

Warlord politics and economic clientelism in Lebanon

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Abstract

Since October 2019, Lebanon has been going through a deep economic and financial crisis that drove the country to a political meltdown. Facing a severe recession, high inflation and unemployment, nationwide protests in the aftermath of the Beirut explosion in August 2020 have led to the resignation of Hassan Diab's cabinet – the second government to resign within the span of a few months. This article studies the interplay of the political, economic, and social factors that led to the current economic and political crisis. We show how warlord politics, and a corporate consociational system have misguided incentives and policies and consolidated a rentier economy that inevitably led to the current situation.

On 4 August 2020, an ammonium nitrate explosion destroyed the Beirut Port and most of the surrounding area, killing around 200 people, injuring over 6,000 and rendering 300,000 inhabitants homeless. While Lebanon's Prime Minister Hassan Diab called the timing of the event *suspicious* and has attempted to divert the blame to undefined external forces,¹ the explosion is seen by many as the outcome of a dysfunctional state led by corrupt political elites and a government that is driven by sectarian interests instead of a commitment towards the common good.

The ensuing nationwide protests in the aftermath of the Beirut explosion led to the resignation of Hassan Diab's cabinet – the second government to resign within the span of a few months. At the same time, Lebanon has been going through a deep economic and financial crisis since October 2019.² The Lebanese currency has lost 80% of its value, inflation and unemployment are soaring and much of the population has been plunged into poverty.

This article studies the historical dynamics that led to the political and economic crisis in Lebanon. It focusses on the social, political, and economic components (along with their interplay) to explain the reinforcing mechanisms that have cemented a sectarian system, eroded state institutions and intensified economic inequalities. We argue that the political and economic deadlock in Lebanon today has been the result of a long history of warlord politics and economic clientelism. Corruption, nepotism, negligence and clientelism under the guise of sectarianism have been the defining features of both the functioning and failure of Lebanon's consociationalism. As the Lebanese civil war (1975-1990) came to an end after over 15 years of a bitter conflict, the cartels of the war generated a war economy that functions to benefit a select elite according to sectarian quotas.

In the next section, we illustrate the Lebanese conflict before and after the civil war. This article then closely analyses the Lebanese corporate consociational system,³ followed by a study of the economic implications and the causes of the current economic and political crisis. The last section concludes, provides some policy

¹ Qiblawi (2020).

² BBC (2020).

³ The consociational system in Lebanon assigns equal presentation to Muslims and Christians in parliament and a proportional representation to their religious denominations. Details will be discussed in the "Lebanon's Sectarian Model and Warlord Politics" section.

recommendations, and demonstrates the limits of these policies.

A History of Conflict

“There is perhaps no other country where so much human complexity is loaded into such a small space,” noted Harris (2009) when describing Lebanon. “[A] cockpit of turmoil and a focus of controversy,” Lebanon “has more demographic diversity, complex internal politics, and crises proportionately than any other country in the world”.⁴ It is home to over 6.8 million people, has 18 recognized religious communities, and a long and complex history of conflict.⁵ The distinct and complex composition of Lebanon as a small country composed of many religious and sectarian communities led to the emergence of conflict early on in Lebanon’s modern history over its own identity, political and economic structures, and its expected role in the Arab region.⁶ Yet, the emergence and institutionalization of sectarianism in Lebanon needs to be understood within its historical context.

While the Lebanese state in its current form dates back to the French mandate of 1920 and the declaration of the formation of the State of Greater Lebanon, sectarian strife and clashes preceded it. Under Ottoman rule, the period between 1840 and 1860 witnessed an escalation of tension between the two prominent religious groups in Lebanon (the Druze and Maronite) that in 1860 culminated in violent clashes resulting in the destruction of at least two hundred villages.⁷

Scholars commonly agree that the events of 1860 in Mount Lebanon represent the origins of sectarianism in Lebanon.⁸ The 1861 *Reglement Organique of the mutasarifiya* of Mount Lebanon (1861-1914), “[which came] to end the strife, institutionalized a more intricate form of sectarian representation”.⁹ The two turning points in Lebanon’s post-independence history that largely contributed to the deep integration of the sectarian system in the public and private spheres in Lebanon are: the 1943 National Pact and the 1989 Ta’if Accord.¹⁰

In 1943, Lebanon gained its formal political independence from international mandate and with that, the National Pact was agreed. The National Pact has been an unwritten power-sharing agreement between Lebanon’s Muslim and Christian communities that “came to symbolize post-independence confessional politics, thereby crowning the process of change that occurred during the mandate both within Lebanon and in its regional order”.¹¹ By and large, the National Pact has been the subject of controversy, being both deplored and praised with the ebb and flow of Lebanon’s tenuous politics. While some view it as a symbol of “national integration and confessional unity”, others perceive it as the embodiment of a “philosophy of confessional coexistence” or “a capitalist confessional deal” that mainly benefits some segments at the expense of others.¹²

