resources among sectarian elites who often prioritize short-term political gains over long-term national interest. Ministries and public agencies are treated as political spoils, weakening bureaucratic autonomy and creating parallel networks of authority (ESCWA, 2021). Decision-making processes are fragmented, and public policy is frequently delayed or blocked by political bargaining and sectarian vetoes (World Bank, 2020).

This institutional fragmentation has prevented the emergence of a coherent development strategy. Lebanon has lacked national development plans with enforceable goals and measurable outcomes. Economic policymaking is reactive and short-sighted, driven more by crisis management than strategic planning (Hausmann, 2020). Institutions such as the Council for Development and Reconstruction (CDR) and the Ministry of Planning (which was dissolved in 2000) have not been replaced with effective alternatives to coordinate public investment and economic priorities (World Bank, 2020).

The weakness of Lebanon's civil service further exacerbates governance failures. The bureaucracy suffers from political interference, outdated regulations, and a lack of merit-based recruitment. According to ESCWA (2021), over 60% of public employees were hired on temporary contracts or outside civil service procedures, undermining transparency and accountability. Training, performance evaluation, and incentives for innovation are virtually absent, and public institutions often rely on donor-funded consultants to carry out core functions (IMF, 2020).

Public financial management is equally compromised. Lebanon did not pass a formal state budget between 2005 and 2016, and even after reintroducing budget laws, expenditure controls remained weak and revenue forecasts were frequently unrealistic (World Bank, 2021). The Ministry of Finance lacks comprehensive fiscal databases and is therefore unable to produce accurate reports on public sector liabilities or arrears (ESCWA, 2021). Key reforms, such as the introduction of program-based budgeting, fiscal risk management, and medium-term expenditure frameworks, have stalled or been poorly implemented (IMF, 2021).

Oversight and audit institutions—such as the Court of Accounts, the Central Inspection Board, and the recently established National Anti-Corruption Commission—lack operational independence, adequate staffing, and enforcement power. These bodies are often bypassed or politically co-opted, and their findings rarely lead to corrective action (ARI, 2022; Arab Center, Washington DC, 2022). Lebanon's score on the World Bank's Worldwide Governance Indicators has declined steadily since 2010, particularly in the areas of control of corruption and government effectiveness (World Bank, 2021). Transparency and access to information are further impeded by institutional opacity. Despite the adoption of a Right to Access Information Law in 2017, compliance has been minimal, and public entities regularly withhold fiscal and administrative data (ESCWA, 2021). Public procurement, which accounts for nearly 20% of government spending, remains vulnerable to manipulation despite the passing of a new public procurement law in 2021.

The management of state-owned enterprises (SOEs) and public agencies reflects broader governance pathologies. Key SOEs, such as Electricité du Liban (EDL), Middle East Airlines (MEA), and OGERO, operate under outdated legal frameworks, often without audited accounts, independent boards, or clear performance targets (World Bank, 2020). EDL alone has accumulated over \$40 billion in quasi-fiscal losses since the 1990s, financed through transfers from the Treasury and borrowing from the central bank (ESCWA, 2021).

International partners and donors have repeatedly highlighted governance reforms as a precondition for financial support. The CEDRE conference in 2018, for example, conditioned over \$11 billion in pledged soft loans on structural reforms in public procurement, electricity, civil service, and anti-corruption (IMF, 2019). Yet implementation has been minimal due to political fragmentation and a lack of political will. Even after Lebanon's 2020 default, proposed reforms remained blocked by competing interests and elite resistance (Hausmann, 2020). The result is a profound erosion of public trust in government. According to Arab Barometer surveys, more than 85% of Lebanese believe corruption is widespread in public institutions, and less than 10% trust the Parliament or political parties (ARI, 2022). Citizens perceive the state not as a provider of public goods, but as an arena for patronage and rent-seeking. This has led to low tax compliance, weak civic engagement, and an expanding informal economy (World Bank, 2021). In sum, Lebanon's institutional crisis is not merely a backdrop to the economic collapse—it is a central cause. Governance failures have distorted policymaking, enabled fiscal mismanagement, and undermined reform attempts at every stage. Without far-reaching institutional reform—rooted in meritocracy, transparency, and the rule of law—efforts to restore economic stability and regain investor confidence will be short-lived (IMF, 2021; ESCWA, 2021).

