

Executive

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EDITORIAL

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Those who raid other people's pockets

Fulfilling your work orders in a timely manner is the absolute minimum requirement if you want to keep your job. Parliament, whose job description is the protection of the people's interests, has started this year by – for the first time in almost forever – nominally satisfying one of its standard yearly obligations by voting on the budget before the end of January.

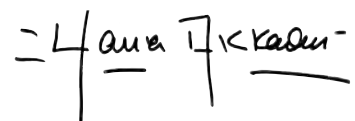
But this theoretically commendable fulfillment of parliamentary responsibility indicates nothing about its real job: legislating a budget that will sustain and improve the livelihoods of the people. This is not, as many vested experts know and state loudly, what the 2024 budget is about: at best, it is weak temporary fix and a dead-end solution.

It's no surprise that the establishment continues protecting a system that has been serving them for decades. One that took so much effort and corruption to perfect. To understand the workings and delusions of the powers that really are in charge among Lebanon's political class, my mind leaps back to a film that was made in the heyday of venture capitalism and hostile takeovers about the thrills and the perverse "romanticism" of being a corporate raider.

Other People's Money with Danny DeVito, Penelope Ann Miller, and Gregory Peck was a 1991 flick whose slick and obnoxious winner was "Larry the liquidator". He got both the company (with the declared goal of tearing it apart), and (in the movie's concluding scene) a hint at further romance with the smart lady that had opposed him and lost. Just like in this movie, to me it seems that there those in our political class who believe they can steal the people's money, liquidate our national assets with impunity, and still have lady Lebanon fall for their oily charm.

Should the people adore their elected representatives for approving the budget for once within the legal deadline? Applaud the government for presenting a budget without a strategy describing how the country's resources will be managed and without clear economic performance indicators to hold its managers accountable for?

Despite the budget's passing, it stinks again and the odor is so foul this time because there is so little left to steal. Continuous improvement can only be achieved when everyone is empowered to achieve its responsibility to protect the people in an inclusive, transparent and accountable manner. Our government and its budgetary perpetrators cannot be permitted to continue raiding our remaining, minimal financial safety by dipping, without creating any prospect for real growth and structural reform, into what are other people's pockets.



Yasser Akkaoui
Editor-in-chief

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■ Lebanon: a study in interconnectedness

Safety, security, stability, and sustainability have become enshrined as humanitarian wishes in our global community. These concepts inform our values and perceptions of universal human rights. In concert with dignity and essential freedoms, these concepts moreover comprise the bedrock of the 21st century's globalized civilization that prides itself on having climbed to historic peaks of prosperity by practicing humanized capitalism.

But these values and wishes of safety are historic anomalies in human affairs. They all but vanish entirely from collective awareness at the all too frequent times that are ruled by fear, hatred, greed, acute need, and aggressive search for dominance.

Rather than non-zero pursuits of security and sustainability for all, our species' predatory traits have been – and are – the staple diet nurturing human mentalities and actions, demonstrated in the rise and demise of empires. Although diametrically opposed to our deepest values, this edge of human evil is what stares us in the eye when reality really hits us over our collective heads. In the case study of Lebanon, this is what all who reside here are once again being forced to see and acknowledge – apart from some entitled talking heads who are deeply and truly stuck in the sands of fake hopes.

To our common, everyday minds going about the ordinary business of life, the greatest shock of October 2023 might be witnessing the wider societal capacity for evil. We are witnessing the harvest of long years of suffering and injustice into the winepress of human wrath outdistance the Lebanese devastating economic

experiences with corrupt individuals and perfidious financial zero-sum players seeking profit at the expense of the greater good.

Notwithstanding the vanity of harboring hopes for restoration of economic democracy, justice, and prosperity during such times, a curious question remains in such a situation: are we deluding ourselves if we think of sustainable prosperity as goal for all or is the business and financial dimension of human affairs a realm where safety, security, stability, and sustainability are valid and achievable paradigms?

Addressing the same question to geoeconomics makes it a fundamental research challenge. The world of finance, where data today can be sourced with minimal delay and in

■ The fateful connection of war and debt is a new cause for worry today

previous ages unseen accuracy, needs to investigate if it truly is a realm where human behavior can be modeled and modified for the achievement of socially optimized, economically healthy outcomes.

Can financial safety and social stability be instilled as a mutually co-created and interdependent achievement of an advanced society? Also, can this ideal be sustainable across markets of different size, scope, and maturity? This inquiry is of great interest for Lebanon in both an abstract, principled way, and for evaluating plans to rebuild the country's financial markets and their supervisory system.

These questions are besetting this country at a juncture where several competing, aggressively confrontational and deeply adversarial geopolitical forces threaten much more

than its territorial integrity and way of coexistence. To put it differently, Lebanon just now has been confronted with the drums of war, and wars are two things: murderous and fucking expensive.

One victim of war, one single universal human war death, is one too many, without regard to their label of racial, religious, national, or age. So much for the moral debate about a terrifying danger that the Lebanese people feel exposed to by forces outside their control.

In the slightly more detached and intellectualized debates over the economics of conflict and post-conflict, wars wreck economies. To start with, there are direct operational costs, physical destruction of infrastructures (etcetera) and their opportunity costs to combatant countries; the loss of human capital, long-term mental health costs and bodily care and rehabilitation needs; and damages to global environments and climate.

The fateful connection of war and debt is a new cause for worry today because global debt has risen to monstrous proportions in relation to global GDP. After climbing to a debt level of 258 percent at end of 2020 in relation to global GDP during the Covid19 pandemic, the world took some courage because the following two years saw this unimaginable debt mountain shrink by 20 percentage points in the next two years. Now, however, the latest news from the US 2023 fiscal year, which concluded at the end of September, jumped by \$320 billion, or 23 percent. Deficit is the progenitor of debt. Witnessing the perilous state of the world, with wars on the rise and unsustainable financial pathways overpowering the world's richest and most powerful nations, the painful dynamics of war finance seems bound to further burden the coming generations. ■

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- > Finding fault in the financial system
- > The viability of an IMF deal
- > The contradictions in Lebanon's financial challenges
- > Inventiveness offering an optimistic outlook
- > Digital finance: an emerging salve to the banking crisis

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A LABORATORY TO STUDY FINANCIAL CHALLENGES

■ BY THOMAS SCHELLEN



SUSSING OUT CONTRADICTIONARY SIGNS TO READ LEBANON'S FINANCIAL FORECAST

By the strange virtue of its unresolved economic and financial crisis of now four year duration, Lebanon has become an examination room and nation-scale laboratory for analyzing an economic and financial catastrophe. The reasons are plain: this crisis of a small, highly and deeply dollarized country was composed of interconnected financial, economic, social, political, and external shocks and has been playing out at the cusp of a hyper-connected, hyper-(mis)informed, heavily globalized, extremely financialized and increasingly digitized world that cannot but expect to see novel

and very hard-to-manage long economic waves and superfast financial cycles.

The people who were involuntarily subjected to this experiment seem to have shown a rebalancing of newly precarious and informal financial safety with equally precarious and massively externally secured social stability. They have done so through their behavior and coping adjustments over the past four years, which, a cynic might note, were not significantly distorted by government interference or by any notion of trust between people and their government.

It could further be hypothesized that firstly fi-

nancial safety and price stability, the domains of central bank policy making that are also the mission of Banque du Liban (BDL), the Lebanese central bank, are not only requirements of stability and/or growth in economic outputs but also quintessential for social security and stability.

Secondly, it could be said that the slowly improving levels of financial safety, economic performance, and social stability in the country show no indication of sustainability. The evidence of informed altruism and healthy self-interest are focused on the here and now of rational coping, not on national or institutional rebuilding.

Attributes that characterize the Lebanese economy after four years of disruption and administrative chaos are economic informality, the dollarized cash economy and the inflow of remittances. Many economists and stakeholders in the industrial sector have told Executive that they consider economic informality to have doubled in the past three years, from an already high level that in the mid-2010s was estimated to be in the 30 to 40 percent range. As to the cash economy and remittances, the World Bank estimated earlier in 2023 that last year's cash economy was worth \$9.86 billion, or 45.7 percent of GDP by World Bank computation, and that remittances equaled 31.7 percent of GDP.

These estimated numbers present a blurry snapshot of the current level of "normalization" in people's daily affairs, snapshots taken with substantial x factors of further growth of the cash economy and increasing pressures of informality in the first nine months of 2023 as well as fluctuations in inflows from remittances and external financing through diverse channels. It is clear, however, that external financial lifelines have been sustaining anything from peer-to-peer emergency aid to rebuilding of schools and hospitals to salaries of teachers, from civil society research pursuits to non-governmental aid efforts and private household sustenance.

HANDS-ON NORMALIZATION

This journalist's daily experience of normalization of living conditions at the end of summer 2023 begins with the personal comfort of mornings that are once again filled with the excited sounds of hundreds of children before the school bell chimes and the national anthem rings out from the school yard next door. For more than two years after the Beirut Port blast, there had been only the sounds of demolition and restoration.

Further anecdotal observations of everyday life around the wider neighborhood and on trips around Lebanon in the second and third quarters of 2023 have made this observer sense a superficial

"normalization" trend in traffic and transportation patterns from the availability of service taxis to the experiences of urban congestion on streets in the Beirut conurbation. At night, the city's streets are – although sporadically – lit better and there has been "normalization" in the supply of electricity to those who can afford it. There is a new normal also in the supply chain flows and retail market availability of increasingly hard-to-afford consumer goods and especially imported foodstuffs, as in the difficulty to find a table at a mid-range but overpriced eatery in shopping malls during the expat visitation season.

The socioeconomic "normalization" delivers a picture full of contradiction. On one side it shows a social landscape of unbearable inequities that have sunk back into hiding but on the other side it also shows a panorama of how a society's economic and social coping efforts have proceeded under a new survival formula. It is to be interjected here, however, that the perceived relative normalization of the economic crisis and living circumstances, where insufficient household incomes were the main source of societal pain, has in October 2023 been overthrown by exponentially rising fears over acute shortages of everything from shelter, food, and water to medical care and communication services because of the threat of war and foreign aggression that again came to loom over Lebanon.