Yet, while the country embarked on a process of decolonization in the following years, sectarian and religious tensions remained unresolved. In the years leading to the 1975 civil war, political developments in the region, from the formation of the United Arab Republic between Egypt and Syria to the 1958 US invasion of Lebanon (at the request of then Maronite President, Camille Chamoun) to curb a Muslim rebellion, have further contributed to the

The economic and political crises of Lebanon provide an example of how warlord politics, and a corporate consociational system, have misguided incentives and policies that consolidate a rentier economy and inevitably lead to conflict and crisis. There are alleviating policy options for Lebanon, but the chances of implementing them seem small.

⁴ Rubin ed. (2009, p. 1).

⁵ People: World Bank (2019a). Communities: El Rajji (2014).

⁶ Khalaf (2004); Traboulsi (2012).

⁷ Mallo (2019, p. 2).

⁸ El Richani (2017, p. 23); Makdisi (2000, p.118).

⁹ Salloukh et al. (2015, p.13).

¹⁰ El Richani (2017, p. 24); Salloukh et al. (2015, p. 2).

¹¹ El-Khazen, (1991, p. 3).

¹² *ibid.*

deteriorating sectarian relations in Lebanon.¹³

Badran (2009, p. 35) describes Lebanon's civil war as "one of the most complex, multifaceted wars of modern times due to its hybrid nature, multiple participants (both state and non-state actors), and its impact on regional and even global balances of power". The reason for its complexity is the many internal, regional, and international players and factors that have fueled the conflict and the multi-dimensional dynamics that prompted the fighting to continue for over 15 long years. This resulted in an estimated physical damage of \$25 billion and over 140,000 deaths and the destruction of about 175 towns.¹⁴ It also brought existing sectarian rifts to the surface, which resulted in prolonged violent and bloody confrontations between the different militia factions. Meanwhile, Syrian troops invaded Lebanon in 1976 and remained in the country until 2005, following the assassination of Prime Minister Rafic Hariri. Israeli forces invaded the south of Lebanon in 1978, and again in 1982, with the purpose of attacking and expelling Palestinian guerrilla fighters and the PLO. Slowly "the country suffered a de facto partition into separate zones of control".¹⁵ The Israeli invasion, which prompted the deployment of UN peacekeeping troops until Israel's complete withdrawal in May of 2000,¹⁶ also contributed to the emergence of the Shi'ite militant group, Hezbollah. Today, Hezbollah, which billed itself as a resistance movement during the Lebanese civil war, has significant power, presence, and authority in Lebanon and operates both as a Shi'ite political party and militant group.¹⁷ The Taif Agreement came to end the conflict after nearly 15 years of brutal fighting. Although the agreement explicitly recognized the abolition of political sectarianism as "a fundamental national objective",¹⁸ it did not set a timeframe for achieving this goal. Today, sectarianism remains at the very core of Lebanon's political and economic structures.¹⁹

Lebanon's Sectarian Model and Warlord Politics

Since the 1943 National Pact, and again with the 1989 Taif Accord, Lebanon's power sharing regime has been a corporate consociational system.²⁰ With the National Pact, consociationalism has designated the presidency to a Christian Maronite, the premiership to a Muslim Sunni, and speakership to a Muslim Shia, and set an informal agreement to fix the ratio of seats in the parliament at six Christians for every five Muslims. The Taif Accord constitutionalized several informal agreements, instated an equal presentation of Muslims and Christians, and established proportional representation among the different religious denominations. It further dictated decision by consensus in the parliamentary cabinet and introduced a two-third majority requirement for "basic issues".²¹ It also shifted the executive power from the president to the prime minister.

This de facto mutual veto power in parliament and the post-war memory of the potentially destructive results of political competition should have created a strong desire for political cooperation and the formation of more inclusive coalitions among elites, as suggested by Lijphart (1969). However, Lebanon's consociationalism engendered the concentration of political and economic power among a few Lebanese families. Thus, the institutional system failed to align elite preferences with the public interest, nor did it align sectarian interests with national interests. It spawned adverse incentives that encouraged the concentration and consolidation of political power within a few elites while

¹³ Mallo (2019, pp. 7-8).

¹⁴ Ghosn (2011, p. 382).

¹⁵ Rubin (2009, p. 3).

¹⁶ Peacedirect (n.d.)

¹⁷ Robinson (2020). While the Ta'if Agreement called for the effective disarmament of all national and non-national militia groups in Lebanon, Hezbollah was the only party excluded from the widespread disarmament, as it was engaged with fighting Israel in order to regain control of the south of Lebanon. Today, it remains "the only Lebanese sectarian party that kept its military power post-civil-war" (Yassine, 2020).

