The Origin of the Crisis in the Lebanese Banking Sector

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In 1990, at the end of the long Lebanese war, the country was devastated. The peace deal struck in Ta'if, Saudi Arabia, was mostly about compensating militia warlords to convince them to drop their weapons—with the notable exception of Hezbollah, which was allowed to keep its arsenal against Israel—in exchange for significant gains and advantages to be given to them under the new system.

The year 1992 was the real beginning. Rafic Hariri, a businessman hardly known to the Lebanese, became prime minister thanks to a wide wave of speculation against the Lebanese lira, which brought down Omar Karami's government under popular pressure and wiped out a significant part of the population's wealth to concentrate it in the hands of insider-trading beneficiaries.[1] Nabih Berri, the head of the Shia Amal militia, became speaker of parliament after the ousting of Hussein Al-Husseini, a highly respected lawmaker who had been instrumental in the making of the new constitution in 1989.

From that beginning and until this day, the Hariri-Berri duo—and its descendants—has ruled Lebanon and its institutions. Berri turned the Lebanese parliament into an active partner in corruption, and he himself effectively became a major player in the executive body, thus totally paralyzing the critical control function of the legislative power. How could parliament control a cabinet of its own making, with ministers perfectly replicating the groups? The two men and their parties—with the support of others, of course—were also widely responsible for the paralysis of the judiciary power, through the appointment of yes-men or sometimes corrupt figures to fill critical jobs, or through the vacancies orchestrated in many control bodies to prevent them from fulfilling their duties.

With neither parliamentary nor judicial control, corruption started to grow, and the system lost its immunity. Thus all parties wanted their share, and opposition shifted from a will to hold the government and its members accountable to pressure for a share of the pie. Worse than all this, two distorted provisions of the law were imposed as given facts. First, Hariri and Berri, with the blessing of other major players at that time, imposed the view that the Council of Ministers, as the supreme executive body, was allowed to take any decision or action, even actions clearly against the law. The second point was even worse: they agreed that ministers were not accountable to the control bodies or to the judiciary and its courts and that only a parliamentarian committee that would be formed occasionally could prosecute them and judge them. The Lebanese constitution refers to this parliamentarian court, of course, but it was meant to apply to acts of high treason and not to vulgar theft and the misuse of public funds, over which normal courts can rule.

With the spirit of the law distorted like this, one can easily imagine the consequences. The whole public administration became totally powerless in terms of making sure that ministers' acts were legal. When public servants would flag certain wrongdoing and step up to block an illegal measure, the matter was taken to the Council of Ministers where, after bargaining, the minister was given the right to violate the law. And if the civil servants (director generals, directors, etc.) reported the violation to relevant inspection offices or to the judiciary, they were told to forget about the matter as ministers are not within their scope of work, as they stand de facto above the law.

It is in this very peculiar context that the story of the Lebanese collapse should be read. As previously mentioned, in 1992, a violent wave of speculation against the lira brought one dollar to LBP2825 (Lebanese pound) at its lowest from LBP880 to the dollar in December 1991 (consider that the exchange rate was LBP18 to the dollar in December 1985), which nearly eradicated the middle class and led to a big concentration of wealth in the hands of insiders from the political and security apparatus, together with some bankers, as well as Syrian officials and intelligence. The new postwar elite was being given the wealth it required to join the political process and maintain its influence going forward. And the hardship pushed the Lebanese into the arms of the person who was portrayed as the white knight and the champion of the currency stability: Rafic Hariri.

The moment Lebanon entered the Hariri era by the end of 1992, the lira stabilized in parallel with the cessation of speculative attacks and also because of a certain confidence factor mostly due to Gulf money and investments pouring into the system. As part of buying political support and maintaining a fragile peace, Rafic Hariri had to organize the redistribution flows toward the occupants, the warlords and new elites, and all de facto powers on the ground. He appointed his former personal Merrill Lynch account manager as governor of the central bank. Together, they started pushing the lira to appreciate very slowly and regularly against the dollar at a very high cost but with great impact in terms of asserting Hariri's influence and domination of the political game. Since 1992, the lira was practically pegged to the dollar but without any legal or regulatory action to endorse the peg, and the rate was finally fixed at LBP1507.5 to the dollar in December 1997.

This de facto very expensive peg is one main reason behind the depletion of foreign currency reserves. Of course, one may argue that the stability brought by the peg had positive effects, but a direct harmful consequence of the overvaluation of the lira was the incentive to import goods and services instead of producing them locally. This pattern was expanding and—together with some unexplainable government policies—was suffocating the productive sectors in Lebanon.[2] The trade balance and the current account were scoring very large deficits year after year, underlining the necessity for Lebanon to revisit its options.[3] But despite the untenable situation and the widening double deficit, the system continued to rely on attracting between $7 and $10 billion every year.[4] Its attractiveness relied on higher interests paid, the illusion of the banking sector's exceptional strength, and the so-called Lebanese resilience that was able to defy logic and gravity. One has to admit that the system was very good at promoting itself along those lines.