NOTHING NORMAL IN FINANCE

The new normal in the financial services sector, by contrast to the societal picture in the first nine months of 2023, has stayed and is quite anti-normal and disturbing: commercial banks, which a little over one year ago overwhelmingly turned themselves into barricaded obstacle courses attracting only the most desperate or daring of customers, have retained their dysfunctionality. On the other hand, visible activity in the financial retail market has been swamped with flashy storefronts and marketing messages of purveyors of money exchange and cash transfer services. All in all, the new normal in finance is a market in alternation dominated by new and recurring stories of corruption and by the reality of zombie banks that have lost many decades' worth of trust and human capital.

But is the ill health of financial markets really a recent problem? In the analysis of Fouad Zmorkhol, dean of the school of business and management at the University of St Joseph in Beirut, financial safety in Lebanon has been a problem long before the onset of banks' liquidity problems. "Financial safety and financial stability are headline issues in all economies, specifically the large developed

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countries. Taken into the Lebanese scenario, we have to be realistic in saying that financial safety and stability was never in existence in the country,” he tells Executive, emphasizing that financial safety and social stability were absent even during the 30 years until 2019, and that safety which was thought to exist during that period, was in truth fictitious.

For Zmokhol, the 1989 Taef agreement to end the civil war involved a pact among warlords to usurp economic power in Lebanon and embark on a debt financing strategy for the country, thereby accepting a huge pileup of public debt and a government that was running on deficits and debt machinations that precluded achieving real financial safety and social stability.

Other indications for the situation of financial safety were elucidated throughout the first nine months of 2023 by the developments, or absence thereof, of banking and financial market reforms, by audits of the financial entities, by the changing of the guard at the central bank, and by fragile but fresh shoots of innovation.

The issue of first magnitude is the absence of financial sector reforms and correlated deterioration in the capacity of banks and financial market participants to channel stored monetary value into productive investments.

For investment expert Khaled Zeidan, chair-

man and general manager of financial consultancy Capital EE, pillars of the financial system are yet to be constructed – probably beginning with capital markets – but there is no going back to the previous system which was so deeply flawed that it practically failed by design. At the exit from the meltdown of the financial system, “the funding of the economy is the issue, because there is no medium to long term deposit base in the country now,” he tells Executive.

On a best-estimate assumed current GDP in the range of \$25 to 27 billion today, the economy would require about 30 percent, or approximately \$7 billion, in funding to securely resume growth but such large access to finance could not be supplied by commercial banks in the foreseeable future. “How do you fund the economy? Let’s say banks come back under a restructuring plan and you will have something like five or six banks instead of over 50 banks as before. Assuming that these banks will be able to address the market needs, I don’t expect them to be capable of addressing more than 30 percent [of it],” Zeidan elaborates.

A second facet in the recent financial developments is the effort of unmasking and cleaning up the sector’s governance breakdowns and illicit practices of the past 10 or 20 years. In a case of crucial institution-building failure for example, a thorough mess was made of seriously delayed regulatory innovation and underwhelming supervisory empowerment of the Capital Markets Authority (CMA).

What many say were political and clientilistic delays in reaching CMA operability, and therefore capital markets functionality, run into years of failures as far as establishing, staffing, and properly operating the CMA institution needed to invigorate the historically anemic but principally vital Lebanese capital markets. The extent of this failure has become clearer this summer, in the revelation of a long-suppressed CMA report of malpractice findings at financial brokerage Optimum Invest (OI) from before 2016.

The report actually surfaced in public debates in conjunction with the forensic audit of the Lebanese central bank, whose governor was at the same time the chairman of the CMA. However, public discourses of the OI case were not so focused on the OI report’s systemic implications – which among other things suggest that conflicts of interest and cronyism were deeply permeating and damaging the sphere of financial intermediaries. Instead, the primary focus of public attention throughout

Capital Markets Authority (CMA)



■ The socioeconomic “normalization” delivers a picture full of contradiction.

the summer of '23 was once again on the person of then-central bank governor Riad Salameh and his alleged culpability in every problem at Banque du Liban as investigated by a forensic audit – whose language was loaded with innuendo and whose preliminary findings appeared less than spectacular and revelatory to informed observers (for more on the culprits and victims, see story page xxxx).

THE VIEWS OF THE PROFESSIONALS

Being not just an informed observer but an active professional stakeholder in the arduous task of unraveling the web of legal violations in the financial sphere of Lebanon is lawyer Iman Tabbara, who serves as board member in the Lebanese Private Sector Network (LPSN). She tells Executive that a group of lawyers, including herself, had been tracking the issue of not only the forensic audit conducted by financial services firm Alvarez and Marsal (A&M) but also two slightly earlier central bank audits by consultancies KPMG and Oliver Wyman. The lawyers actually obtained a court decision that forced the Ministry of Finance to make their results accessible. “As to the outcomes of the three audits, we were very well aware that the practices [of the central bank] were not in accordance with the applicable laws or the accounting standards that we knew of. Even the figures highlighted in the forensic audit we knew in an approximation,” Tabbara says.

Having gained the audit results, law firms were able to prove that their allegations of rule violations at the central bank were backed by relevant numbers and not just politically motivated witch hunts. But for Tabbara, the audits were still falling short from many of their objectives such as bringing financial sector and banking transparency and facilitating better accountability in commercial banking through individual audits of the top 14 commercial banks.

Moreover, in some ways audit debates in media and society, in their singular concentration on personal corruption findings at the top of BDL, even contributed to the Lebanese people being side-tracked “from the bigger issues that the regulatory authority was unregulated and that the central bank was the gate keeper or accountant of the deeply rooted, deep state,” Tabbara says.

Despite these shortcomings, the audits confirmed that legal professionals’ criticism of the central bank’s adherence to laws and standards is warranted. The audits flagged specific failures in BDL practices and behaviors, such as the A&M audit’s testifying to non-implementation of “Chinese Walls” of separation of responsibilities and authority between the governor, central bank departments and BDL-associated entities. “It was very alarming

to us because it showed how one man, to whom all authority had been given, could design something of a monetary policy irrespective of any checks and balances in the central bank,” Tabbara elaborates.

Her conclusions confirm to private sector stakeholders how important the completion of the audit and resolution process for central bank and the banking sector is. “There is no doubt that the private sector needs a proper and healthy banking system. Today we are unfortunately in a cash economy, which means that the banking sector is no longer playing its part. When the banking sector is no longer playing its part, this will affect the private sector negatively, in many ways,” she says.

A NEW GUARD

While it cannot be said today that any closure has been achieved in either the audit process or the process to repair the banking sector’s brokenness in terms of trust, capacities, manpower, and capital, an important intermediate step has been taken this summer in the changing of the guard at BDL’s leadership level. The experts and stakeholders in finance who talked with Executive during the research for this financial safety report commented very positively on the ascendance of First Vice-governor Wissam Mansouri, and specifically acknowledged his decisions on monetary issues such as retiring the relatively non-transparent Sayrafa platform in favor of the external Bloomberg platform for lira exchange rates.

Commenting on the early declarations and decisions of the acting BDL governor, USJ’s business school dean Zmokhol notes four positive signals, including Mansouri’s commitment to the central bank’s regulatory responsibility and approach to exchange market operations that aims to maintain balance at times when having to buy dollars for fuel or similar purchases. “[Mansouri] says he will not lend to the government while not being sure if the money would come back and has stopped the Sayrafa platform because he saw it as neither transparent nor ethical, and went into Bloomberg platform, which, however, has other pitfalls,” says Zmokhol – who otherwise sees no signs of progress towards financial sector rebirth on the level of Parliament or in the presidential issue.

Asked about his view on the adoption of the Bloomberg platform, Zmokhol approves the move

■ An important intermediate step has been taken this summer in the changing of the guard at BDL’s leadership level

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in principle firstly because international platforms will not enter any local political games. “The second positive aspect is the psychological effect of being linked again to the global economy and appearing back on the radar of actors in global markets through presence of [the Lebanese lira] at a sort of floating rate,” he adds.

On the side of risks and potential pitfalls, the economist names the possibility of high and sudden fluctuations and currency speculations on a platform that is managed internationally, as well as such platforms’ computation of exchange rates relying on official money supply data and other official economic data that do not reflect the totality of monetary flows and economic activities, due to the massive role of the informal economy.

“Providing a free float in a small economy may mean that you can have some major players, from locals to foreign banks to exchange offices and speculators, who can play around with the exchange rate by simply making big transac-

tions,” Zmokhol warns.

Other negative effects would in his view be inevitable if locally controlled exchange rate information tools and data streams, such as opaque apps with unknown sources and concealed agendas, were continuing to contravene the concept of a unified exchange rate. Zmokhol finally sees arbitrage opportunities and risks of significant deposit withdrawal pressures in situations where either the Bloomberg market rate and a still existing low rate at the banking deposit level were scissoring, or when BDL were to adopt the platform’s rate for depositors’ withdrawals from hitherto inaccessible “old” dollar accounts – albeit this would in the short term be a boon to deposit holders.

INNOVATE AND LIVE

According to all who were queried by Executive, the start of the fourth quarter in 2023 is too early for new banks entering the Lebanese market from the region or new local banks acquiring operating licenses. Expectations are that this will change at some point because of currently unmet market opportunities. Capital EE’s Zeidan, who reasons that Lebanon’s resilience during the crisis years proved stronger than many had expected, says for example

that there is a great opportunity for large regional banks to enter the financial market in Lebanon and do “huge business”.

As the country’s innate power of survival in the past three years has defied most conventional financial and economic logic, Zeidan and others among Lebanon’s entrepreneurial minds and economists still have faith in Lebanon’s capacity to rise quickly into a new financial culture. Tender shoots of innovation are present on the digital edge of the financial market (see story page 20) and in online banking (see interview page 26) – despite the still underdeveloped aspects of digital finance.

Thus it is undeniable today that on many fronts of finance, many more efforts are required. For a financial feat of the magnitude needed for new and more sustainable economic growth, – and based on the assumption that the political system becomes adequately functional – Zeidan in this sense calls for functioning capital markets and “multiple different verticals”.

To his mind, it is imperative for the Lebanese to develop market verticals for short-term commercial paper and longer-term debt, or bonds, and specialties such as leasing or microfinance, plus the necessary support system of credit assessment. At the same time he has at least one eye firmly locked on the digital finance and tech realm, including e-wallet operators.

By his reading of the financial system, Lebanon can in no way “be restructured to be the way it was before the crisis” and may not have a future as a regional commercial banking hub – principally because of what he says is a global shift away from commercial banking. At the same time, he regards the long-term lesson of the financial crisis as a positive one. Since the country’s financial elites have quasi fallen on their own sword of corruption-prone and narrowly self-interested practices, Lebanon’s banking and finance model cannot be rebuilt with same mindset, he tells Executive: “This resulted in a new paradigm, where the Lebanese are forced by circumstances to reinvent the finance model that we [have used until] now. This, in my opinion, is going to give us an advantage five, six, or ten years down the road.”

