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EXECUTIVE SUMMARY LEBANON

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EXECUTIVE SUMMARY

The Political Economy of Debt Accumulation in Lebanon

Lebanon is experiencing one of the most profound economic and financial collapses in modern history. Triggered by a sovereign default in 2020, the crisis has cascaded into a simultaneous currency crash, banking system paralysis, and social breakdown. At its core, the crisis is not only economic—it is the consequence of decades of political dysfunction, elite capture, and institutional decay.

The crisis has exposed the structural weaknesses of Lebanon's post-war economic model, which relied heavily on capital inflows, financial services, and public borrowing to fuel consumption and reconstruction without fostering a productive economy. Since the 1990s, repeated failures to undertake fiscal reforms, restructure debt, or build credible public institutions allowed vulnerabilities to accumulate. Monetary policy—particularly the central bank's financial engineering operations—temporarily masked these weaknesses but ultimately exacerbated the fallout.

A key feature of the crisis has been the entanglement of the state, the central bank (Banque du Liban), and commercial banks. This sovereign-bank-central bank nexus created shared exposure to unsustainable debt, magnifying losses across the entire financial system. As of 2023, when accounting for central bank liabilities, Lebanon's public debt has surged to more than seven times the country's GDP, an unprecedented figure in peacetime.

Despite the scale of the crisis, Lebanon's political establishment has shown limited will or capacity to deliver structural reforms. While a staff-level agreement with the IMF was reached in 2022, implementation has stalled. Critical legislation on capital controls, bank restructuring, and judicial independence remains pending. As a result, the burden of adjustment has fallen disproportionately on ordinary citizens—through inflation, loss of savings, and declining public services—rather than on those who profited from the system's dysfunction.

CONCLUSION & RECOMMENDATIONS

Lebanon's debt crisis is not simply a fiscal problem. It is the product of a broken political economy where weak institutions, lack of accountability, and entrenched interests have prevented reform. Addressing the crisis requires a comprehensive approach that integrates fiscal, financial, and institutional rebuilding. Below are the six core recommendations that emerge from this analysis:

1- Rebuild Fiscal Credibility: Lebanon's fiscal policy has been opaque and politically manipulated. Transparent, rules-based budgeting is essential to restore trust and enable donor support.

- Institutionalize multi-year budgeting with parliamentary oversight.
- Eliminate off-budget spending and adopt a modern public financial management (PFM) system.
- Shift toward progressive taxation—especially on wealth, property, and high incomes.
- Phase out regressive indirect taxes (like VAT hikes) as a primary source of revenue.

2- Restructure the Banking Sector and Address Central Bank Losses: Without cleaning up the banking sector, credit cannot flow to the economy, and confidence will not return. Avoiding politically convenient but economically harmful solutions—like monetizing losses—is critical.

- Pass and implement the banking restructuring law transparently.
- Recognize and allocate Banque du Liban's losses in a fair and transparent manner.
- Protect small depositors while ensuring that shareholders and large depositors bear part of the losses (bail-in mechanisms).
- Create an independent Asset Management Company to manage bad loans and impaired assets.

3- Conduct an Integrated Domestic and External Debt Restructuring: Around %37 of Eurobonds were held by domestic entities before the default. Isolating foreign and domestic holders has proven harmful. A holistic strategy is essential.

- Treat Eurobonds and domestic debt holders together to avoid fragmentation.
- Coordinate with the IMF and bondholders to ensure fair burden-sharing.
- Ensure that any restructuring protects future fiscal space and enables social spending.

4- Preserve and Reorient Social Spending: Social protections must cushion the adjustment. Austerity without safeguards will deepen poverty and fuel unrest.

- Institutionalize and expand targeted cash assistance programs (e.g., Daem).
- Prioritize spending on public education and healthcare to prevent human capital collapse.
- Replace broad subsidies with targeted ones that protect the most vulnerable.

5- Foster a Competitive, Productive Economy: Lebanon's recovery cannot depend solely on aid or remittances. A new economic model must be built on productivity, not financial rent-seeking.

- Prioritize investment in tradable sectors (agriculture, manufacturing, ICT).
- Reduce bureaucratic barriers for SMEs and promote digital transformation.
- Mobilize diaspora capital through structured investment instruments.

6- Revive Institutions and Strengthen Governance: No recovery is possible without tackling elite capture. Restoring institutions is key to regaining public trust and attracting international support.

- Fully implement the National Anti-Corruption Strategy with independent oversight.
- Empower the judiciary and strengthen the independence of the Court of Accounts and public procurement bodies.
- Restore rule of law, transparency, and public participation in decision-making.

Lebanon stands at a crossroads. The crisis has created space for reform, but time is running out. Without decisive political action, Lebanon risks a prolonged state of economic paralysis, institutional breakdown, and rising social instability. Recovery will not come from technocratic fixes alone. It demands a rebalancing of power, rebuilding of state institutions, and reimagining of the economic model to serve the broader public, not just the privileged few.