This is to say that very early in the nineties, the central bank needed permanent inflows of dollars to compensate for the current account deficit and to support the peg. And very early, various ways of securing the flows were adopted, clearly underlining the weaknesses of the system, but were stubbornly dismissed by the political elite and the central bank governor.[5] Initially, between 1997 and 2001, the market witnessed the so-called junior/senior operations and various other tricks, always hidden behind banking secrecy (whether it was truly appropriate and legally covered by banking secrecy or not).[6] Then came the Paris donors' conferences, which proved to be the ultimate curse.

In 1998, the system was nearly bankrupt and Rafic Hariri was struggling to find a way out. He then admitted that Lebanon needed different policies, but he fell short of proposing them. By December 1998, the newly elected president, Émile Lahoud, clashed with Hariri, and the latter joined the opposition. His appointee, Riad Salameh, was very successful in undermining the government's action until the 2000 elections when, thanks to an electoral law imposed by Ghazi Kanaan—the Syrian "gauleiter" who benefited from Hariri's largesse—Rafic Hariri scored a landslide victory that brought him back to the Serail at the head of a government representing the Lebanese clans.[7] He immediately started a policy of open borders by massively reducing customs duties and other measures that flooded the Lebanese market with competing foreign products and decimated productive segments and jobs. While the government was expecting growth to pick up, the real economy started paying a very heavy price, as the Treasury was bleeding because of lower duties and a falling income tax. This time, bankruptcy was very quick to threaten the system. At the central bank, Salameh was as usual extremely complacent with the Hariri-led government and was printing local money while hiding his net reserve figures.

In 2002, we estimated net reserves to have fallen below minus $3 billion. At that point, the French president Jacques Chirac flew to the rescue of his close friend Hariri and called for a donors' conference for Lebanon. Held in the French capital and known as Paris II, the conference gathered pledges amounting to $4.4 billion in support of Lebanon's ailing system (out of which only $2.4 billion would ultimately be disbursed).[8] Meanwhile, the central bank of Lebanon eliminated a significant part of the debt against a revaluation of the gold reserves, and the commercial banks were requested to participate in the effort by lending enough money to the Treasury at zero percent to secure a reduction of the public debt by $400 million.[9] The impact of the combined measures was very significant for the central bank, and the interest rates fell sharply, but the absence of substantive conditionality tied to the international support transformed the positive shock into a generous check written for the benefit of a corrupt elite that was unwilling to undertake any significant reform. The same elite considered the whole thing to be a permanent bailout promise from the international community, and that was a big encouragement for the elite to continue to do the wrong things instead of correcting the trajectory. Nearly two decades later, it is not easy to assess whether Chirac's real intentions were to help Lebanon reemerge or to unconditionally support his friend Hariri, whichever way he wanted. In any case, the Paris II episode was a strong boost to the disastrous policies and the corrupt system, in the sense that when the inflows that were covering the bleeding started to dry up, a deliberate exogenous shock was delivered to allow the system to keep going as is. And it did.

Paris II had its impact though, and the trend of inflows resumed, until the car bomb assassination of Rafic Hariri on February 14, 2005, in Beirut. Following this tragedy, a long period of uncertainty prevailed, and outflows very subtly picked up. The man whose name was tied to the peg was gone, and expectations remained relatively volatile. Riad Salameh, the governor of the central bank, quickly seized the opportunity to replace his slain mentor as the figure of stability, and he forcefully used all possible means to forge a very advantageous image of himself. The central bank spent a lot of money in support of the media and various opinion makers, and the Lebanese were hammered with news such as Salameh being selected as governor of the year worldwide. He also secured a strong relationship with the Syrian leadership around the end of 2004. This campaign kept mounting, until it became really far-fetched a short time before the banking and central bank collapse.

Nevertheless, back in 2006, the destructive Israeli war on Lebanon triggered sizable funds from the international community, which was immediately followed by the Paris III donors' conference on January 25, 2007, where $7.6 billion were pledged for Lebanon (nearly half this amount was disbursed). This was enough to buy the country some extra time, even if the central bank's net reserves were estimated to be around minus $7 billion just before Paris III. It was becoming obvious that the system was completely unsustainable and that deep reforms needed implementing. However, the political elite knew that every reform measure would go against its interests, and the central bank governor was not willing to let the alarm bell go off, as he was busy building for himself an image as a superhero who can deal with all situations. He also needed the full political support from the elite for a future presidential bid. Accordingly, with time, reformists were more and more isolated in the public sphere, despite the catastrophe that was already looming on the horizon.

But once more, an exogenous event—although totally unrelated to Lebanon this time—saved some significant time for the ill-managed system where corruption continued to spread across the political spectrum. The global financial crisis in 2008 triggered massive inflows toward Lebanon, as investors exited the financial markets and ran away from advanced economies. In Lebanon and since the early nineties, even forward sales on the dollar were not allowed (let alone any kind of derivative operations) in an effort to isolate the overvalued lira from the market and to maintain the peg against all logic, as one man's image-building became more important than the country altogether. The near-complete absence of exposure to international markets was very attractive to the money that was fleeing advanced economies as well as some developing ones. As a result, Lebanon's banking sector received new deposits equivalent to 59 percent of its GDP in 2009, and a total of $20.7 billion flowed into the system.[10] During the two following years, instead of taking advantage of this massive opportunity to upgrade the infrastructure and improve the safety nets, the government misused the budget surplus, and the system continued to operate on the same pattern. Calls from within to grab the opportunity to change were dismissed, and the need for larger financial inflows continued to grow. These bigger inflows were indeed covering the increasing needs, as if this situation could last forever.