¹⁸ Taif Agreement, (1989).

¹⁹ Yassine (2020).

²⁰ Kerr and Hamdan (2013).

²¹ Boogards (2019).

enabling them to extract public resources for their own gain, to the detriment of state institutions and Lebanese citizens. At its heart lies a plurality, or first-past-the-post electoral list-based system, that drastically weakens contestants without sectarian affiliation and solidifies the power of incumbent elites through vote trading across sectarian lines. These elites act in self-managed communities and exploit the sectarian quota within the state administration to both assign public offices and resources to dedicated and loyal associates and family members, and to abuse it as a token of power in negotiations to extend political influence.²²

Such corporate consociational systems, which encourage a perspective that fundamentally impacts on the political decisions made by elites in positions of power, has been heavily criticized in the literature.²³ At its core, it is defined by a perception of citizens not as individuals with inalienable political, economic, and social rights, but as members of an inequalitarian system of sectarian communities. Indeed, a sectarianized welfare system (in the form of state funded sectarian NGOs, private institutions, communal associations, and religious charities) and sectarian courts as the rulers over personal status laws, reinforce the perception of citizens as sectarian subjects. Consequently, attempts to secularize personal status laws in Lebanon, through establishing optional civil personal status laws or allowing civil marriage, have been seen as a threat to existing political power relations and structures, and thus have been either abandoned or heavily restricted in practice.²⁴ While such secularization and liberalization measures would have benefited the public, they would also have separated the public from the private spheres and weakened the sectarian system.

Consolidating sectarian social relations and maintaining a need to remain within the boundaries of their sect ensured that subjects remained under the control of sectarian elites and reinforced sectarian identities and clientelist dependency. It further helped to intertwine kin-driven alliances, political authority, and economic control. For example, in the aftermath of the Lebanese civil war, substantial public funds were channeled to the Council for Development and Reconstruction. The Council allocated public contracts to companies controlled by Rafiq Hariri, such as Solidere, Sukleen and Geneco, who conveniently appointed former employees and associates to the Council.²⁵ At the same time, the establishment of political parties as political blocks, thereby compounding parties and kin relations, concentrated the economic and political power within a few Lebanese families. Succession of political leadership by next of kin has occurred frequently in modern Lebanese history. For example, Saad Hariri succeeded his father as the leader of the Future Movement Party after the assassination of his father in 2005. Similarly, Walid Jumblatt took over as leader of the Progressive Socialist Party upon his father's assassination in 1977. Familial succession in political parties that control governmental positions has led to a system of nepotism and idiomatic kinship.²⁶

Inept state institutions, weak social and political security, and the lack of trust in and loyalty towards state organs precipitated the dependence on sectarian and family support while negatively affecting the functioning of the state. Consociationalism in Lebanon has thereby spawned a self-reinforcing system that diverts loyalties away from state institutions towards sectarian communities and, in particular, their political and sectarian leader. This has created what Suad Joseph called "kin moralities".²⁷ It consolidates both elite power and sectarian divides, thereby further weakening state authority and any attempts at secularization. It also instigates sectarian groups to wrestle over corporatized power and alter allegiances based on regional power shifts instead of domestic interests.²⁸

²² Salamey (2009).

²³ See e.g., Jabbara and Jabbara, (2001); Salamey (2009); McCulloch, (2012).

²⁴ See also Chapter 3, Salloukh et al. (2015) for more details.

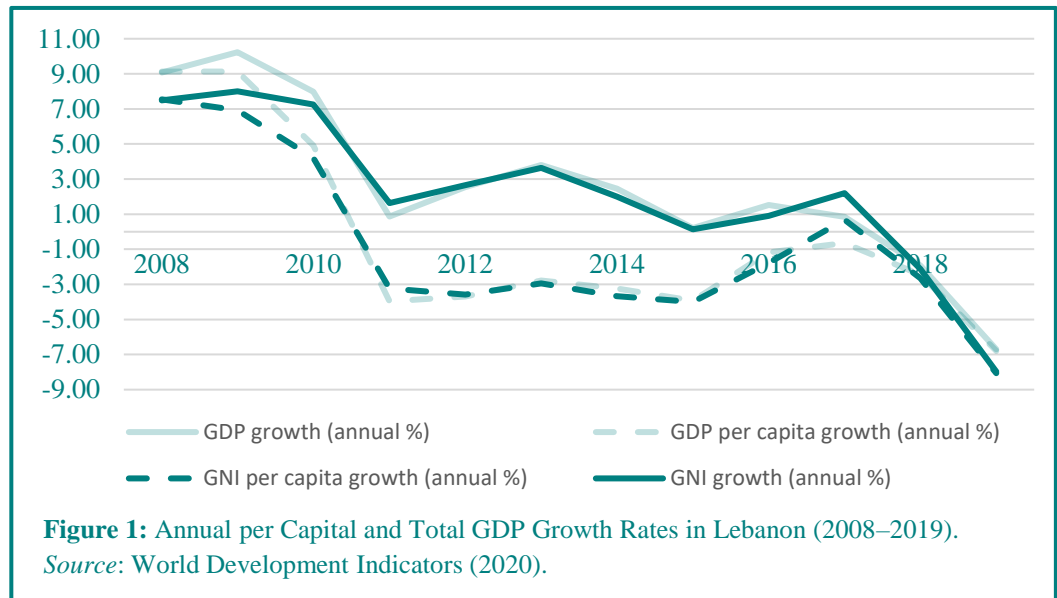
²⁵ Leenders (2003); Vloeberghs (2015, pp. 55-6).