International Actors and Stalled Reforms

Since Lebanon's financial collapse in 2019, international actors—including the International Monetary Fund (IMF), the World Bank, the European Union (EU), and bilateral donors—have repeatedly called for comprehensive reforms as a prerequisite for financial support and debt restructuring. Yet, over the past years, Lebanon has made only halting progress on the reform agenda, hindered by political paralysis, elite resistance, and institutional fragmentation (International Monetary Fund, 2021; World Bank, 2021).

Initial efforts at reform, including the Lebanese government's April 2020 financial recovery plan, faced strong opposition from entrenched interests, particularly within the banking sector and Parliament. Although the IMF supported the plan, it was rejected by key domestic stakeholders and subsequently shelved (Hausmann, 2020). Negotiations with the IMF were stalled until April 2022, when Lebanon reached a staff-level agreement on an Extended Fund Facility (EFF) of approximately \$3 billion. However, disbursement was conditioned on the implementation of critical prior actions (IMF, 2022).

While some technical progress was achieved, such as the passage of a reformed public procurement law in 2021 and amendments to the bank secrecy law in 2022, core structural measures remained unimplemented for over two years (World Bank, 2022; ARI, 2022).

In a significant political development, Lebanon elected a president in January 2025, following more than two years of a presidential vacuum. A new government was also formed shortly thereafter, renewing hopes of reform momentum and improved engagement with the international community. The Lebanese government approved several important draft legislations, including amendments to the bank secrecy law, the independence of the judiciary, and bank restructuring. During the 2025 IMF Spring Meetings in Washington, a Lebanese delegation led by the Minister of Finance and the newly appointed Central Bank Governor held high-level talks with IMF officials and international partners. Discussions emphasized the urgency of implementing the EFF framework and securing international confidence (IMF, 2025a).

In May 2025, the IMF concluded a technical mission to Beirut and issued a communiqué acknowledging "some positive steps taken by the Lebanese authorities," including Parliament's approval of amendments to the bank secrecy law and the Council of Ministers' endorsement of a draft law on bank restructuring (IMF, 2025b). The communiqué welcomed these developments but underscored the need for accelerated implementation of other structural reforms, particularly those related to fiscal governance, central bank transparency, and judicial independence.

Despite these advances, the broader reform landscape remains precarious. Fiscal consolidation efforts continue to face resistance, and Lebanon's banking sector remains largely frozen, with restrictions on withdrawals and transfers still in place. Public confidence in state institutions remains low, and the country continues to rank poorly on global governance and anti-corruption indices (Transparency International, 2024). International support is contingent on "meaningful reform" (World Bank, 2025). Despite "some positive steps" acknowledged by the IMF (IMF, 2025b), core structural measures remain unimplemented due to "political paralysis, elite resistance, and institutional fragmentation" (IMF, 2021; World Bank, 2021). This situation reveals a critical challenge: the problem is not merely a lack of technical solutions or external financial pledges, but a profound deficit in political will and institutional capacity to implement reforms. The "long-standing procedural and institutional weaknesses" and "political interference" (ESCWA, 2021) are deeply embedded within the system.

Looking forward, the path to recovery hinges on the Lebanese government's ability to capitalize on the current political momentum. The recent reforms are important initial steps but must be followed by more profound institutional changes, including the restructuring of the financial sector, judicial reform, and a comprehensive social protection strategy (IMF, 2025b). The new government must demonstrate not only technical capacity but also genuine political will to confront vested interests and restore the state's legitimacy (IMF, 2025a). Without sustained engagement, transparent policymaking, and inclusive economic recovery strategies, Lebanon risks prolonged stagnation and deeper social fragmentation. The role of international actors will remain essential in monitoring progress, providing technical assistance, and supporting implementation; yet, the primary responsibility for reform lies with Lebanon's domestic leadership (ARI, 2022; IMF, 2025a). The crisis is fundamentally a governance crisis, and economic recovery is contingent on political reform.