Then came 2010–11, which was in many ways a turning point. Oil prices had tumbled on international markets, and because of their very high correlation with Lebanese inflows, the impact on the latter was significant.[11] In addition, at the end of 2011, the Syrian war had started, which led to higher volatility in Lebanon coupled with political instability, trade and transit disruptions, and a flow of refugees that was going to become overwhelming. In addition, the Gulf countries started to off-load their Lebanese real estate and deposits in retaliation for the rising role of Hezbollah in Lebanon and its involvement in Syria. All those elements contributed in tilting the balance of payments into the red, to reach a low—26.2 percent of GDP in 2014. From that point onward, the secretly managed Ponzi pyramid started to unravel. Yet this remained off most radar screens because the central bank governor did not share his institutions' financial figures with anyone, including the president of the Republic, the prime minister, the minister of finance, or even his own vice-governors, and the extent of the losses therefore remained heavily underestimated.

When the flow of incoming money became tighter, the commercial banks—whose assets were growing in parallel with the public debt, already nearly four times Lebanon's GDP—found themselves under pressure from the central bank to find ways to attract dollars from abroad. Yet they lacked the ability to openly increase interest rates because the governor had cornered himself in a self-inflicted situation whereby he would maintain the lowest possible rates to help the governing elite hide part of the fiscal deficit linked to the debt service. Basically, on top of hiding accumulating losses in dollars to support the peg and finance the deep current account deficit, the central bank also made the choice of stepping in between the government and the banks to buy government paper at cheap rates in lira and sell certificates of deposit to the banks at higher rates. Of course, this would allow commercial banks to maintain the illusion of growing earnings, which deceived depositors, while also allowing the government to understate its deficit. However, the central bank was accumulating losses that would soon become unmanageable, even as the governor tried to maintain the reputation he built for himself, at the expense of his institution.

For many years, every time we argued about the unsustainability of the system, the banking elite would follow, willingly or forcefully, the central bank governor's argument: as long as confidence remains, there will be no problem. This was obviously music to the political elite's ears, but the surprise kept coming from the international markets that were still showing appetite—although limited—for the Lebanese paper. But this situation changed in 2016 when Lebanon practically lost its access to the international markets, in parallel with the unveiling of unorthodox operations by the central bank that would subsequently be referred to as "financial engineering" by the head of the institution. It is a fact that those operations convinced the markets that Lebanon was becoming a very dangerous area, but they increased drastically after the access to the markets was lost. Only the person running the show in the most secret and opaque way could know the details, which were kept completely confidential, and even vice-governors had no idea what was going on.

Eventually, some bankers started wondering how two banks in particular were able to draw depositors away from other banks by overpaying the depositors. Indeed, the principle of "financial engineering" involved having banks bring in fresh dollars from abroad against Eurobonds given by the central bank and, in parallel, bring lira-denominated Treasury bills to the central bank against cash payments in lira equivalent to the discount at zero percent of the said bills, thus generating very high returns, up to 35 percent. It is very difficult to say whether that was already the scheme when Bankmed and Bank Audi benefited from it at the end of 2015, when Bankmed was nearly bankrupt because of its very high exposure to Saudi Oger (Saad Hariri's contracting company, inherited from his father) and its suppliers, and when Audi was in serious trouble, after its expansion in the Turkish and Egyptian markets, due to the losses of its subsidiaries.[12] As always, the governor of the central bank unilaterally decided to use public money to bail out banks without anyone's authorization. Such operations would have required a law from parliament, but he did not even bother to let his own board know about them or discuss them. It is worth noting that the governor was completely free to do anything he wanted practically since his appointment, when the prime minister and the minister of finance dismantled the control systems that had existed to oversee the central bank.[13]

Many months after the beginning of those operations, the other bankers started complaining to politicians, and the governor had to admit that he indeed provided support to some institutions chosen arbitrarily, supposedly because they were too big to fail. But that support was not legally authorized and was given in complete opacity. As a result, on one hand, there was significant pressure to treat the other banks on equal footing—again by using public money!—and, on the other hand, the central bank needed substantially more dollars from abroad, as it was buying all the Eurobonds issued by the Treasury and had to exchange them for dollars in cash. Indeed, in March 2017, the Republic did its last market transaction, which was followed by a placement deal of $4.2 billion at the central bank in November of the same year.[14] Then, the central bank fully subscribed to the Eurobond issuing of $5.5 billion in 2018 and $3 billion in 2019, which brought the total of what the central bank had bought solely to $12.7 billion.[15] This situation was an unannounced default in itself. The so-called financial engineering operations were expanded to all banks with very large amounts, and the process was ongoing, although the governor repeatedly announced their end, to avoid any investigation or hearings.[16] And the operations kept going even after the Republic defaulted in March 2020, with evidence that they were done with financial companies that did not need them in any way and that even individuals selected by the governor benefited from them. Very simply, the governor would choose the beneficiaries, the amounts, and all other details. Clearly, the corollary to this simple fact was the total absence of law enforcement or political will to refrain the central bank from going rogue, as practically all parties were benefiting—although not equally—from the largesse of the out-of-control governor. Many do not want to believe it, but the fracture in Lebanon is not between various clans from the political elite along sectarian or political lines. It is rather between most of this predatory elite and the segments of the population that are not willingly abiding by the clan logic. And in between, there is a large army of people who do not understand what is going on at all.