²⁶ See also Joseph (2011) for more details.

²⁷ Joseph (1997); Joseph (2000); Joseph (2011).

²⁸ Salamey (2009).

Maintaining this self-reinforcing mechanism is critical in perpetuating Lebanon's post-civil war consociationalism. The perceived gains and added social security offered by sects need to outweigh the cost of operating within the limits of sectarian affiliation and of partaking in an exploitative sectarian client patron relationship. Active policies against a



growing middle class and secular neighborhoods encourages spatial stratification and confessional resentment by pitting well-to-do Maronite Christians against indigent Shia Muslims in Beirut.²⁹ Migration and demographic changes have also tilted sectarian demographics further away from a proportional allotment of national offices and, at the same time, the list-based electoral system has entangled the struggle for political control with demographic and territorial control. This has led to further dissatisfaction among the population. In addition, recent years have not only seen an evolving secular youth tired of policies guided by sectarian interests and personal gains, but a vanishing middle class and an increase in regional disparities and poverty rates.³⁰ This contributes to increasing dissatisfaction with sectarian elites, but also dependence on their support.

Economic Clientelism and Inefficiency

Existing data on Lebanon shows significant discrepancies and inequalities in income and wealth distribution. In fact, today, the evidence suggests that Lebanon remains one of the most unequal countries in the world.³¹ World Bank data for 2011 shows that the top 10 percent receive about a quarter of the total population income and the top 20 percent hold 40 percent, leading to a Gini coefficient of 31.80.³² A 2017 report by the UNDP estimated a Gini coefficient of 50.7 or 45.3 (depending on the calculation), indicating an increasingly unequal income distribution.³³ A low personal income tax return as a share of GDP of 0.8% has kept the Gini coefficient at 48.5 for 2017 after tax redistribution. While this low-income tax collection may be partially caused by tax evasion and a large informal sector (encouraged by a distrust in state authority and institutions), it may also be caused by the high degree of tax exemptions provided by sectarian-driven policies.

GDP and GNI have significantly declined since 2010 and the per capital growth rates have been negative since 2011, with a minor exception in 2017 (see Figure 1).³⁴ This negative growth was accompanied by continuous

²⁹ Salamey (2009).

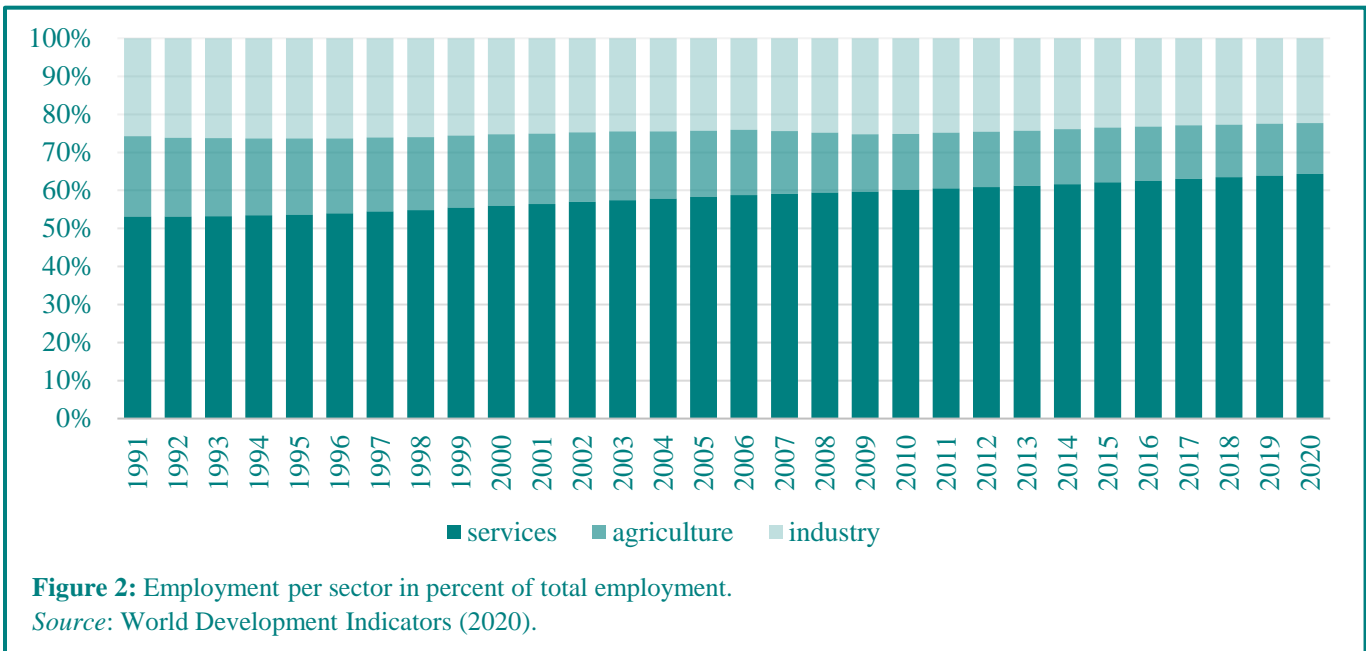
³⁰ Middle class: Hamd (2019). Regional: El-Laithy et al. (2008).