Editor’s note: Interviews for this article were recorded in October 2023 and do not reflect updates or changes that may have occurred since.



■ Tender shoots of innovation are present on the digital edge of the financial market

STRATEGY
FINANCE
GOVERNANCE



FINANCIAL SAFETY

Analysis

WHO'S TO BLAME?

■ BY ROUBA BOU KHZAM



POINTING THE FINGER AT COSTS, BENEFICIARIES,
AND TOLLS OF FINANCIAL MISMANAGEMENT (2015-2023)

In the annals of economic distress, poignant statements often serve as harbingers of the challenges that lie ahead. Three years ago, then-President Michel Aoun's proclamation that we were going "to hell," echoed through the corridors of power. At the time, he was warning about the road Lebanon would tumble down if a new government were not formed. Today his words have proved prescient: we are once again without a government, and the gravity of the economic predicament has only festered.

Aoun failed to prevent a tumble into economic and financial hell, government or no government. The work of today is to unravel the costs of past financial mismanagement, spotlight the fissures in the central bank and banking sector, and install a stable government or at least fully uncover its overarching role of financial responsibility for past and future. But citizens' voices are full of distrust in their government, most of the state's institutions, and all public and private financial institutions.

With a grand failure to adopt the relevant laws,

the process of establishing future accountability has hardly even begun, and the forensic analysis of the responsibilities and misdeeds of institutions and individuals is far from complete. The audits and forensic findings that span the timeframes from 2015-2019, and then from the start of the crisis until now, highlight these pressing questions: What led us to the precipice of economic catastrophe? Who were the ones that the World Bank's Lebanon Economic Monitor (LEM) described as the "very few" that thrived amidst the turmoil, and who bore the brunt of the nation's financial undoing?

HOW DID WE GET HERE?

The Lebanese economy has long faced challenges arising from lopsided production and consumption patterns. Productive sectors contribute to just 14 percent of the GDP, with the economy heavily dependent on consumption, accounting for 88.4 percent of domestic product from 2004 to 2016. As per the World Bank's assessment, Lebanon's economic engines, encompassing real estate and con-

struction, finance, and tourism, have continued to face sluggishness since the onset of the Syrian crisis in 2011. The country's overreliance on consumption is nothing new: over the 2004-2016 periods, private consumption averaged 88.4 percent of the domestic product.

Crucially, the key sectors, including real estate, trade, and public administration, are not productive by nature, resulting in a significant reliance on imports. Furthermore, total investments, constituting 23 percent of GDP, were concentrated in the real estate sector, which experienced a 2018 decline, creating an employment shortage, as it traditionally provides one in every ten jobs in the country. The trade deficit escalated to \$8,431 million in the first half of 2019, indicating a consumption pattern heavily skewed toward imports.

The balance of payments exhibited a considerable cumulative deficit, reaching \$5.4 billion by June 2019. Successive deficits were recorded between June 2018 and May 2019, totaling over \$10.4 billion. The insufficiency of dollars received by Lebanon to meet its external obligations heightened the demand for the dollar, jeopardizing the stability of the local currency, the lira.

A PUBLIC DEBT CRISIS

In 2018, Lebanon's fiscal health sharply declined, marked by an expanding public budget deficit soaring to 11.5 percent of the GDP. Despite the central bank's inverted role of funding government spending, by January 2019, the public debt had surged to \$85.3 billion, escalating further to approximately \$85 billion by June. In May 2019, the proportion of public debt service relative to total payments reached a concerning 34.3 percent. The estimated cost of servicing this debt, known as interest, stood at about 8.5 billion Lebanese pounds (approximately \$5.5 million) in the 2019 budget law, draining a substantial 44 percent of public revenues.

As per the Association of Banks in Lebanon's December 2019 report, Lebanon faced a severe deterioration in public finances in 2018. The public budget deficit surged to 11.5 percent of GDP, with public debt reaching \$85.7 billion by June 2019. The debt service accounted for 34 percent of total payments in May 2019, costing around \$5.5 billion or 44 percent of public revenues. This escalation highlights rampant corruption in the government and public administrations. The escalating public debt and fiscal deficit, in relation to the GDP, pose as one of the most critical challenges for Lebanon's public finances. The public debt crisis stresses the widespread corruption embedded in the Lebanese state and its public administrations.



THE PERILS OF BDL'S "UNCONVENTIONAL TOOLS"

In 2015, Banque du Liban (BDL), the central bank, led by then-governor Riad Salameh, introduced a massive financial engineering scheme. The rationale, according to BDL's November 2016 document on the strategy, was that following the regional effects of decreased oil prices, the flood of Syrian refugees into Lebanon, and the two-year lack of consensus to form a government, Lebanon's economy showed signs of protracted weakness and the central bank would play savior. It cited a 144 percent debt-to-GDP ratio, an eight percent fiscal deficit, and the 11-year absence of an official state budget as some of the woes the country faced at the time. As evidence of its record in steering the country to economic growth, the BDL referenced the stabilizing role of its 2013 stimulus package. It concluded that the financial engineering scheme would make Lebanese society "the ultimate winner: it will benefit from more financial inclusion, better economic development, and a more stable social welfare."

"Attracting foreign investment through high-interest rates on Lebanese pound deposits could have been a wise move, but it created a dependency on new deposits to meet the returns promised to existing depositors," Mounir Younes, an economist and head of the economics department at Nidaa Al Watan, a news and media website, tells Executive, capturing the precarious

■ Lebanon's economy showed signs of protracted weakness and the central bank would play savior.

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nature of BDL's financial engineering.

The recent release of a preliminary forensic audit conducted by Alvarez and Marsal, a US-headquartered firm, has uncovered peculiarities in central bank management and hinted at personal culpability at the level of governance. Encompassing the span between 2015 and 2020, the audit revealed a concerning "absence of comprehensive governance and risk management structures" within the central bank. It pointed to Salameh's "unrestricted" discretion in implementing expensive financial engineering policies, at first widely praised as a buffer to reckless state spending, but now subject to scrutiny.

"A linchpin in BDL's strategy was the fixation on maintaining a fixed exchange rate between the Lebanese pound and the U.S. dollar. While the government and the central bank believed that the fixed exchange rate would constitute stability at first, it became a source of vulnerability as economic challenges mounted and the fiscal deficit burgeoned," adds Younes. "In our pursuit of financial engineering to attract foreign currency inflows, often through high-interest financial instruments, Lebanon found itself trapped in a cycle of borrowing to sustain its operations, leading to an ominous cloud of indebtedness hanging over the nation's economic prospects," notes Younes.



The repercussions of these strategies were keenly felt in Lebanon's banking sector, where the fixed exchange rate contributed to a shortage of U.S. dollars. Younes elaborates, "The scarcity of dollars, exacerbated by a loss of confidence in the Lebanese economy, triggered a wave of capital flight, further depleting already strained dollar reserves." This scarcity undermined the stability that the Lebanese banking system had previously been known for, pushing the financial system to the brink of collapse.

PERSONAL CULPABILITY?

The audit points to Salameh's "personalized" and "unscrutinized" approach. A striking revelation from the audit indicates that the central bank consistently reported profits each year by offloading costs onto its balance sheet, even in years marked by "actual losses amounting to several billion dollars." Alvarez & Marsal also questioned the "non-traditional" accounting standards adopted by BDL, criticizing the opacity with which the institution published its financial data, effectively concealing substantial losses. "BDL's unconventional tools were implemented with a notable lack of clarity, leaving investors and the public in the dark," remarks Younes.

The report unveiled the existence of illegitimate commissions during the 2015-2020 periods, totaling a staggering \$111 million, and directed to seven banks, one Swiss and six Lebanese, over the following half-decade, which seemed related to the same commission scheme under investigation by Lebanese and international prosecuting authorities. The report concludes that Lebanon's problems are due to weak governance, a poor internal regulatory framework, and a largely ineffective government.

EXAMPLES OF INEFFECTIVE MANAGEMENT

In addition to the state's record of serial political paralysis that led to repeated absences of state budgets and subsequent spending reports, the fixed peg of the Lebanese pound to the U.S. dollar and the extensive government expenditures had hampering financial effects. These factors have played a pivotal role in triggering the crisis, leading to a lack of trust in the local currency and exacerbating the challenges faced by an inherently uncompetitive economy that relies heavily on importing 80 percent of its products. The repercussions extend to the

public sector, where hiring for administrative positions becomes a cumbersome burden. Lebanon's public debt is due in part to an excessive workforce of around 360,000 employees by some estimations, a public employment structure that many argue far exceeds the country's actual needs and is fraught with nepotism.

Relying on external assistance, both the central bank and the Lebanese government placed particular emphasis on convening a financial conference to rescue their economic model from impending collapse, drawing parallels with historical instances like the Paris conferences. They were hopeful for loans and aid from the 2018 CEDRE conference to instill confidence in the nation and catalyze economic recovery. However, as Younes points out, a departure from past practices occurred when French President Macron stipulated that financial support would be contingent upon the implementation of reforms.

As an example, proposed reforms included establishing an electricity regulatory authority; a step that would potentially reduce the authority of the Ministry of Energy and Water as designated by the Taif Agreement. Consequently, a consensus was not reached, resulting in the failure to establish regulatory bodies for sectors like electricity and the broader economy.

Wissam Abou Sleiman, auditor and director of Abou Sleiman & Co (for ERM, Assurance, and Tax Advisory), tells Executive about an instance during Prime Minister Hassan Diab's tenure from January 2020 to September 2021. Abou Sleiman and other auditors recommended the establishment of an audit committee to supervise both internal and external auditing activities for public institutions handling state finances and project expenditures. Unfortunately, this proposal received inadequate attention, indicating a disregard for transparency and a failure to adhere to established procedures. Another notable occurrence during this period was the neglect to implement suggested reforms, including those targeting the restructuring of state-owned enterprises. This failure exacerbated the crisis, perpetuating inefficient practices and leading to a misallocation of resources.

WHAT ROLE DID SAYRAFA PLAY?