In few words, banks (and insiders) were making profits on paper, but the dollar was becoming scarcer by the day. Worse, the central bank was taking losses in a very opaque way, and in 2017–18, commercial banks brought a significant share of their money from correspondent banks back into Lebanon and deposited it at the central bank, probably under pressure from the governor. In simple terms, the banks were exposing themselves to the central bank's risks and losing their ammunition in case of liquidity needs.

At the beginning of 2019, the then minister of finance, Ali Hassan Khalil, announced that he was working on the restructuring of the Lebanese debt before retracting. Within days, Moody's downgraded the Republic to Caa1, and Fitch followed to CCC in August. Lebanon was already paying 20 percent plus on the dollar. Some banks were making it public, and many would take one fresh dollar (coming from abroad) and deposit 2.5 dollars or more in the bank account against it.[17] This was already revealing the losses in the system, as liabilities in dollars were larger than the remaining assets. The central bank had created enormous amounts of fake dollars in the system through the exchange operations on Eurobonds and through the very high interests paid locally on the dollar, thus increasing the liabilities. The natural consequence is that by the end of the spring of 2019, the commercial banks introduced serious restrictions on depositors' withdrawals, and that was one solid reason behind the popular movement that started on October 17, 2019. Of course, the official trigger was the tax on WhatsApp users, but people were already very anxious about their deposits. At that moment, the banks—backed by the central bank's governor—decided to shut down for several days, which was an unannounced default that created even more uncertainty.

In November 2019, after the resignation of Prime Minister Saad Hariri, his caretaker government decided to pay $1.6 billion to Eurobond holders, and this amount immediately left the country in the absence of capital controls. Clearly, the country was splitting between those who were sucking the dollars to the last penny and those who were seeing their savings vanish. For Hariri and his ministers, all representing the various clans who control the country and who are either banks' shareholders or indirect godfathers of most bankers, what mattered was to secure the flow of money in the direction of the elites, despite the terrible consequences on the population. This payment was totally unjustified and was accompanied as usual by the central bank's governor's speeches about the existing confidence and the stability of the pound. As Ambassador Pierre Duquesne said during an event organized by the Lebanese Citizen Foundation in May 2021, Lebanon should have defaulted a long time ago only by comparing the spending on health (13 percent of GDP) and education (8 to 9 percent of GDP) with the debt servicing (38 percent of GDP).[18]

When the new government was sworn in in February 2020, it was left with very tight options. The default was unavoidable, especially after the banks had restricted access to the dollar to very small amounts, while the central bank would not disclose the figures related to its foreign assets and net reserves. On this point, Lebanon is a unique case in which a governor of a central bank can deny the president of the Republic and the prime minister access to this information.[19] And when the new prime minister asked whether Lebanon could afford paying the Eurobonds in March ($1.2 billion), April ($0.7 billion), and May ($0.8 billion) of 2020, the governor's answer was that his preference would be to pay in March, with no guarantee for the other payments.

Worse, while discussing whether to default or not to default on the Eurobonds, the Lebanese banks and the central bank were off-loading very large amounts of Eurobonds to foreign holders who were not traceable by the government under the pretext of liquidity needs. By doing so, they were denying the government the possibility of having an orderly default, as it requires a deal with 75 percent of the bondholders. The cherry on the cake was the Association of Banks in Lebanon (ABL) and the central bank refusing categorically to talk to the government's advisor on the restructuring, Lazard, and not agreeing to any meeting, despite Lazard's repeated requests. In addition, the central bank and ABL were to claim later that the government and its advisor had not consulted with them before coming up with the government plan. Yet not only had they been offered a plan for negotiation, they also were the ones who refused any sort of discussion or coordination.

This attitude is very symptomatic of what Lebanon had become. The system was about a group of clans whose interests were guaranteed by the governor and most bankers and by most of the media in the country that were on the payroll of the latter, with too small a market to allow them to be truly independent. The vested interests were so large and the balance required among the groups so important to maintain that no one really wanted to see any change happen, and the status quo was to the benefit of all. Caught in between is a population maneuvered by communitarianism and fake news, but also by fear, as the clans mastered this element, especially along communitarian lines: the Christians should be afraid of any change as they will lose the right of having half the MPs and half the ministers, the Sunnis should be afraid of losing the benefits of the Ta'if constitution and the prerogatives of the prime minister, and the Shia should beware of any change as they are being targeted by the whole world. And in the meantime, all of them—except the clans—are being dispossessed from everything they have, and the sovereign State of Lebanon remains a vague idea extremely difficult to realize.