³¹ Assouad (2017).

³² World Development Indicators (2020).

³³ Saliba et al. (2017)

³⁴ World Development Indicators (2020).



increases in household consumption expenditure and a negative gross domestic saving.³⁵ In addition, the ties between the political elite and private companies further imposed hidden costs on the Lebanese population. The inability of the authorities to provide a consistent supply of electrical power and clean water opened additional opportunities for extortion. Regular blackouts created a dependence on diesel generators and a generator mafia that curtails competition and dictates prices, not only for the use of the generators but also for spare parts. Additionally, homeowners have to choose between paying private suppliers for clean water and storing it in tanks or relying on local wells that are frequently filled with salt and wastewater. The inadequacy of government policies and the “inefficiency by design” of state institutions culminated in the garbage crisis of 2015 which led to the “You Stink!” protests that continued throughout 2016.³⁶ While these protests attracted a substantial following and led to the foundation of the Beirut Madinati movement,³⁷ it failed to affect the incumbent elites around Saad Hariri and has had no lasting impact on the political system.³⁸

This situation has been made worse by Lebanon’s strong historical dependence on the service sector and its lack of an agricultural and industry sector. Figure 2 shows that the service sector employs roughly two thirds of Lebanon’s workforce (mainly in commerce, tourism and finance). Its contributions to GDP has been stable at around 70 percent for a period of roughly 20 years but increased since 2016 to reach a height of 79 percent in 2019 (World Development Indicators 2020). The share of goods-producing sectors – agriculture, industry and construction – in GDP has consistently remained under 35%.³⁹

After 1990, Lebanon’s banking sector managed to sustain a high level of stability and resilience, despite severe economic shocks and countless violent conflicts, turning the sector into the backbone of the Lebanese economy.⁴⁰ The banking sector “ensured 60% of the public sector financing needs, 30% of tax revenues, 50% of foreign trade

³⁵ World Development Indicators (2020).

³⁶ Kraidy (2016).

³⁷ Beirut Madinati (Beirut, My City) was founded by a group of academics and activists in autumn 2015 and originated from Lebanon’s earlier waste management movement.

³⁸ Kraidy (2016).

³⁹ Raphaeli (2009, p. 112).

⁴⁰ Conflicts: Raphaeli (2009, p. 109). Backbone: Bank Audi (2020, p. 11).

financing, in addition to dynamic private sector financing with loads to GDP exceeding the threshold of 100%”.⁴¹ This high dependency on the financial sector not only caused economic distortion and gradually rendered Lebanon’s economic sustainability dependent on the financial markets, but also became the main assurance of continued political stability.

In 1997, Lebanon fixed the exchange of the Lebanese lira (also known as the Lebanese pound) to the US dollar at a rate of 1,507.5:1. The dollar peg ensured price stability and, at the same time, inflated purchasing power across all social strata. It rendered imports cheaper and indirectly subsidized the prices not only of food and oil, but also of luxury goods and cars. This seemed like a win-win solution for both the elites and the average Lebanese citizen. Pegging the dollar then became a requirement for public trust, not only in the economic system, but also in the corporate consociational system. Consequently, the peg turned into a social and political necessity. It has become a political signal for the elites to “prove” the economic strength and stability of the country. On the other hand, the fixed exchange rate, especially with the appreciation of the US dollar from 2011, rendered exports more expensive. This curtailed the competitiveness of Lebanon’s agricultural and manufacturing sectors and cemented the economic dependency on services and imports. Additionally, fixing the exchange rate required significant foreign exchange reserves.