The Path to Debt Sustainability and Policy Recommendations

While Lebanon's outlook for 2025 is shaped by a fragile stabilization in the political and security environment following the formation of a new government, the path to recovery remains precarious (World Bank, 2025b). The World Bank's 2024 real GDP contraction estimate is 7.1 percent (World Bank, 2025b). This underscores that any recovery will be slow and highly contingent on sustained reforms and a stable security situation.

Table 4: Key Economic Indicators (2023-2025)

Indicator	2023	2024	2025 (Proj.)
Real Sector			
Real GDP Growth (%)	-0.8%	-7.1%	4.7%
Inflation (CPI, Annual %)	221.3%	45.2%	15.2%
Public Finance (% of GDP)			
Total Revenue	13.7%	15.3%	15.9%
Total Expenditure	3.2%	14.7%	15.9%
Overall Fiscal Balance	0.5%	0.5%	0.0%
External Sector (% of GDP)			
Current Account Balance	-28.1%	-22.2%	-15.3%
Trade Balance	-53.2%	-44.5%	-30.5%

Source: World Bank, Lebanon Economic Monitor, Spring 2025

Achieving debt sustainability in Lebanon requires a multi-pronged approach that extends beyond mere debt restructuring to encompass macro-financial stabilization, robust fiscal discipline, and comprehensive financial sector reform. The following recommendations are designed to address the challenge of debt sustainability as well as the urgent macro-fiscal, social, and institutional priorities identified through recent economic diagnostics and policy consultations.

1. Rebuild Fiscal Credibility

Adopting a realistic, multi-annual budget anchored in transparent revenue and spending forecasts is fundamental (World Bank, 2025). Domestic revenue mobilization must be enhanced by simplifying taxation, reducing exemptions, and promoting greater compliance, particularly in sectors operating outside the formal economy. It is crucial to ensure adherence to modern public financial management practices by linking spending authorizations to actual cash flows, enforcing procurement laws, and reducing off-budget expenditures. Transitioning to a transparent fiscal framework is critical for rebuilding public trust and mobilizing external financing (IMF, 2025a).

2. Advance Macro-Financial Stabilization, Comprehensive Banking Sector Restructuring, and Equitable Burden Sharing

Activating the legal framework for bank restructuring is paramount, with a strong focus on transparency, equitable burden-sharing, and the protection of small depositors (World Bank, 2025). Addressing the Banque du Liban's massive losses and the subsequent impact on bank capitalization is central to this process. Eliminating market distortions and increasing transparency across the economy is also paramount. The resolution of the banking crisis, particularly who bears the losses, is not merely an economic issue but a fundamental question of social justice and the rebuilding of the social contract. A perceived inequitable burden-sharing could further erode public trust in institutions and hinder long-term recovery and reform efforts (Hausmann et al., 2020).

The complex composition and ownership of Lebanon's public debt profoundly impact the dynamics and outcomes of negotiations with various creditor groups. The significant domestic holding of Eurobonds—with 37% of the original total held by local banks and BdL in October 2019 (Blominvest Bank, 2025)—blurs the distinction between "foreign" and "domestic" creditors. This means a default on Eurobonds directly impacts the solvency of Lebanese banks and the central bank, creating a sovereign-bank doom loop (Hausmann et al., 2020). This interlinkage necessitates an integrated approach to debt restructuring, rather than separate negotiations for domestic and foreign debt. Any haircut on Eurobonds impacts domestic financial institutions, which then requires a separate, but linked, plan for their recapitalization and depositor compensation.

Negotiations must adopt a holistic approach, recognizing the interconnectedness of sovereign, banking, and central bank balance sheets. A key challenge is ensuring perceived fairness in burden-sharing across all creditor groups—domestic depositors, local banks, foreign bondholders, and multilateral institutions, as well as the broader Lebanese population (current and future generations). Transparency in financial data

and restructuring plans is crucial for building trust. Ultimately, debt relief must be sufficient not only to restore sustainability but also to create fiscal space for growth-enhancing investments, rather than merely reducing the debt stock. The IMF's projections of a two-decade recovery to pre-crisis GDP levels (IFI Policy Blog, 2023) underscore the necessity of deep structural reforms alongside debt relief to foster stronger, more sustainable economic growth.