After these events and the closing of banks, and because the government was unable to form a clear picture regarding the central bank's accounts, it became evident that the payment of the maturities due in March alone was totally inappropriate.[20] Either the government was able to pay the $4.7 billion for the full year (though absolutely nobody indicated that it was possible to find those dollars) or the default was the single remaining option. Who would throw $1.2 billion to bondholders, knowing that every dollar would leave the country, when the import of basic needs was entering the danger zone? Thus, the demonstrators who had brought the Hariri government down and who were still in the streets were unanimously calling for an immediate default, and the government logically followed them. Paying in March would have only enriched those who made a bet on the payment, and would have accelerated the depletion of foreign assets. The only way out was to save as much of the reserves as possible to last a couple of years, until reforms were adopted and a program was implemented. Needless to say, at that point, the ability of banks to lure more depositors to bring money into the Lebanese system was long gone.

My team and I, together with our advisors at Lazard, came up with a recovery plan establishing the proper diagnostic and covering the various actions needed, including restructuring the debt, restructuring the central bank and the banking sector as a whole, reforming public finance, creating social safety nets, developing a growth agenda, and making other structural reforms. After many meetings at the Council of Ministers, the plan was unanimously approved in April 2020 and was widely praised by the international community, including the International Monetary Fund (IMF), the World Bank, and several US banks. It was the first time the Lebanese government came up with a proper diagnostic admitting the real losses in the system. But the losses were huge, and accepting them would have had big consequences for the criminal system.

Indeed, when the crisis started, nobody would have imagined how large the central bank losses were. The "other assets" account in the central bank's published balance sheet was growing enormously, but no useful explanation was ever given. Only a handful of people knew what those other assets were, until Lazard's team was inadvertently told by a central bank accountant that the other assets were in fact the losses of the central bank. The governor had very simply decided that the accumulated losses would be balanced by seignorage over time and thus considered that the central bank did not have to report any loss whatever the situation.[21] And the scary figure was out: the central bank's losses already exceeded Lebanon's GDP at its highest (they would climb above $60 billion by 2021). The immediate consequence is that practically all commercial banks were bankrupt, simply because they had 65 percent of their foreign-denominated assets deposited at the central bank, while 25 percent of them were lent to private corporates and individuals and about 10 percent were in Eurobonds.[22] Of course, after the default, the banks lost about 70 percent of the Eurobonds' value, but this alone was manageable by them (a maximum of $9 billion lost, compared to equities of $21 billion). It was, however, the central bank losses that were the game changer. And since banks could not get their money back from the central bank, depositors were deprived of their rights.

This accurate diagnostic was a mandatory first step on the way to recovery, as no adequate program can be built on wrong and underestimated figures. Otherwise, the country will not be able to reimburse and the problems will recur at a bigger scale down the road. But this diagnostic had many consequences, as we already said, on the system. It meant that the governor was not a magician and a natural presidential candidate, and it meant that banks' shareholders had to bring back part of their savings abroad to recapitalize their institutions, if they wanted to remain major shareholders. It also meant that many politicians who were shareholders or owners of preferential shares had lost significant amounts of money, and that those of them who had not succeeded in putting their money abroad were under the threat of a bail-in or a discount that local depositors would have to take. And they were very angry that the government plan, in order to protect small and medium depositors from any loss, proposed a 30 percent bail-in for large deposits (above $500,000). In general terms, the implementation of the government plan—especially under an IMF program—would bring an end to the various loopholes in the system that generated very large sums for the clans, which included smuggling at the borders and the scandalous management of electricity utilities, as well as inconsistent tax collection enforcement, various black boxes under certain clans' control, twisted benefits in the public sector, and, above all, the illegal money channeled by the central bank to various beneficiaries without any visibility or control.

The counterattack was very violent but, I have to admit, well orchestrated. Some media launched a very harsh attack on the plan, calling it "the haircut plan," as—according to them—it was about taking depositors' money without a counterpart. And in the meantime, ABL was claiming that it would never accept any haircut on depositors or any loss for shareholders, a totally absurd but populistic position, knowing that banks were the ones imposing systematic haircuts on all depositors who wanted to withdraw money from their accounts. And although the government plan was precisely about protecting all medium and small depositors, it was portrayed as a "haircut plan" by those who were effectively taking massive cuts from their customers.[23] After this, the clans used another weapon: after insisting that parliament could not interfere in the process before law proposals were sent to it, the same MPs formed a fact-finding committee to look into the figures of the plan in May 2020, in an effort to hide a big part of the losses so as to preserve shareholders from recapitalizing their institutions, save the governor's reputation, and avoid reforms in general. This committee, which was not formed by the plenary as it should have been, gathered members from all the main clans who, hand in hand, worked on torpedoing the reform process.

Because that committee had no reason to exist, its members pretended that they just wanted to look into the discrepancies of the figures between the government and the bankers and contribute to reconciling the figures. The show was pathetic. The ministers who were supposed to defend the government plan would sit and watch silently, while MPs would vociferate insults and threats, claiming that losses' figures in the government plan were inflated, and while the IMF would issue one statement after the other certifying that the losses computed by the government plan were correct and very close to IMF estimates.[24] Those MPs were called by the population "the bankers' MPs," as suspicion regarding their real motives to support the central bank and bankers against the mass of voters was growing.