Lacking industry and an agricultural sector, the country has become highly dependent on external funds and remittances. Remittances increased significantly after 2003 and constituted roughly one quarter of Lebanon’s GDP, decreasing continuously after 2008 and falling to less than a sixth after 2012.⁴² In addition, the collapse of the oil price in 2014 further curtailed remittances coming from the diaspora living in oil-producing countries. The absolute value of remittances in current US dollars has been stagnating at around 7 billion since 2017. Thus, while Lebanon seemingly survived the Great Recession, the economic stimulus has largely been financed by external debt. Since 2009, it has been fluctuating at around 140 percent of GNI, with the total debt service payments approximately 30 percent. The country could only service the interests of its high debt rate and fix the exchange rate of the Lebanese lira against the US Dollar by borrowing either externally or from commercial banks at interest rates above the market rate. Such debt financed debt service added risk to commercial banks and the financial system. At the same time, the dollar appreciated from 2011 and demand for the currency increased. To cover the gap and continue the dollar peg, Lebanon issued dollar-denominated Eurobonds.⁴³ In addition, commercial banks offered depositors interest rates above 7 percent, translating into an average real interest rate of 4.7 percent for the period between 2007 and 2019. A rate that is significantly above regional interest rates and the US, e.g. 0.4 percent in Egypt, 2.1 percent in Israel, 3.7 percent in Jordan, 3.9 percent in Algeria, and 2.4 in the US.⁴⁴ The high interest rate was used to encourage expatriate Lebanese to deposit foreign currency in domestic banks. Meanwhile, commercial banks converted deposits into local currency and passed on US dollars to Banque du Liban which was in desperate need of foreign reserves to peg the Lebanese lira to the US dollar at a rate of 1,507.5. Thus, the lack of inflow of foreign funds required the Banque du Liban to undertake financial engineering operations from 2016 which led to losses of 40 billion US dollars.⁴⁵

The expansion of the service sector, the constant need for foreign currency, and the dependence on imports generated an unstable economic system that was crucially reliant on trust and political stability. Saad al-Hariri’s resignation in late 2017 led to a temporary outflow of funds. The situation raised initial concerns about the sustainability of the financial system and the liquidity of commercial banks, as the latter started offering customers higher interest rates to entice clients to deposit more funds. In late 2019, confidence in the financial market collapsed

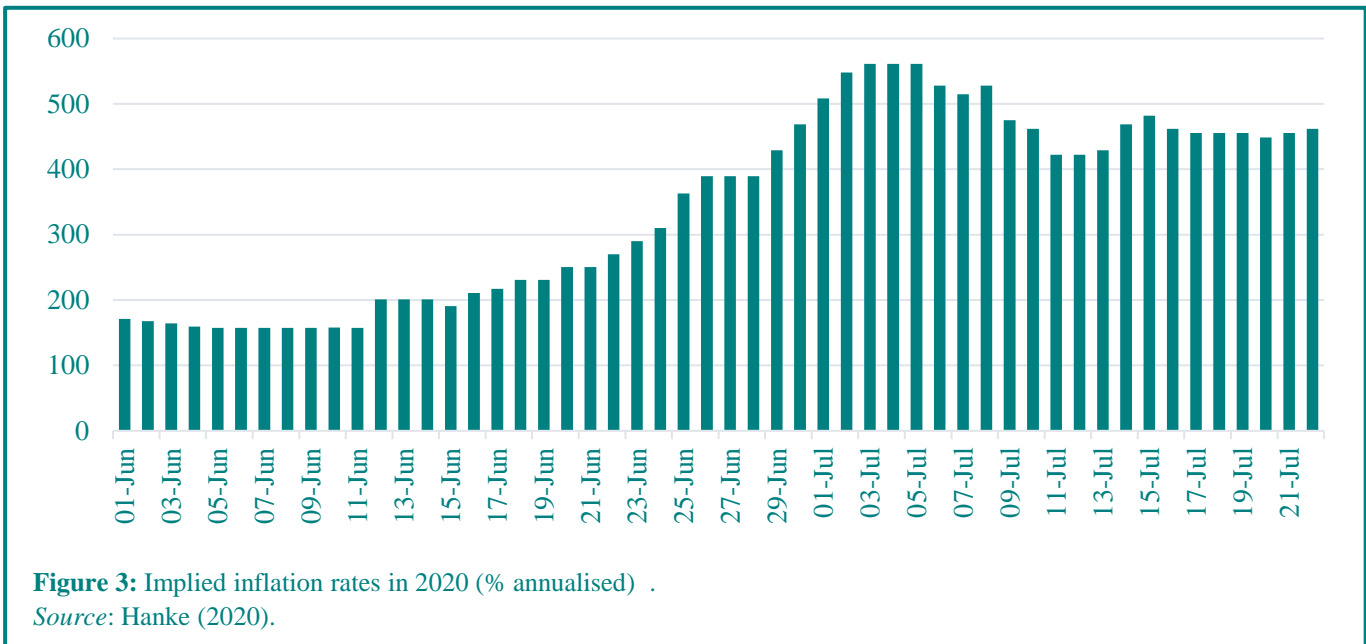
⁴¹ Bank Audi (2020, p. 11).