In 2020, the Sayrafa platform was launched by the BDL in a bid to stabilize the Lebanese pound. Under Circular 157, all banks were mandated to register, facilitating the trading and recording of customer exchange transactions at rates set by the central bank. The platform aimed to enable banks

to sell dollars at rates lower than those in the parallel market, supporting businesses and mitigating severe currency fluctuations. However, the platform's intent shifted as it became a tool for quick profits, exploited by a wide segment led by merchants, importers, financiers, and individuals benefitting from a "quota" system.

Some individuals went as far as borrowing money for speculative trading through "banking." Notably, cases of "excessive importation" were recorded, where merchants sought to capitalize on profit margins through the platform. The World Bank LEM in spring 2023 criticized Sayrafa, stating it turned into an unfavorable monetary instrument, facilitating profits of up to \$2.5 billion for dealers, excluding public sector salaries. The platform's financing mechanism remains unclear, raising questions about its reliance on Lebanese depositors' funds in the central bank's "mandatory reserve."

Younes highlights a distinction between trades under Circular 157 and public sector salary funding under Circular 161. He notes that the central bank used cash reserves from currency printing to finance government expenses, avoiding inflation. Despite legal provisions, Sayrafa defended the exchange rate using funds from both banks and depositors, violating Lebanese monetary laws. Lack of transparency is a glaring issue, with Younes emphasizing the necessity for clear records of transactions and user identities, a feature currently absent on Sayrafa. Known users include public administration employees and bank depositors, but the identities and benefits of merchants, speculators, and banks remain unclear, underscoring the need for regulatory clarity and oversight in Lebanon's financial landscape.

Karim Daher, an attorney and chairman of the committee for safeguarding depositors' rights at the Beirut Bar Association, tells Executive that beneficiaries of Sayrafa can be categorized into two groups: public sector employees receiving salaries in dollars and individuals who rely on Sayrafa as their primary income source. Daher criticized the proposed 2024 budget law, which imposes taxes on Sayrafa earnings, deeming it unreasonable to burden public sector employees when this arrangement was initially permitted by the government in collaboration with the central bank. The proposed

■ Lebanon's public debt is due in part to an excessive workforce that many argue far exceeds the country's needs and is fraught with nepotism.

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law entails progressive income taxes for individuals, ranging from four percent to 25 percent, a 17 percent tax rate for companies, and a 10 percent tax on distribution. Daher recommends additional taxation for those reliant on Sayrafa income, proposing adjustments to standard taxes, the removal of banking secrecy through Law 306/2022, and a census to identify major beneficiaries. He underscores the necessity for regular tax arrangements and increased transparency measures.

WINNERS AND LOSERS AMID ECONOMIC TURMOIL

Lebanon's financial crisis, marked by government mismanagement and risky central bank policies, has left a stark divide between a privileged few

and a suffering majority. Daher emphasizes the urgent need for accountability, citing the failure to address corruption and implement reforms as exacerbating the crisis.


This sentiment aligns with the findings of the LEM spring 2023

report, which states that the crisis has resulted in a scenario where only a few emerge as winners while the majority faces losses. The report underscores

the systemic failure of Lebanon's banking system and the collapse of the currency, creating a pervasive dollarized cash economy, nearly half of the GDP in 2022.

As the crisis lingers, disposable income sees a marked decline, and a widening current account deficit hampers growth prospects. The ripple effects extend across all sectors – agriculture, industry, and services – leading to soaring unemployment, poverty, and inflation. Moreover, the crisis has given rise to increased informality, tax evasion, and money laundering, further straining the economy.

The Lebanese people bear the brunt of the crisis, with allegations against the political elite for embezzling and laundering hundreds of millions of dollars in public funds. Millions of citizens find themselves robbed of their life savings in a country grappling with the harsh realities of an economic downturn that disproportionately impacts the vulnerable majority.

President Michel Aoun's warning three years ago about Lebanon heading "to hell" has materialized. The urgency lies in untangling past financial mismanagement, addressing institutional pitfalls, and restoring trust in a government plagued by citizen distrust. Lebanon is at a critical juncture, requiring swift action for economic recovery and sustainable governance. 

■ The Lebanese people bear the brunt of the crisis, with allegations against the political elite for embezzling and laundering millions.

Rouba Bou Khzam is a journalist at Executive Magazine

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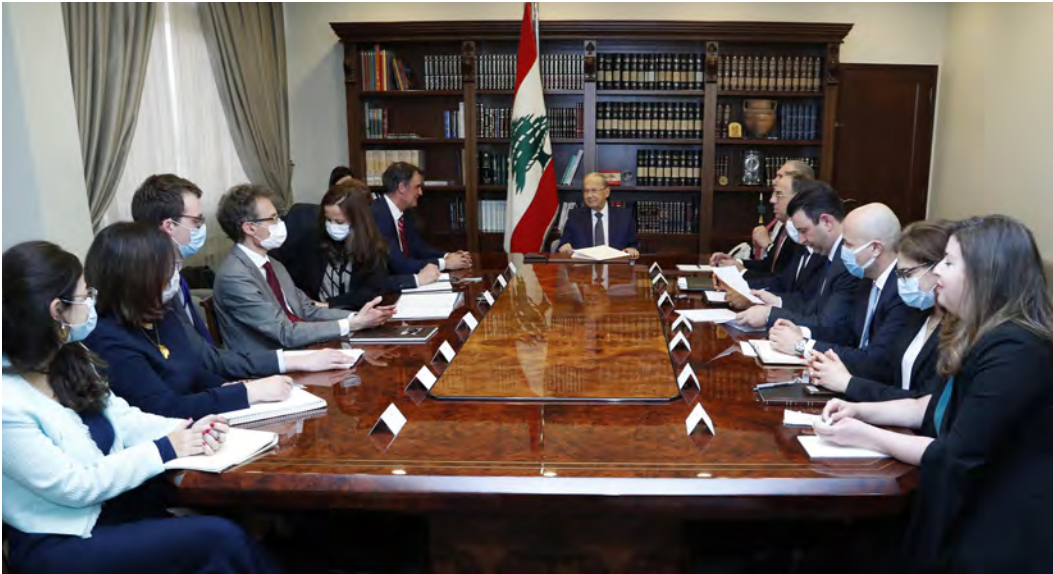
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Comment

DEAL OR NO DEAL?

■ BY MOUNIR RACHED



AN UNEQUIVOCAL RESPONSE TO THE DRAWN-OUT IMF QUANDARY

Today, one-and-a-half years after the April 2022 staff-level agreement between the International Monetary Fund (IMF) and the Lebanese government, the challenges to implementing the proposed \$3 billion deal have become increasingly evident. A final agreement hinges on a fundamental demand from the IMF: the sustainable and serviceable restructuring of public debt in foreign currencies. In the current IMF scenario, the burden would indisputably fall on the depositors, while the state would be relieved of the \$73 billion it claims in estimated losses. A deal under these conditions would indubitably do more harm than good.

This massive unburdening of the state would happen through the write-off of bank deposits in dollars at the central bank, Banque du Liban (BDL) which is offset by the write-off of bank deposits from both citizens and foreigners, and, finally, the write-off of the government's obligations to the central bank. As a result, the state would only have market debts in foreign currency—including from eurobonds (banking and non-banking)—and bilateral and multilateral debt. Half of these eurobonds

are held by international financial institutions, and most have been acquired at high discount. Although this strategy would enable the rescheduling of eurobonds after reevaluation, it is not possible to write them off. Major financial institutions have too much dominance in financial markets, and the local and international courts where eurobond debts have been registered would be too severely impacted.

THE CRUX OF THE IMPASSE

In the IMF's view, writing off deposits would transform the state's dollar debt into an amount less than 100% of the gross domestic product (GDP), making its solvency level acceptable. The state would then be able to service its debt with a reform program supervised and financed by the IMF.

The most important question is: why does the IMF require the cancellation of dollar deposits and the debt owed by the BDL to banks? In short, the IMF is obligated to protect the quotas of its member countries. From these reserves, the IMF members obtain interest equivalent to the interest of Special Drawing Rights. The IMF must ensure that the quotas

of its member countries are not exposed to any risks, as it is responsible for lending to countries facing liquidity shortages and providing global liquidity.

For this reason, the IMF first demands that Lebanon, as a member state, avoid high sovereign risks by writing off the BDL's—and the state's—obligations to banks. An agreement will not be reached without cancelling most of the deposits and banks' capital against their assets in the BDL. It seems the government's leadership is moving in this direction to obtain a certificate of good behavior from the IMF.

A BANKRUPTCY CRISIS?

The IMF justifies its position by stating that the current situation is one of bankruptcy and not default, and, consequently, writing off most of the banks' liabilities and corresponding assets would ensure Lebanon's ability to service its debt to the IMF without default. This scheme was developed by the technical team comprising government and IMF representatives, based on the 2020 Lazard rescue plan initially presented to the Diab government at the beginning of the crisis. The aforementioned plan, which never reached implementation, proposed a massive bail-in scheme by depositors and equity holders. What is surprising is that the IMF, through its consultations with the Lebanese state, did not give enough attention to stopping waste and only focused on the role of reform.

Can the state realistically implement the IMF's demands and gain its assistance? That is, can the state write off \$73 billion in exchange for a loan from the IMF of only \$3 billion? If the government wants to pursue this option, it must convince the banks to write off their capital, and depositors to write off most of their deposits in the banks. It is very difficult for society and the parliament, which represents the Lebanese people, to accept this option.

The government acknowledges the difficulty of achieving the IMF scenario, and is trying to convince the citizens that it will preserve their dollar funds by maintaining deposits of up to \$100,000, which represent only 15% of the total deposits, to be paid over several years. According to the government's assertion, the remainder would be transferred to a fictitious deposit recovery fund, where the nominal deposits would only be replaced after 70 years.

The reality of the matter is that the BDL and the state are not bankrupt. Bankruptcy requires liquidation, and the state and the central bank have enough assets to cover their liabilities. The crisis is a liquidity crisis. In 2019, the central bank had \$50 billion in reserves, exceeding the dollar debt and equivalent to what would be considered the loss for the central bank.

AN ALTERNATIVE PATH

The government's alternative solution is to secure confidence and liquidity first (and not by writing off deposits or returning them). This is possible by taking these immediate steps:

- Completely liberalize the exchange rate and abolish both the 'Sayrafa' platform and the multiple routes for the exchange of the Lebanese pound issued by the BDL, which set various rates. Liberalizing the exchange rate restores confidence and liquidity, equalizes the role of the dollar and the Lebanese pound for internal transactions, and puts an end to the 'lollar' phenomenon. In addition, the liberalization of the exchange rate eliminates the need for holding dollar deposits in the central bank, providing banks with additional liquidity equivalent to at least \$10 billion and ensuring the return of billions of dollars from the local cash market (the dollarization) to banks. It also restores check and credit card payment methods.