At that point, all dirty tricks were used by the opponents of the government plan. Permanent fake news, media bashing, and calumny against the reformists were released, carrying all kinds of accusations and personal threats. The deputy speaker went so far as to lie live on television, saying he had information about my being promised a job at the IMF in return for inflating the losses. As pathetic as it was, the cabinet did not dare say a word to defend its own plan against the representatives of the clans and the mafia system.

In the meantime, banks were still off-loading Eurobonds, practicing haircuts, but also smuggling money abroad to the benefit of the most powerful, probably some politicians, MPs, or bank shareholders, and all that under banking secrecy.[25] Also, some bankers would tell their American counterparts that the government plan was about surrendering the banking sector to Hezbollah, while the same bankers, the very next day, would complain to Hezbollah leaders that those behind the government plan wanted to put the system under IMF scrutiny to curtail the party's freedom of action in the financial system. Also, they told various diplomats that the forensic audit of the central bank was meant to go after one side of the political spectrum only, whereas the government plan included forensic audits on all public procurement and state-owned enterprises. The goal was of course to present the reform package as politically motivated, whereas reality clearly showed that all clans and parties in this system were desperate to keep this ill system going, that all of them were standing hand in hand against reforms, and that they were unwilling to let go of any of the illegal benefits the system guaranteed.

A parenthesis: one may ask why capital controls were never put in place until this day, practically two years after the beginning of the crisis. One may also ask why Lebanon still suffers from many currency rates imposed by the central bank, despite the harm done to the real economy and the corporates, and why, until this day, no banking resolution framework has been instituted. The answer is simply that the central bank does not want to take responsibility for official capital controls, and thus, it puts the banks in the front row to impose them de facto on most depositors while smuggling some influential people's money abroad. In addition, the central bank and its political sponsors use the multiple currency rates to impose haircuts without admitting it, while banking resolution is not even under preparation because the central bank still denies the existence of losses and the necessity of dealing with the banks' situation and wants to keep the bankers mobilized by its side. Meanwhile, the capital controls' pathetic circus continues: The central bank claims that it does not have the legal authorization to impose capital controls, which is not true, and at the same time it allows banks under its supervision to impose de facto controls, which is totally illegal and should be immediately reprimanded. Then, the government questions who should prepare the draft, while finally the pathetic parliamentarian budget and control committee claims that it is working on it but wastes as much time as possible, deciding at the end of the process that it is the government's responsibility to propose the text. Many more months were wasted before the draft was sent again to the said committee whose speaker (the same MP who headed the above-mentioned “committee of fact-finding”!) pompously announced several times that the law is ready to pass, without any result whatsoever.

Another remarkably telling process is related to the forensic audit of the central bank. At the beginning of 2020, the government unanimously decided to conduct a forensic audit at the central bank, and Kroll was picked to carry it out. After months of time wasting, a security report was issued warning against Kroll because it has a representative in Israel (with which Lebanon is formally at war). The report was used to freeze the process. Yet since the president kept insisting on having the audit, the government nearly agreed on replacing Kroll with a company that had a fully staffed office in Israel, but it was later known the new company was providing marketing services to the central bank of Lebanon! Finally, after a wasted year, Alvarez & Marsal was appointed to carry out the audit. Since then, the central bank has not provided the auditors with the information they requested, and no action has been taken against it even though it is sabotaging a Council of Ministers decision.[26] On a regular basis, there are news reports that the central bank has given all information requested by Alvarez & Marsal, followed promptly by the latter denying receiving the information it had requested.

Coming back to the global picture, and also as part of the counterattack, the bankers finally came up with their own plan for restructuring, which boils down to three points. The first one was about transferring the property of all public assets to the banking sector. Although nobody has a precise valuation of those assets, the plan assumed their value at $40 billion, simply because it was convenient to assume so.[27] Second, the plan relies on freezing deposits for a long period, and instead of admitting that this represents a very large haircut on deposits, it claims that it helps avoid the haircut. Finally, the bankers reject the restructuring of the lira-denominated debt in order to limit the size of their losses, without taking into consideration that this restructuring is unavoidable if Lebanon wants to bring its debt to sustainable levels. Even if we forget about how unfair and inequitable the bailout with public properties would be, and even if we accept the massive haircuts this plan imposes on depositors, the banks’ proposal does not bring fresh dollars into the economy and is therefore pointless. Very quickly, the IMF and all other international counterparts dismissed it totally.