⁴² World Development Indicators (2020).

⁴³ Ministry of Finance (2020).

⁴⁴ World Development Indicators (2020).

⁴⁵ Khraiche (2000).



as nationwide protests against corruption led to the resignation of Hariri’s cabinet. Commercial banks closed for two weeks; upon reopening, they introduced monthly withdrawal limits of around 1,000 US dollars. These limitations could not avoid capital flight and bank runs, but further weakened trust in both the political and economic stability of the country. While official data is unavailable, a first “silent” bank run, before the bank closure, was probably instigated by elites who transferred their dollar deposits abroad in fear of capital controls after the US threatened commercial banks with sanctions in August 2019. This was after the commercial banks had been involved in Hezbollah’s global money laundering.⁴⁶

Since then, the banks have further tightened restrictions on foreign currency withdrawals to enforce the use and reliance on the local currency. In April 2020, the wire transfer rate increased from 1,507.5 to 3,625 Lebanese lira per US dollar and the Central Bank limited withdrawals from US dollar bank accounts to Lebanese lira. However, Lebanese firms, companies and commercial venues have remained critically dependent on imports and thus foreign currency. The “lirafication” enforced by foreign currency restrictions created a high excess demand for US dollars and a black-market exchange rate far below the official rate, while the ensuing dollar liquidity crunch rendered a fixed exchange rate increasingly impossible. As the black-market exchange rate soared to 8,000 Lebanese lira per US dollar by mid-2020, businesses have been passing on the additional costs to customers, leading to a significant rise in consumer prices. Meanwhile, the government defaulted on a Eurobond payment worth 1.2 billion US dollars in March 2020 and payments due in April and June worth 1.3 billion US dollars.⁴⁷ The increasing political uncertainty, the ensuing lack of confidence in the government’s ability to improve the country’s future economic prospects and to stabilize a local currency, has eroded trust in the domestic currency. This has led to dollarization and hence an increased demand for US dollars. As excess demand pushed up the black market exchange rate exchange, trust in the lira further diminished, leading to a spiral of hyperinflation since June 2020 (see Figure 3).

The ensuing recession and political instability imposed significant challenges for the Lebanese government in relation to implementing adequate measures to combat the coronavirus pandemic. The explosion in Beirut in early

⁴⁶ Rickards (2020).

⁴⁷ Cornish and Stubbington (2020); Agence France-Presse (2020)

August 2020 further eroded trust in the government, while the loss of purchasing power made it impossible for many of the affected inhabitants to repair the damage. This is likely to further erode the trust in the corporate consociational system and the value of the Lebanese lira. The Lebanese government is only able to stabilize the market rate of the Lebanese lira to the US dollar (12,400 Lebanese lira per US dollar)⁴⁸ through subsidizing key food and essential imports with a dwindling amount of foreign reserves. At the same time, the government sells foreign relief and goods from humanitarian aid for dollars, thus further depriving the poorest of much needed support.⁴⁹

While the government is seeking to maintain political credibility and control by adhering to the fixed dollar-lira exchange rate at 1,507.5, the peg is becoming increasingly unsustainable as foreign reserves deplete. The unavoidable devaluation will weaken purchasing power and impoverish those with lira-denominated bank accounts. Additionally, most of Lebanon's debt is denominated in foreign currency (mostly US dollar), but Banque du Liban's assets are denominated in Lebanese lira. It is therefore unclear whether the central bank has sufficient assets to service its debt obligations. Those Lebanese with dollar accounts face an inevitable haircut after the behind-the-scenes lira conversion by commercial banks. Abandoning the peg is not only likely to ruin the government's economic and political credibility, it is also likely to significantly contract wealth across all strata of society. Meanwhile, the shortage of reserves will render subsidies of food and essential imports increasingly infeasible. In addition, Electricité du Liban (EDL) remains highly dependent on government subsidies in excess of \$1 billion per year.⁵⁰ The government's lack of liquidity will potentially cause an electricity crisis once temperatures rise that, in turn, will presumably boost demand for private generators and drive electricity prices. The government's plan to corporatize EDL is, given the lack of a functioning political and economic system, unlikely to solve the problem. In turn, these dynamics will likely further undermine the perceived gains and stability of Lebanon's corporate consociational system.