- Reschedule all financial obligations, bank assets, and public debt for a period not exceeding five years for deposits.

- Achieve a fiscal balance within a short period through an increase in revenues after liberalizing the exchange rate. This will improve the revenues of public sector institutions by relying on the private sector to manage them, curb useless spending, and take advantage of the rescheduling of the state debt and its interest.

- Establish an integrated program whose cornerstone is to preserve all deposits. Citizens have lost billions of their own deposits through restrictions on exchange rates and withdrawals. It is enough.

■ The reality of the matter is that the BDL and the state are not bankrupt.

The new government should take into consideration that the IMF looks at the solution from one perspective, which is preserving the rights of the member countries and recovering their loaned-out funds without risk. Its primary concern is not preserving the deposits of the Lebanese and foreigners using Lebanese banks. Is a consensus with the IMF achievable? This seems impossible, given that the requirements of such a deal place an insurmountable burden on the Lebanese people. ■

A version of this article was originally published in Arabic in Aljournhouria.

Mounir Rached is the president of the Lebanese Economic Association

FINANCIAL SAFETY

Outlook

FATED TO RETURN THROUGH INVENTIVENESS

■ BY THOMAS SCHELLEN

LEBANON CANNOT BUT REBUILD ITS FINANCIAL MARKETS FROM THE ENTREPRENEURIAL EDGE

Banking everywhere is being confronted with deep societal paradigm shifts and digital transformation challenges. Demands for better governance and heightened societal and environmental accountability are being leveled by civil societies, regulators, and, at least verbally, some governments and the community of nations. They are reflected in innumerable global discussions on diverse topics such as universal financial inclusion, climate risk mitigation, and gender awareness, which are augmenting the age-old discourses on the role of finance in economic justice, prosperity, and productivity.

The challenges of a fundamental redesign of money, banking, and all financial relations matter hugely, perhaps more than ever, for every human being – much more so in a year like 2023 when armed conflicts of historic consequence are shaking every assumption of a world heading towards peace. The reasons for the financial challenges alone are so many that they cannot be enumerated and much less argued in this short elaboration on financial safety in Lebanon. But the combination of operational and fundamental systemic banking challenges in the global financial system are also decisive for Lebanon's future, although – or rather exactly because – its banking industry has fallen back into a pre-financial, quasi stone age of its own making and the resuscitation of legacy financial structures is looking more difficult with every passing week.


This means that, with dim prospects for reconstruction of financial markets from the regulatory and political top layer, the gap between the progress in best banking practices in Lebanon's regional

partner economies and the dysfunctional market here widens. Can innovative approaches designed to be disruptive to digital finance invigorate operational integrity and competitiveness? The many disappointing examples of the past 25 years raise doubts. Can digital propositions, from new e-wallet operators to online banks boosted by a regime of yet imperfect licenses, progress into systemic pillars of domestic financial markets? When set against challenges of lacking digital infrastructures, ever growing cyber threats, and not yet clear legal frameworks, the answer is far from certain. Will they find enough trust and fulfill their promises of ethics and inclusiveness to the point of efficiently redrawing financial markets on the domestic scale and fulfill currently still nascent aspirations to perhaps claw back a role beyond the confines of their small economy?

TRACKING THE YEAR'S GLOBAL TREMORS

On the international banking industry's operational side, dangers of bank runs and overexposure to various risks have spiked in the first half of the year. These dangers and overexposures have been documented to great international attention in a few hyper-speed bank runs on overstretched US and Swiss lenders. Being digital bank runs, these depositor and investor stampedes underscored a hitherto almost theoretical, severe downside of the digital era.

In another big financial system tremor with worldwide implications, but one involving the more conventional grounds of a national property market, specters of trouble for China's financial stability have kept making headlines since early



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in 2023. Drawing attention of the International Monetary Fund (IMF) and all presumed guardians of global financial stability, this trouble factor, which is linked to the continuing real estate crisis in the People's Republic, was flagged repeatedly in the IMF's latest Global Financial Stability Report (GFSR) that was released on October 11, 2023.

And even at the top of the increasingly stressed development finance system, change pressures have

■ The World Bank “needs to run better,” as it is engulfed in the global economy’s “perfect storm” of challenges

recently been acknowledged. According to recent remarks by Ajay Banga, the new World Bank president, “operational dysfunctionality”, or a diminished ability to meet its purpose of boosting eq-

uitable prosperity and reducing poverty, has been hinted at in the world’s eponymous, and largest, development finance institution (DFI).

The World Bank “needs to run better” as it is engulfed in the global economy’s current “perfect storm” of challenges, Banga lectured an audience of sympathetic peers at American NGO, The Council on Foreign Relations (CFR), at the end of September – about four months after taking office.

Pointing to the current conflagration of global social and economic crises, Banga said that the World Bank was now needed more than ever, but immediately moved on to describing a personal shock: seeing the institution not being able to lead from the front and get things done as needed made him understand, in his words “that there is some-

thing dysfunctional in the way the institution needs to be changed and operated with. And that’s kind of what was my biggest surprise.”

PARALLELS AND DIVERGENCES, NOTED FROM A DYSFUNCTIONAL SLIVER

Despite the local banking sector’s strength relative to the size of the national economy, and despite the renown of Lebanese bankers in the international halls of finance, the country’s financial market was a niche market even when it was at its strongest. Today, seen against the broad range of worldwide operational and systemic challenges, Lebanon’s state of continued financial incapacitation is infinitely less relevant than the above cited troubles of the DFI system, the Chinese financial sector, and some surprisingly vulnerable banks in the United States and Switzerland.

In this context, the relative (in)significance of the Lebanese system in the eyes of shakers such as the IMF, can perhaps be read from the fact that a query into the latest GFSR returns 98 matches for “China”, three for “Middle East”, and zero mentions of Lebanon. Similarly, neither the September 2023 issue of the IMF’s Finance and Development magazine, which offered a preparatory focus on Arab financial markets ahead of the October annual meeting in Marrakesh, Morocco, nor the public statement on the IMF’s 2023 Article IV mission to member country Lebanon, were sources of enlightenment on practical or even theoretical solutions for restoring the operational integrity of the country’s financial system.

This is especially noteworthy against the background that the IMF’s efforts at addressing the Lebanese emergency have not yielded fruits in the past three years. In a side note to this from the Marrakesh annual meeting’s press briefing on the Middle East and Central Asia, a journalist’s question about the prospects for an easing of the IMF’s reform demands before disbursing any funds to Lebanon was deflected with a reminder on the required three “prior actions” for an agreement that were listed in the staff level agreement of April 2022.

While not answering the question of whether the IMF could have been more creative in its proposed solutions and more accommodating of the Lebanese case (see comment piece on page 18), the painful failures of producing salient banking reforms and legislation to protect the stakeholders –

from the average depositor to the IMF as prospective lender – are the failures in securing minimal operational integrity and must be laid at the doorstep of the local occupants of power. This political constellation has revealed a very inconvenient, deep incongruence in the operational structure of the post-Bretton Woods system of international economic and monetary control, a fissure that is as indicative of this system's inherent weaknesses as it seems to be embarrassing to the IMF.

DIGITAL, THE BEST OR THE ONLY GAMBIT ON THE TABLE?

But enough of that. On the flipside of the coin, or, as it were, the token of future finance in the digital era, Lebanon's system is subjected to the same immense transformation pressures as the global financial system.

The overburden of under-addressed systemic risks and emerging radical changes in the global economy and especially its weaker clogs coincides with Lebanon's devastating inability of creating stable and adequate regulatory ground and realizing top-down financial system reforms. Against this backdrop, the only discernible local flashes of hope come from fintech innovators, who are endeavoring on adventures in digital banking and operations relating to e-wallets – which during the economic crisis astoundingly saw several steps of regulatory progress – with the unquenchable verve of Lebanese entrepreneurs.

LOCAL PLAYS ON THE E-WALLET PROPOSITION

Market participants say that more than ten licenses for operation of a digital wallet, mobile applications that are also known as electronic or e-wallets, have been issued by the central bank of Lebanon, Banque du Liban (BDL), earlier in 2023. In response to this accommodative regulatory action, several corporate names that represent Lebanese and foreign investor interests as well as some mid to high tier Beirut-based money transfer enterprises and payment processors are either in the process of establishing their e-wallet brands or have already launched wallet apps, including new interoperability deals aimed to improve the apps' utility and acceptance.

To visualize a digital wallet in one's pocket, one can say that the common container for carrying one's essential documents and currency has been restyled from leather or fabric to plastic and glass, and expanded from a few compartments to a portable bookshelf with an integrated strongbox: e-wallet is a catchy term for an app on a smartphone. More than to the pouch of victuals, bag of coins or

billfold in the Renaissance-era roots of the term "e-wallet", this mobile app's everyday financial functionality can be compared to that of a slick payment card, such as a bank-issued debit card or credit card with numerous conveniences and preset options/limits. An important mark of distinction of digital wallets is that they do not require their owners to have a bank account. Convenience and tech appeal has been another key selling point.

Interestingly, the recent cohort of entrepreneurial e-wallet contenders in the local market includes licensees with dedicated visions of contributing to a new made-for-and-in Lebanon. One example for this is Purpl, a Fintech startup that has commenced operating earlier this year and was conceived in a deep trench of the financial and economic crisis. Then there is MyMonty, a BDL-licensed Financial Institution under Lebanese ownership, which has a transnational profile in online banking and mobile

phone-based Fintech services. While very different in scope, both enterprises hold e-wallet licenses and at the same time profess their dedications to Lebanon beyond what the local financial market today offers in size and growth prospects.

Purpl was formed in 2021 by three entrepreneurs on the basis of a very critical assessment of the costs and services platforms of vitally important remittances in the Lebanese market. "We decided to tackle the problem of remittances," says Purpl co-founder Wassim Ghorra who has previously worked with Lebanese banks domestically and in Switzerland. It was from the idea of creating a price-competitive and convenient digital remittances platform that, "what followed logically was the digital wallet, so that customers could cash out or have peer to peer transfers and spending options," he adds.

MyMonty is a unit in Monty Holding owned by Lebanese businessman Mountasser Hachem. The company, which has offices in 25 locations around the world, wants to start offering digital lending in Lebanon beginning from later in 2023 and to date has obtained two BDL licenses, a Financial Institution license and an e-wallet license, strategy and business development manager Charles Matta tells Executive (see interview on page 26).