We were left discussing the situation with the IMF without any chance to move forward. The political parties did not want an IMF program, but they did not want to admit it. Initially, they thought they could get financial support with some façade and limited reforms, like what they used to get in the old days, but when they realized that the IMF knew perfectly well how deep the crisis was and how critical it was to recognize the losses in the system and distribute them in a fair manner, and to implement all long-lasting reforms swiftly, they decided to let a few insignificant MPs undermine the process without clearly rejecting an IMF deal. Basically, the central bank would insist its losses were smaller than the IMF and the government plan estimate, before acknowledging that the government plan's figures were correct, and the very next day, the same discussion would have to start all over again. The government and its ministers would not dare defend their own plan, and MPs' protests would be taken to show that parliamentarian groups supporting the government are against its plan. When laws related to reforms would reach parliament, they would not be voted on. In such a context, the IMF deal was dead and buried before it even started, and no party claimed responsibility. Since the IMF would not allow the continuation of the old game this time, it was not welcome, even if the Lebanese elites were leaving absolutely no other viable option for the country.

Here, the system decided once again to rely on the person who catered to its needs for so long. Riad Salameh, the governor of the central bank, was given full powers to implement the alternative plan that shifts the losses from the banking system to depositors and average citizens: the "do nothing" plan. In a chaos of micro-measures, taken through central bank circulars, often in contradiction with each other, the governor wasted a lot of time while printing an enormous amount of liras, thus igniting the local currency against the dollar and allowing massive haircuts to be executed on the dollar deposits (the Lollars). This was meant to shift the losses to the most fragile, through the massive depreciation of the Lebanese lira, which dropped on the black market from 1508 against the dollar to about 20,000, and to depositors instead of bank shareholders through unannounced but permanent haircuts on deposits.

Even the IMF showed a lot of concern regarding the harm inflicted on the population, but the Lebanese elite did not mind. Ultimately, of course, a balance will be reached, but by that time, Lebanon will look more like Yemen or Somalia in their worst years, especially given the enormous losses. Of course, we may wonder how one can be so insensitive to the hardships of one's own people, but the case of the central bank governor—and the same applies to many of the ruling political or financial elite—is telling. For him, it was not only about defending his legacy and his poor policies, such as the ones described above, and not only about possible incompetence; it was also about a quasi-criminal organization of a Ponzi scheme and thus about protecting himself from legal questioning and potential direct and personal implication in financial crimes, if they prove to be real.[28] The curse of the Lebanese is to be left in the hands of people who care about saving their necks before anything else, even if this leads to crushing a whole population.

Nearly two years after the banks' closing, a quick comparison can be made along the following lines. Although it was not implemented and various risks were facing it, the intentions and goals of the government plan that was approved in April 2020 were to stabilize the lira around 4,000 to the dollar within two years, protect all small and medium depositors from any loss, and have a bail-in of about 30 percent of the big deposits, while attracting some $27 billion in fresh dollars over five years.[29] This process would have brought back some normality by the end of 2022. The local elites, instead, deliberately chose to do nothing and to have the lira crumble to reach 20,000 to the dollar, with no floor to stop its fall.[30] They also chose to have all depositors lose about 90 percent of their money as of today and to deny Lebanon any access to sizable fresh funds, with the end of the fall in sight. And for those who argue that Lebanese banks will be again able to attract billions of dollars from depositors provided confidence comes back, the simple question to ask is what they would do with those billions and where would they place them? The bankrupt central bank cannot pay them high rates anymore, and the market cannot absorb large loans in the billions. They would have to place them at low rates, and it is difficult to see why depositors would want to bring money into a devastated banking system only to be paid low interest rates.

In the banking system, it is urgent to clean up the financial sphere and to put in place some very efficient controls. The resolution framework has to be introduced and implemented as quickly as possible, and wrongdoers should exit the system for good. Clearly, banking secrecy played a very negative role allowing criminal behavior to remain unnoticed and should be quickly eliminated to boost transparency and trigger some credibility. The control mechanisms around the governor of the central bank should be reinstated according to the law, and any governor should certainly not retain the presidency of the Special Investigation Commission in charge of money laundering, terrorism financing, and other criminal activities.

This situation is changing the face of Lebanon, something that wars and political crises were not able to achieve. The country faces a genuine case of lawlessness that is taking it to the brink of the abyss, with potential widespread chaos if not internal armed conflicts. After all, with the eradication of the middle class and the massive emigration (which has long been the unfortunate adjustment variable of Lebanon's economy), the heads of clans will remain, surrounded by helpless people who can easily turn into militiamen. And once again in this country, the militia will win against the State. The political castes will continue to entertain a corrupt system that supports all types of criminal activities and spreads its corruption throughout the financial arteries of the world. And as long as the world maintains the illusion of having friends and foes within the system, lawlessness will continue to spread, sovereignty will continue to fade away, and corruption will continue to grow. It is about the whole system with all its components, not about a few clans or a few individuals.

It is high time that a modern state be built in Lebanon.

NOTES

1 Rafic Hariri's own bank, Banque de la Méditerranée (which became Bankmed), was suspected of being one main speculator against the lira. It was managed at the time by Fu'ad Saniura, who became Hariri's minister of finance and then prime minister after Hariri's tragic assassination on February 14, 2005.

2 Rafic Hariri and his emulators used to believe that Lebanon would never be a productive country, that it was not useful to support its production base, and that it could only serve as an intermediate and a service provider.

3 The current account deficit plunged to 29.6 percent of GDP in 1998, to 25.6 percent in 2003, and to 26.2 percent in 2014.