Conclusion

Since the second half of the 19th century, Lebanon's institutional framework has been sectarian. The complex interplay of external and domestic interests, both of state and non-state actors, engendered and maintained sectarian institutions. Political, social, and economic conditions formed self-reinforcing mechanisms that solidified sectarianism, disintegrated national cohesion, and promoted religious tensions by pitting sects against each other; culminating in a civil war that lasted fifteen years.

With the end of the civil war, corporate consociationalism appeared to be the means of ensuring sustainable peace between sects, but it distorted incentives, eroded state institutions, and consolidated the sectarian regime. Sectarian elites abused consociationalism to foster their own political agenda and to enrich themselves financially. The power-sharing regime was sustainable as long as Lebanese across all social strata prospered, so GDP growth and an overvalued currency were critical to ensuring political and social stability. Under the pressure of the recent global economic crisis and the coronavirus pandemic, high growth rates and a hard currency are no longer feasible.

Lebanon is facing two major challenges. First, economic policy making remains strongly dependent on elite interests; consequently, economic reforms cannot be enacted without political reforms. Second, the current economic uncertainty is detrimental to investment and external support. So far, Diab's government has been unwilling to implement any reforms, and while the government did eventually decide to engage in IMF negotiations in May 2020, the lack of any fundamental changes to the Lebanese corporate consociational system renders external financial support unlikely. Lebanon's debt obligations are not only external but internal. In the absence of any reform, either a

⁴⁸ Based on the latest figures in Taha (2021).

⁴⁹ Information based on informal consultations conducted by the authors in Beirut, Lebanon (2 January 2021).

⁵⁰ World Bank (2019b); World Bank (2020).

complete lira-fication of all assets or a financial haircut will be inevitable. Both would significantly diminish the life savings of those who lack any other form of old-age insurance. Seeing their life savings eroded by the end of the dollar peg, Lebanese citizens would be unlikely to support the corporate consociational system. However, it is unclear whether they would blame the current political elite or would direct hostility towards other sects leading to the potential eruption of violence and civil strife.

An official dollarization should reinstate price stability, thus reducing the risk of holding money, and could potentially restore, at least partially, economic faith. With many shops only accepting dollars, the country is already on its way to unofficially implementing dollarization. Dollarisation would, however, still entail a tremendous loss in purchasing power, since the Banque de Liban will not be able to settle its liabilities leaving commercial banks with insufficient dollar liquidity. Exchange rates close to the current black-market rate would need to be implemented for all accounts, independent of their denomination. Additionally, the central bank would lose any control over monetary policymaking while the actual causes of the economic and political crisis would remain unaddressed. Similarly, the establishment of a currency board and a fixed peg would not address systemic issues. Both approaches would be unsuitable to address the risk of growing conflict and the potential of another civil war.

Future policies will need to address the core of these fundamental problems. The Lebanese model of consociationalism is untenable, but a technocratic government that acts outside of sectarian boundaries could address Lebanon's fundamental issues. It would need to reform the electoral system by prohibiting vote trading and ensuring equal chances for contestants without sectarian affiliation. The Beirut Madinati movement has shown that Lebanese citizens are willing to abandon the equal presentation of sects in favor of more efficient and less clientelist governmental institutions. While abandoning equal representations is not without risk of stirring sectarian resentments, a retention of the current system poses a much greater risk. Additionally, the government would need to regulate exploitative utility providers of energy and water and heavily invest in public utility infrastructure to ensure fresh water and reliable electricity supply. These investments would not only support confidence in the new government but also provide employment and support economic growth. Expansionary fiscal policy will, however, require funds from foreign donors and investors who would only be willing to support Lebanon if reforms are credible. Unfortunately, it is unlikely that the sectarian elites would be willing to relinquish power to a technocratic government and would potentially either block the government entirely or manipulate its decisions behind the scenes. In the end, it is unclear whether any feasible policies could be instated to prevent such sectarian influence, given the deeply-rooted political control of major Lebanese families.

An overvalued lira allowed the Lebanese to live beyond their means and neither a continued exchange rate at 1,507.5:1 nor a peg is conceivable. Issuing a new and floating currency that is initially issued at an exchange rate between the official and the black-market rate could bring the purchasing power closer to its real value and would mitigate losses. It would also send a public signal of a break at the systemic level and could bolster the credibility of the political reforms. A new currency would further ensure control over monetary policymaking and not tie the hands of a new government. Such policymaking would need to be transparent and occur in agreement with external donors. Furthermore, the financial sector would need tight regulations, but again it is unclear how political actors, such as Hezbollah, would react towards capital controls.

While there are policy options that might provide a way out of Lebanon's crisis, the chances of implementing them seem small. The deeply ingrained sectarianism in state institutions and the concentration of economic and political power in the hands of the elite may ultimately render the implementation of such reforms impossible. This will probably make a resurgence of violent clashes unavoidable.

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