[Editor's note: this story does not reflect any updates that have occurred between writing and publication]

Self-funded and still under formation but not

■ Both enterprises [Purpl and MyMonty] hold e-wallet licenses and profess their dedication to Lebanon

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needing an e-wallet license is Vault-ki, a developer of a password storage solution for decentralized e-wallets – the variant of wallet apps that incorporate the blockchain philosophy of seeking independence from third-party guarantors of trust in a fiat currency. Founder Georges Haddad, who established his fascination and qualifications with both the blockchain and finance, tells Executive that it is his dream to provide a made-in-Lebanon solution for a ubiquitous security need in the decentralized wallet sphere.

“Anyone’s journey in the decentralized world starts with knowing how to safely store your passwords,” Haddad outlines as the baseline proposition of his venture, which he characterizes as “a solution on the periphery of Fintech” that has international competitors but none that is a native enterprise to the Middle East.

While very different in their business plans and at very different points of their business journeys, the commonality of the three ventures is that their founders, co-founders and executives who spoke with Executive incorporate a passionate commitment to Lebanon in their perspectives on digital finance – even as the concerned enterprises are in the short, medium, and long term clearly focusing on business horizons that range outside of the small Lebanese market.

In addition to their Lebanese corporate DNA, the interviewed Fintech players share a conviction that the Lebanese financial crisis is an apt argument in support of the digital finance proposition and

their respective corporate visions of online banking and lending (MyMonty), money transfer and e-wallet services (Purpl), and ancillary provision of a security product whose design as a stainless steel chain of blocks alludes strongly to the mental image of a blockchain (Vault-Ki).

Vault-Ki’s Haddad opines that many Lebanese depositors and holders of moderate financial wealth would have been better protected if part of the monies in the Lebanese financial system had been held in decentralized e-wallets. If people come to share this insight, it will be good for his business. “Trying to succeed as a made-in-Lebanon product and operating from here, partly for the [local] market but mostly to sell abroad, is the business vision of Vault-ki,” he says, and enthuses: “This is not only because I am Lebanese and want to contribute on my scale to a better economy, but also because we have that story [of the recent crisis]. What better proof of concept [for owning a decentralized digital wallet] than what happened to Lebanon?”

However, e-wallet propositions and even online banking in itself are extremely unlikely to become full substitutes of old banking and intermediation pillars in recreating local financial markets. Observers and entrepreneurs alike note that the market still lacks much in digital finance infrastructure and acceptance even as high smartphone penetration rates, general education levels, society’s eager adaption of tech gadgets, and age and other social barriers transcending user profiles of money trans-



■ An important mark of distinction of e-wallets is that they do not require their owners to have a bank account

fer services signify growth opportunities.

"I am not here to disrupt the banking system. I am here to offer alternatives to users, services that are complementary to banking services," Purpl's Ghorra tells Executive. According to him, the company encountered two client types over its first few months of operation this year. The first is people sending money to themselves from outside of Lebanon and using the platform for its lower costs when compared with cash transfer service providers, and the other is made up of individuals who resort to Purpl to receive remuneration of freelance work they did for their clients abroad. "We saw two personas and this is where our [customer acquisition] focus will probably be."

MyMonty, whose global concept of an online "impact bank" is targeting unbanked, underbanked, and under-served individuals (which in Matta's perception today includes every resident of Lebanon), locally uses a direct-to-market approach, something that does not point to quickly seeking a proportionally vast customer base in the country. Moreover, while this does not suggest an extremely rapacious appetite for a rapid market share acquisition, Matta tells Executive that, "microfinance is definitely part of our proposition," whereby acquisition of very small merchants and building of credit scores on MSME level is in the longer-term planning under the financial inclusion lens.

A slow but hopefully steady acquainting of scarred Lebanese bank customers with digital options appears to be the rational choice of market entrants, conceivably for a large number of reasons. This begins on the regulatory front where BDL regulators are said to be working diligently on moving their relevant frameworks towards greater completion. Although this is assumed to be done under a central banking rationale that e-wallet adoption by citizens will partially countermand unhealthy trends of informality and growth in the easy-to-subvert cash economy, it deserves also to be noted that minds at the central bank and among decision makers do not appear able to be firmly focused on the digital financial future. Lebanon is already suffering severe deficits in political, financial and institutional trust and now, further unspeakable dangers that outweigh lacking a full set of central bank regulations for e-wallets and their providers.


THE LONG VIEW AND WIDE ANGLE


Finally, on historic terms, the digital age has still much ahead before it can be seen as mature. Over the past 25 years, the virtual sphere has repeatedly been hyped and over-marketed despite numerous incidents showing that digital finance in general and the cryptocurrency realm in specific are not at

all immune to human imperfections and criminal endeavors. As are other aspects of digital finance, the e-wallet concept and online banking are loaded with behavioral risks on the part of their users and vulnerable to theft and attacks by digital pickpockets, extortionists and cons. Quite a few technology driven financial solutions, or tech-fin as some experts say is a more apt name, were supposed to be disruptive and revolutionary by design but failed to deliver on their vast promises.

Systemic points of weakness have been revealed in multiple jurisdictions and presumably digitally advanced societies, with the most significant systemic problems ranging from inept or lagging legislation and regulatory confusion to state intrusion. In the Lebanese financial arena, restrictive and uneven regulation of Fintech forays certainly combined with weak digital infrastructures and cultural reluctance of conservative bankers into creating a digital finance backwater in the 2010s when compared with Fintech sectors in jurisdictions that were hungrier for the competitive edges and unicorn-breeding potentials.

Today the regulatory situation appears more hopeful but at the same time, the economic and general challenges keep piling up on all fronts. For Lebanon, acute threat of war builds while in tragic irony, the world's top financial players convening in an Arab setting had nothing more relevant to offer to the Arab world than a formal "call for inclusive growth in the MENA region", in which IMF Managing Director Kristalina Georgieva claimed that "perhaps one of the most promising changes [in the Arab World over the past 20 years since the last annual spring meeting hosted in 2004 by Dubai] is that inclusive growth has become a household word and a unifying call across the region."

As the human catastrophes and the violent drivers of emergent geopolitical compuncions seem to be racing into darkness, the Fintech entrepreneurs and stakeholders in Lebanon's financial fate who spoke with Executive before the outbreak of the acute confrontations in Palestine may very well be fundamentally on point when they enthuse that the future of finance is digital. New and monumental obstacles may rise at any moment against the optimistic and fully confident late September remarks of Purpl's Ghorra: "We are today building the foundations for the next financial sector in Lebanon and shaping them in the way we would like to see." But try Lebanon must. 

 Today the regulatory situation appears more hopeful, but the challenges keep piling up

FINANCIAL SAFETY

Q&A

THE DIGITAL OPTION

■ BY THOMAS SCHELLEN



INTERVIEW WITH CHARLES MATTA OF MYMONTY

A new tenant has made a home in the business center of Beirut. Monty Holding and its numerous business units have established a highly visible all-round inclusive presence. They've achieved this virtually by venturing on the arduous endeavor of strengthening digital finance in Lebanon, and physically in visibly invigorating the Gefinor business center. They've added a corporate flavor reminiscent of the region's most active investment hubs – from an office of payment gateway unit, MontyPay, and the publicly accessible “Monty Café” on the ground floor, right up to a private business club at the center's highest point. To understand the digital banking proposition of the group's Banque du Liban licensed financial institution, MyMonty, Executive sat down with Charles Matta, a member of the group's Monty-Finance technology venture team and the chief strategy and partnerships officer of MyMonty.

E Is it right what I heard about Monty earlier this year acquiring a license for an e-wallet from Banque du Liban?

That is 100 percent correct. We [have initially] acquired a license as a Financial Institution (FI)

that allows you to provide a broader spectrum of services. Under the FI [status] we applied for an e-wallet license that was granted three months ago. There are also other licenses [that we will be seeking] to have the full spectrum but as we speak, we have two licenses from the central bank of Lebanon.

E Will you work as financial intermediary under your local license?

The FI status allows you to do lending and brokerage activities, meaning trading and fiduciary activities for assets under management and so on. But [for us] the primary purpose of the FI is digital lending because that is something that is not [available] in the market. This would be a major product under the financial institution.

E By descriptions of the My Monty financial concepts that you gave on our website and in other interviews, your business concept and vision is that of digital banking, sometimes called a neobank. Is there a geographic scope to your business model? Is the scope focused only on this country, on the Arab region, or other?

Basically, the scope of the vision is to have digital banking across the globe. It is not just Lebanon, not just the region, because digital obviously surpasses geographical borders. But for all the well-known reasons which we respect, regulatory authorities are bound to a geographic location. Hence, we applied for a license to operate in Lebanon. It unfortunately is not a digital banking license as the whole infrastructure for a digital banking license has not yet been defined by the regulator.

E In operating an e-wallet as a private sector Financial Institution, what is your target group in Lebanon?

We follow the same approach and vision in Lebanon, the region, and globally. We cannot call ourselves a bank here because we don't have a banking license, but we are proud to call ourselves an impact bank globally. Why impact? Because it is financial inclusion of a target segment that is unbanked, under-banked, or under-served. An under-banked

person is one who may have a bank account for transactional purposes or emergency purposes but who is not actively using these financial services. This is our target group internationally. Unfortunately, under the environment of the Lebanese crisis, I can call everybody an unbanked or an under-banked person. I would say that in Lebanon, all the people are our target segment because all are in need of new financial services.

E *When talking about Lebanon as a market, which is a minuscule market in global terms, did your plan to address this market by rolling out a digital bank originate before the pandemic, did you devise it during the pandemic, or did your strategy perhaps change due to the economic meltdown?*

Internationally, where our overall vision is focused on the unbanked and under-banked, the fastest strategy to acquire unbanked customers is through mobile [phone] operators. Presenting that strategy [here in Lebanon] started in 2016. We held one of the first summits as a group where we invited some of the local banks to the Four Seasons [hotel] to talk about mergers between mobile operators and banks. Everyone was surprised; it was [like we were talking] Chinese to them. It was not something they cared about. But our vision started at the time, and we worked on it internationally. The first project was a credit card that was issued by a local [banking] player and a mobile operator in Asia.