4 The years 2009 and 2010 were very exceptional due to the world financial crisis.

5 Riad Salameh, an executive at Merrill Lynch, was appointed governor of the central bank of Lebanon in 1993 by the Council of Ministers at the request of Rafic Hariri, and he is still at the head of the institution in 2021.

6 One part of the placement would guarantee the forward currency rate, while the interest rate was capped, and the counterpart would receive higher interest rates without being hedged against any depreciation.

7 The Serail is the headquarters of the prime minister in Beirut.

8 Paris I was held as a preparatory event to Paris II, which took place in November 2002.

9 Revaluation of the gold reserves would be completed three times (in 2002, 2004, and 2007) by the central bank with the approval of the minister of finance and the prime minister. The total amount of debt that was eliminated was LBP5600 billion (the equivalent of $3.715 billion at that time). Those operations were totally illegal and were strongly opposed by the author of this paper. The government and the central bank decreased the size of the debt against a higher value of the stock of gold, while this value was only on paper and the gains were not realized.

10 According to Bank Audi.

11 The Institute of International Finance (IIF) estimated the inflows to have fallen to $7.5 billion in 2011 and to $6.9 billion in 2012, reaching a low of $4.9 billion in 2013. But it is important to note that IIF had estimated the inflows at about $12.9 billion in 2009 (to be compared to $20.7 billion according to Bank Audi).

12 Bankmed is the bank historically owned by the Hariri family. At the time of the operations, Saad Hariri owned 40 percent of its shares and his brother Ayman another 40 percent, whereas Nazek Hariri, Rafic Hariri's widow, owned 20 percent. Bank Audi is the largest commercial bank in Lebanon. By 2017, Saudi Oger was reported to be on the brink of bankruptcy.

13 The minister of finance stopped looking into the central bank's operations, probably at the request of the prime minister, and the government commissioner to the central bank was completely sidelined. On top of that, many high-ranking judges were on the central bank's payroll at a time when the central bank was by far the public institution that paid the highest compensations.

14 The Republic would issue Eurobonds and the full amount would be subscribed by the central bank. This placement was the result of a deal struck between the minister of finance, Ali Hassan Khalil, and the governor of the central bank, Riad Salameh.

15 This is the equivalent of 24.2 percent of GDP at that time, and 55 percent of GDP today.

16 Those amounts were never accurately estimated. The central bank governor refused to provide any detailed breakdown or even a lump sum figure. He even refused to unveil them to the director general of

the Ministry of Finance who requested them for tax purposes, on the false pretext that the information falls under banking secrecy. However, their impact on the central bank was an increase of the losses by $23 billion from 2016 to 2020.

17 In Lebanon, a dollar coming from abroad is called a fresh dollar. This refers to the losses in the banking sector, where existing dollars cannot be withdrawn from banks without a big discount. Those dollars are referred to as Lollars (i.e., Lebanese dollars).

18 Pierre Duquesne is the French ambassador in charge of the international support for Lebanon. The Lebanese Citizen Foundation is involved in promoting citizenry and proposing public policy options for Lebanon and the Arab world.

19 After years of permanent requests, the president of the Republic received three handwritten pages of calculation made by the governor. These pages were obviously nothing close to an official document and were not even signed by the governor.

20 The opacity of the central bank's accounts was so obvious that the Council of Ministers, based on the president's request, decided to pursue an audit of the central bank, as well as a forensic audit that would trace the dirty money in and out, as banking secrecy covers all operations, and the only persons who would have the details of bank operations are the central bank governor (who is also the president of the Special Investigation Commission) and the banker who executed the operation.

21 One has to imagine how many liras should be printed to cover losses in the tens of billions!

22 Nonperforming loans were estimated at about 30 percent at that time.

23 It is to be noted that Nabih Berri, the speaker himself, called the government plan a haircut plan and announced its death.

24 Based on the unanimous approval of the government plan by the Council of Ministers in April, the prime minister and the minister of finance requested an IMF program on May 1, 2020, and talks with the IMF started the same week.

25 On July 13, 2020, the author of this paper told the *Financial Times* that "bankers have 'smuggled' up to $6 billion out of Lebanon" and accused "'dirty money elite' of protecting vested interests as economy collapses."

26 In Lebanon, the Council of Ministers is the highest executive power.

27 A recent serious study estimated the assets to be worth around $22 billion, but one has to be mindful of the absence of interest from any external potential buyer.

28 The central bank governor is currently under investigation in Switzerland for aggravated money laundering and embezzlement. He is also under investigation in the UK and France.

29 This amount is a combination of IMF money, CEDRE conference pledges, and international support around the IMF program.

30 The World Bank's *Lebanon Economic Monitor*'s headline in December 2020 was "The Deliberate Depression."

27 26 25 24 23 22 21 7 6 5 4 3 2 1

About the Author

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Alain Bifani served as director general of the Lebanese Ministry of Finance from 2000 to 2020. He received the United Nations award for improving tax services and transparency, and he was named commandeur de l'Ordre du Cèdre (Lebanon) and chevalier de la Légion d'Honneur (France) for his relentless fight against corruption.

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