3. Role of State Assets and Future Budget Surpluses

The debate on the use of state assets (such as land and state-owned enterprises) or future budget surpluses to compensate depositors underscores the deep political economy challenges in Lebanon. The allocation of state assets and future revenues is highly politicized, with competing claims from various stakeholders, including depositors, external creditors, public services, and future generations. It highlights a fundamental tension between different approaches to debt resolution and burden-sharing.

One perspective prioritizes strict fiscal sustainability and seeks to avoid creating new contingent liabilities for the state. The other emphasizes inter-generational equity and the principle that the state, having caused the crisis, should use its assets to compensate those who lost savings (IMF, 2023). The decision on whether to utilize state assets or future surpluses directly impacts the recovery rates for depositors and the perceived fairness of the restructuring process. If these assets are not used for depositors, they might be considered for other public purposes or debt reduction. Still, their sale under current governance practices is problematic due to opacity and potential for manipulation (IMF, 2023). The outcome of this debate will significantly influence the feasibility and public acceptance of any debt sustainability plan, and thus the pace of economic recovery. A failure to resolve this could perpetuate the crisis by blocking comprehensive solutions.

4. Strengthen Social Protection and Human Capital Development

Scaling up and institutionalizing poverty-targeted cash transfer mechanisms, with clear eligibility criteria and integration with existing social registries, is essential (ESCWA, 2023). Essential public spending on health, education, and food security must be safeguarded, especially for children and low-income households. Subsidy reforms should be designed in a way that minimizes regressive impacts and incorporates compensation mechanisms for vulnerable groups. Without robust social safety nets, economic adjustments may deepen inequality and hinder recovery (ESCWA, 2023).

5. Support the Recovery of Productive Sectors

Expanding access to finance for small and medium-sized enterprises (SMEs) through guarantee schemes and concessional lending is vital (IMF, 2025b). Bureaucratic procedures should be streamlined, and regulatory barriers to formalization and job creation in the agriculture, manufacturing, and technology sectors must be reduced. Engaging Lebanon's diaspora and regional stakeholders to foster investment in tradable sectors and exports that have a comparative advantage is also crucial. Productive sector revitalization is key to transitioning from consumption-led to export-led growth (IMF, 2025b).

6. Enhance Governance and Restore Institutional Legitimacy

Implementing judicial and administrative reforms that ensure accountability and reduce political interference in public institutions is paramount (Transparency International, 2024). The national anti-corruption strategy must be implemented, and the national anti-corruption strategy must be enforced. Independent oversight bodies must be provided with enforcement capacity and budgetary autonomy (Transparency International, 2024). Promoting participatory governance by fostering civic engagement, transparency in service delivery, and strengthening municipal capacities is also necessary. Institutional credibility remains a prerequisite for sustainable reform and long-term stabilization (Transparency International, 2024).

Conclusion

Lebanon's protracted economic collapse is deeply tied to the failure to manage public debt sustainably and equitably. Years of fiscal mismanagement, excessive reliance on regressive indirect taxes, and distorted monetary policies have led to an unsustainable debt burden, eroded public trust, and stifled private sector activity (World Bank, 2020). While recent steps—such as reforms to banking secrecy and a draft law on bank restructuring—signal some technical progress, they remain insufficient in the absence of a broader stabilization plan (IMF, 2025b).

Reviving the economy and restoring debt sustainability will require a comprehensive and credible macroeconomic and fiscal framework that prioritizes public finance reform. This includes improving revenue collection without overburdening consumers and businesses, shifting away from indirect taxation, and broadening the tax base in a progressive and transparent manner. Creating fiscal space must not come at the cost of social equity or economic competitiveness (World Bank, 2020). A key pillar of recovery must also be a more enabling business environment—one that is no longer hostile to the formal private sector but instead incentivizes investment, productivity, and job creation. Addressing governance failures, reforming state institutions, and ensuring the fair distribution of adjustment costs are essential to rebuilding the social contract (World Bank, 2020).

The path to debt stabilization is difficult but achievable. Lebanon must move decisively from fragmented, short-term measures to a coherent reform strategy that addresses the root causes of fiscal and debt distress. The interconnectedness of debt ownership, financial sector health, and political will necessitates an integrated and politically courageous approach to secure Lebanon's future stability. Without such action, debt will remain unsustainable, the private sector will continue to be strangled, and the prospects for recovery will dim further (World Bank, 2020).

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