As you said, Lebanon is a tiny market that might not show if you put it on a score card. But if you zoom in, you understand that it has a huge value from a financial aspect. People are educated, smartphone penetration is very high, and the crisis is a huge opportunity for new players as most of the people lack all trust in the legacy players. All this triggered us to move in, [spurred on by] pain points in our own daily lives. Part of our team is located here and [we had to deal] with problems in salary domiciliation, usage of funds, and all this. This was a big driver for us. The licensing process unfortunately took a bit longer than we expected. We were planning to roll out our products more than one year [ago] but this [slow licensing] is understandable when a new player is coming into the market.

E *So, while some e-wallet startups and electronic money transfer platforms in Lebanon were motivated by the crisis and the emergence of near monopolies in the money transfer market, you had the strategy of developing an e-wallet already before the crisis. Was your e-wallet vision inspired in any way by the success of the famous Alipay platform in China?*

Even Asia in general was an inspiration for mo-

bile money because of the super apps that they have built, one of which is Alipay. From our side, we believe that the potential for such services is huge because you can easily target millions of subscribers when you go through a mobile operator. For example, we are in advanced discussions with a mobile operator in Indonesia that has more than 100 million subscribers.

E *But you are not particularly interacting with mobile operators in Lebanon at this time?*

No. [Our value proposition here] is direct-to-market acquisition of customers. But for inclusion, it is to note that we are offering three things: we have the direct-to-customer approach, but we also sell our services as a technology provider under a white label, empowering other [providers] who are interested in offering these services. The third thing, which we are currently discussing with the regulator, is agent banking, allowing non-financial services providers, including mobile operators, to leverage on the whole package.

■ I would say that in Lebanon, all the people are our target segment because all are in need of new financial services.

E *In the “New Economy bubble” of “click and mortar” bank-type ventures, some large mobile telephony groups from Europe and the Middle East – Africa realm were assessing the potential for financial inclusion through mobile telephony. Did your group have experience in Africa back in those earlier iterations of the digital financial economy?*

We have international experience. We have 25 offices around the globe and are connected to more than 1,000 mobile operators in many more countries. We have a big customer base in Africa and Asia and have, from mobile operator perspectives, huge experience in Africa and long relationships with mobile network operators there.

E *In how many places do you do direct-to-customer digital banking?*

The trading name of our brand is MyMonty and we are currently live across the whole European Economic Area, 31 countries including the UK in Europe with a digital banking application that we rolled out in 2021. We are currently working on [further] markets, starting with the US. Another strategic market that we are advanced on is the Philippines and there are three markets in Africa where we are very advanced. We follow a light operating model internationally, so we start by partnering with an existing banking license [holder] and act as a digital bank.

FINANCIAL SAFETY

Q&A

E *In simple terms, 99 percent of your business is outside of Lebanon. What then is the plan you have for this market in the coming 12 months?*

Even though there are large international markets that I have spoken about, there is that special relationship with Lebanon, especially since Moun-tasser [Hachem], the owner of the group, is him-self Lebanese. We also have a big team in Beirut [of about 700 people] and even though the market is tiny from a population perspective, we see a large opportunity. We are putting a lot of efforts into our rollout plan for Lebanon. We are planning to go live

by mid-December of this year, with an e-wallet proposition where customers can onboard digitally and have an account.

[Editor's note: This interview was recorded in October 2023] We already closed a num-

■ But in Lebanon, the question has turned into if and how this country can find a future as a place of finance.

ber of deals with local providers [from payment to payout providers] and on top of this have a virtual lending product as I mentioned at the beginning of this interview.

Our major goal is to gain the people's trust. We are working a lot with other players who are our peers in the market and want to really bring awareness into the market, of understanding the importance of having an e-wallet account and the use of these accounts. As regulations are shaping up, we have bigger plans, but our first strategic objective is to show the capabilities that we have and that we have succeeded in delivering internationally and are planning to deliver in our home country. We want to gain people's trust in terms of financial services.

E *Would the lending product be of a retail lending type, similar to attractively priced car loan products that some banks were pushing into the market in the years before the crisis? And what is your equity proposition?*

We will have different lending products, the first one starting with an advance on your salary. Every person will have the right to get an advance on their salary as long as the salary is domiciled with us. The mechanism will be purely digital at our end. There will be other fintech related lending products down the line. At a financial institution, lending has to come from equity as we are not supposed to have

deposits. So we are lending from our own money, from equity that is injected into the financial institution from our part.

E *Thinking beyond the very large local challenge of rebuilding trust, trust has always been a fickle asset in the business of banking and trust in the digital era has become hyper-fickle if one goes by the evidence of how fake financial news and rumors can go viral and cause a bank run. We have recently seen digital bank runs, are those not scary for you as operator in this space?*

I see it as the opposite because bank runs have always [involved] physical branches. In digital banking, you feel as if you are digitally owning the money. If I take my own case, I felt insecure and that I did not have access to my money when the banks closed back in 2019. But even as the banks closed, money was available online and I did small purchases online. When this still worked, I felt much more comfortable as a consumer. I do not disagree that digital banks have a long road ahead in proving their trustworthiness. Traditional banks have existed for centuries, digital banking is very new. A good indication of trust in digital banking is that the average deposits remaining in digital accounts has increased significantly, by almost 250 or 300 percent.

E *When compared with when?*

From five years ago. So, you see that when people first start [using a digital bank], they look at digital banks as being much cheaper in terms of transacting and much more reachable. But with time, there are other services and people start using them.

E *You mentioned impact finance as your value proposition. Impact investing and socially conscious investing with focus on inclusion have been highly touted propositions for years but on the other hand, the digital era since the beginning of the 2000s has seen numerous failures of digital banking visions that were not as powerful as the brick-and-mortar banking model. But in Lebanon, the question has turned into a question of if and how this country can find a future as a place of finance.*

The situation looks shaky, but I believe that every experience you go through is temporary. If I go back to 2019, Lebanon was among the top five countries regionally in terms of FinTech [startups]. Development, technology, innovation, and so on, and this was just prior to the October 2019 crisis. Things can turn around very fast. Everything in

Lebanon can be a quick fix if there is an international and local decision.

E *From your perspective, is inclusion still just a hype word that sounds great in speeches, or is it something that is happening?*

Inclusion is a huge problem that [development finance institutions] have been talking about internationally. But I believe honestly that Covid 19 had a positive impact on it and drove up financial inclusion. When you look into Africa, it is very unbanked and under-served, whereas mobile money penetration is at very high percentages. But this still does not represent a full digital banking proposition with the whole spectrum of financial services that the consumer has the right to benefit from. However, we as a group interact with international players in Africa, Asia, the US and Europe, and we see a lot of advancement when it comes to mindsets, readiness and acceptance by banks to collaborate.

E *Did you see the readiness for more collaboration also in Lebanon? And from the perspective of digital finance, what was for you the bigger change factor in this country, the pandemic or the economic meltdown?*

In Lebanon, it has been quite a journey. I would say we have two, three banks that we were able to

collaborate with on different opportunities. This has not been the mindset before. To be honest, not just in Lebanon but in the region, banks have [previously] been in very strong positions and did not need to collaborate. But I believe the need is striking them. Even in the UAE and Saudi Arabia, we see and hear of a lot of collaboration opportunities today that were far away two or three years ago. In Lebanon, I believe both [the pandemic and the economic crisis] were change factors.

Covid-19 has driven up customer expectations on digital readiness and digital savviness. The [economic] crisis has driven

banks or major players to have a more collaborative mindset, to collaborate seeking to have different and more diversified revenue streams. Both aspects [of the Lebanese crisis years] had their positive impacts in terms of digital readiness. Unfortunately, they had many negative impacts on people, their trust, their money, and their health when it comes to Covid-19. But speaking about digital readiness, [this crisis] has helped internationally and locally.

■ The crisis has driven banks to have a more collaborative mindset

The interview has been edited for brevity

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Executive

Beyond the “Muddle-Through” Option

■ BY LAMIA MOUBAYED, SABINE HATEM AND ISKANDAR BOUSTANY



THE CASE FOR A NEW TAX DEAL IN LEBANON

Lebanon stands today at the crossroads of a more strenuous and challenging muddle-through phase on one hand, and progressive recovery on the other.

The road it will end up taking will ultimately depend on a series of sound and rational decisions, chief among which is the reform of the country's taxation system. A new tax deal could ensure the country greater fiscal stability, allow for the funding of social programs, and rebuild trust between citizens and the government.

These policy objectives are fundamental if the country is to exit one of the worst financial crises of modern

times and alleviate the despair of a sizable part of its population that has been plunged into poverty.

Inevitably, such a system needs to reconcile growth with equity, particularly given the extensive financial damage that has been wrought upon individuals and households.

In the report “How can a new tax system restore growth and equity”, The teams of the Institute of Finance Basil Fuleihan and Financially Wise-Lebanon, make the case for a new tax deal that would be designed to address the current system's inefficiencies and weaknesses. The full report is available here.

■ Piecemeal tax measures eventually created a dysfunctional tax regime that was neither sustainable nor conducive to greater economic growth.

A DECADE OF CONTRADICTIONS

The decade that preceded the crisis can indisputably be considered one that was marred by contradictions. Broadly speaking, the current tax system continues to be an amalgamation of tax policies implemented in an ad-hoc manner without a medium-term plan or strategic foresight.

Quick-fixes can't replace a long-term vision. Piecemeal tax measures eventually created a dysfunctional tax regime that was neither sustainable nor conducive to greater economic growth. Despite constituting the largest share of total State revenues, the picture is much grimmer when benchmarked to the country's GDP. In that regard, tax revenue has dropped from 15.1 percent to no more than 6.6 percent between 2019 and 2023.

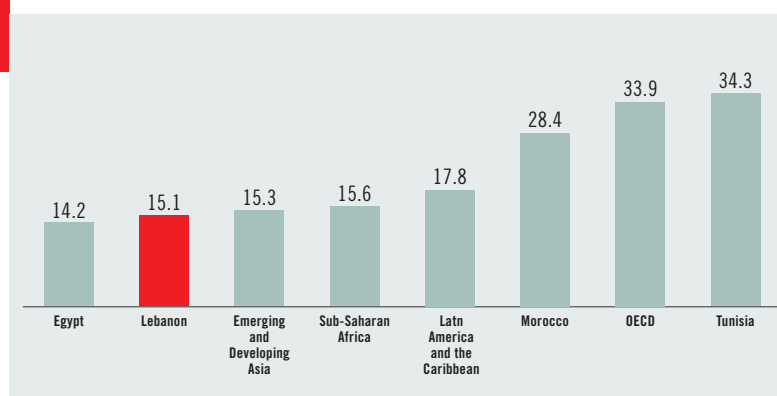
Nearly deprived of its main source of revenue, the State's functions have greatly slowed down or in many cases come to a halt. Tax collection, already limping prior to the crisis, has been unable to offset this collapse in tax revenues.

Consequently, current spikes in VAT collection are no reason to celebrate. They need to be viewed as circumstantial and unsustainable. Low tax revenue aggregates and low tax revenue predictability are symptoms of the system's overall inefficiencies

HUMAN CAPITAL: ON DEPLETION MODE

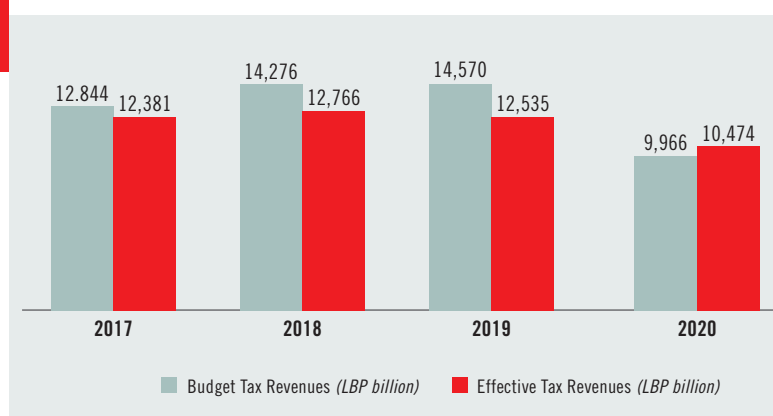
Decades of constant weaving to build talents and skills within the tax administration, a great deal of them the work of the Institute of Finance Basil Fuleihan, have been dealt a crit-

LEBANON'S TAX REVENUES IN COMPARISON TO MENA AND OECD (2021)



Source: MoF, Public Finance Monitor 2021

LEBANON'S TAX REVENUE (UN)PREDICTABILITY



Source: MoF, Public Finance Monitor 2021

ical blow by the economic crisis.

The tax authority has witnessed a significant level of deterioration in staff productivity, owing greatly to the country's deteriorating work conditions, escalating living expenses, currency depreciation, income erosion, weak substantive leadership, and the departure abroad of skilled human capacities, mostly to join higher paid jobs at big consulting firms advising ministries of finance of the region. With little incentives and an overwhelmingly negative outlook, productivity within the public sector has stalled.

The tax administration can't be left on autopilot. This talent drain

■ The tax administration can't be left on autopilot. This talent drain imperils the tax administration's ability to roll out reforms and weakens its rapport with tax payers.

imperils the tax administration's ability to roll out reforms and weakens its rapport with taxpayers. Ultimately, this would lead to increased tax fraud and evasion, an issue that the country has had to deal with well before the crisis.

KEEPING THE BOOKS IN ORDER

History has demonstrated that tax records are correlated with successful statebuilding. In Lebanon, the tax administration faces several challenges in maintaining the integrity and effectiveness of its registries and operations.

While data regarding taxpayers is available, the registries remain vulnerable to inaccuracies and potential cybercrimes due to the absence of automated verification processes. Weak risk management allows for tax loopholes, often benefiting specific groups of taxpayers and affecting overall revenue predictability.

DYSFUNCTIONAL SYSTEM THAT WIDENS INEQUALITIES AND DETERS VOLUNTARY COMPLIANCE

Food on the table—or the fulfillment of basic needs—precedes voluntary tax compliance. While the depletion of human resources exacerbates compliance checks, complex and continuously changing procedures, corruption, inefficiencies, interruptions in automated services, to name few of many constraints prevent people from opting for voluntary tax compliance as a rational choice.

Such dysfunctions widen inequalities among taxpayers at a time where the rift between those earning in US Dollars and those earning in Lebanese Pounds continues to widen. Undoubtedly, tax dispute resolution that is timely and effective will prove unavoidable in the settlement of unpaid taxes. At present time, confidence in tax dispute resolution is at its very low.

DIFFERENT TAX APPLICATION TO THE SAME TAX BASE

FISC ALL YEAR	PERIOD DESCRIPTION	WAGE EARNED (in USD)	APPROXIMATE TAX WITHHELD (equivalent in USD)
2019	Prior to the crisis	24,000	974
2020	Yearly average exchange rate on the parallel market: 6,705LBP	24,000	217
2021	Yearly average exchange rate on the parallel market: 16,820LBP	24,000	87
2022	Yearly average exchange rate on the parallel market: 30,313LBP	24,000	462

Source: Author's calculations

PROGRESSIVITY: A LOST GAMBLE?

Lebanon has a set of progressive taxes that are by all measures far lighter than their equivalent tax schemes in OECD countries. Yet despite their relative competitiveness in that regard, the evidence points to significant flaws within their inherent design. These shortcomings primarily stem from the absence of cumulative filing, which eventually creates loopholes that undermine the intended progressivity.

Owning a house and living abroad is a go-to strategy for those seeking to circumvent progressivity altogether. Indeed, non-residents are exempt from progressivity, and the built property tax, among others, lacks cumulative progression.

While income tax progressivity was eroded by currency devaluation and the existence of multiple exchange rates, the 2022 budget law amendments widened the gap between different earning categories and accentuated disparities across labor income categories.

THE ROAD AHEAD

Ultimately, the achievement of equitable taxation hinges on a country's social contract and its capacity to harmonize taxation goals with economic

■ Ultimately, the achievement of equitable taxation hinges on a country's social contract

and societal development objectives. This process typically commences by formulating a clear strategy for the government's fiscal role, resource allocation, income redistribution, economic growth, and economic stabilization, all of which need to be in coherence with broad macroeconomic principles.

The Lebanese case is intrinsically unique, and given current challenges, two avenues remain possible:

A. Firstly, a far-reaching, long-term exercise that would entail anchoring reform within a national political and policy dialogue. This participatory approach would allow reconfiguring the country's tax system towards greater progressivity. This would include consolidated tax structures, a wealth tax, earmarked taxes, targeted incentive schemes, bolstered administrative capabilities, and enhanced public financial awareness.

B. The second scenario which

might as well go in parallel with the long-term plan, would involve implementing immediate, corrective measures to stabilize the existing system in the short to medium term. These measures encompass bolstering revenue collection, stemming the loss of skilled personnel, enhancing policy design, streamlining procedures, and intensifying citizen engagement.

Finally, evidence around the world has shown that when citizens like what the government is doing with its tax revenue, then they are likely to comply. Conversely, if citizens disapprove of how the government is spending taxpayers' money, or cannot find enough concrete evidence that their money is being put to good use, their appetite for evasion augments.

In a country where inequities are at record heights, fostering equity in society is a building block for restoring the lost trust. Tax reform is fraught with complexities, resistances, and defiance, but it is a must for a country that needs to recover. ■

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LAST WORD

Taking the local path towards enhanced economic security and urban stability

■ BY TAINA CHRISTIANSEN

THE LOCAL PATH TO FINANCIAL SECURITY AND URBAN STABILITY

In Lebanon, nearly 90 percent of the population live in urban areas, making it a country of cities. Therefore, applying an urban lens onto the future economic – and social – stability of Lebanon, where localized urban investments are seriously considered and encouraged, must be at the heart of Lebanon's sustainable and inclusive tomorrow. Local economic development and investment, where local dynamics and the involvement of respective authorities and stakeholders are at the centre, should be a key consideration within the overall ongoing deliberations of macro-economic reforms in Lebanon.

Urban social stability and safety is intricately linked to people's inclusive access and rights to key basic services, such as housing, water, electricity, infrastructure, public spaces, education, health and more. In Lebanon, this is no exception. Haphazard urbanization and expansion of informality across Lebanese cities, coupled with historical mass internal and external displacement – amongst other factors – has made it challenging for government institutions at national and local levels, to resolve or at least mitigate conflicts over land, resources, property rights and equitable services for urban inhabitants. Appropriate economic management in Lebanon can tap into strategies that improve efficiency of revenue collection (as part of a broader financial strategy) and contribute to the beginnings of a renewed social contract – which in turn can improve urban affordability for the poor, and contribute to enhanced social stability and safety.

Financing sustainable urbanization is an investment in Lebanon's present and future. Lebanese local government capacity must be expanded to harness private sector participation, leverage local assets through value capture, and partner with the central government to invest in urbanization. At the global level, United Nations member states have clearly committed to this through the New Urban Agenda, where the need for a strong municipal finance system is clearly highlighted as a requirement for advancement towards the Agenda 2030 for Sustainable Development. Lebanon's 1977 Municipal Law outlines the range of sources of finance available to municipalities. This includes fees collected by the central government on behalf of municipalities in an Independent Municipal Fund (IMF) – managed by the Ministry of Interior and Municipalities and Ministry of Finance – which in theory sees funds redistributed back to municipalities and unions of municipalities. In practice municipalities rely largely on funds from the IMF, some more than 30 percent, others up to 70 percent and smaller municipalities almost entirely. However, these allocations have been beset by delays – for multiple reasons – even prior to the ongoing economic crisis, and current distributed allocations are on hold. Local authorities have thus sought international assistance to finance part of this gap, even more so since 2019 (with a previous increase since the onset of the Syrian

displacement crisis in 2011), through innovative ways to support municipal finance and capacity building in order to enable service delivery and contribute to social stability through investments in Lebanese cities and localize development and humanitarian assistance.

The system for financing local governance and development in Lebanon stands to benefit from a comprehensive overhaul to move closer towards self-sufficiency of municipal services. Doing so, will afford local authorities a real chance in addressing local social instability in a bottom-up approach. As summarised in the UN-Habitat Lebanon and ESCWA State of the Lebanese Cities Report 2021, a key aspect of national and sub-national public finance reform, must re-consider the fairness of the intergovernmental grant system to better take into account actual differences in local needs: "A particular and well-known source of bias in the budget allocation is its blindness to the pressure on municipal services exerted by people who are not registered in a given municipal jurisdiction. This mismatch, which disproportionately affects urban communities, is symptomatic of complex issues spanning voting rights reforms, lack of national population data, and the long-term policy approach to rights afforded to non-Lebanese nationals. This suite of recognized issues may find traction as part of the overall governance reforms." ■

Taina Christiansen is the Head of UN-Habitat's Country Programme in Lebanon

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