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LEBANON'S FINANCIAL COLLAPSE:

A POST-MORTEM

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Executive Summary

Lebanon's simultaneous collapse of the exchange rate of the Lebanese Lira and, more seriously, of the banking sector is unprecedented. The causes of the two failures are separate and separately investigated. The current situation is in contrast with that in the 1980s when the fall of the Lira was more severe but was nonetheless accompanied by a fully functioning and strong banking sector.

The policies of the central bank, Banque du Liban (BDL), and of commercial banks brought the failure of the banking sector. That failure was independent of the level and financing of government debt. BDL's "financial engineering", which was intensified in 2016, was characterized by continuous borrowing of $ funds from banks at significantly high interest rates, compared to international rates. The policy attracted ever larger $ deposits from banks, who voluntarily shifted most of their $ liquidity at correspondent banks abroad to illiquidity as deposits at BDL. As a result, banks' $ liquidity continued to decline until it reached prior to the collapse 7% only, compared to an average of about 90% throughout the war period in 1975-1990.The danger signals were evident for years, negative $ net reserves for BDL and low $ liquidity for banks. Underlying these developments was the process of inflows and outflows of $ funds, especially through BDL. A table presents BDL's detailed sources and uses of $ funds during 2009-2019. Most of the $ funds originated from banks, and largely went back to banks also, as profits and high interest income. And it was Government that has been lending $ funds to BDL, rather than the other way round. The finding is contrary to the prevailing discourse that the origin of the financial collapse is Government debt, and BDL's lending to Government.

Government debt, however, is mainly responsible for the depreciation of the Lira. Rising debt and continuous balance-of-payments deficits confirm that Lebanon has been long living beyond its means. In particular, the responsibility falls on the Government debt's financing of current rather than capital expenditures, which averaged only 8% of total expenditures during 1993-2019. Overall, those expenditures financed a public sector that has swelled with political appointments, and many expensive projects that mostly served personal and political objectives.

Lebanon's political and military sovereignty has become subservient to Iran, through the Lebanese party Hezbollah. The current financial collapse has now imposed new rules of the game, which require fundamental political and economic change for recovery to take hold. Above all, the need is for Lebanon to regain its sovereignty, starting with the effective full control of its international borders. Failing this, a sustained economic recovery is virtually impossible.

> I believe that banking institutions are more dangerous to our liberties than standing armies.
>
> Mervyn King
>
> (former Governor of the Bank of England)

Introduction

The central bank, Banque du Liban (BDL), and the commercial banks are responsible for the collapse of the banking sector in Lebanon, independently of the level and financing of government debt. However, the collapse of the exchange rate of the Lebanese Lira is mainly the result of the Lebanese Government's irresponsible economic and political behavior. Years of mismanagement by these agents have regressed the Lebanese economy into its current state of a rudimentary cash economy. An economic recovery is nonetheless feasible, though difficult, especially with the added substantial damages associated with the massive explosion at the Beirut Port. But financial and economic recovery requires, above all, responsible government over a country that enjoys full control over its political and military sovereignty. These assertions constitute the theme of this paper.

Since the birth of the Lebanese Lira (LL) in early 1948, including fifteen years of wars, military occupation, and numerous political and security upheavals, Lebanon remarkably has maintained a fully operating and prosperous banking system, a freely convertible currency, and totally free capital movements. In many respects, Lebanon's long-dated financial freedom and openness was unique in the world. It all ended in October 2019.

Lebanon's financial landscape now is completely transformed. Today, in late September 2020, the Lira has already lost vis-à-vis the $ about 80 percent of its market exchange value. The purchase of foreign currency and capital transfers, the withdrawal of $ or even LL funds from deposits at banks, have all become severely restricted[1]. These measures have affected the equivalent of about $170 billion in total private sector deposits, resident and non-resident, representing more than three times the GDP prior to the collapse, and of which about three quarters were in foreign currencies. Lebanon's banking collapse may therefore turn out to be one of the largest banking collapses in modern history.

What happened, and who is responsible? This paper provides an answer to that question. Section 1 argues that it was BDL's and the banks' policies, rather than their financing of government debt, that led to the failure of Lebanon's banking sector (BDL and banks). As the banking failure in Lebanon is essentially related to the availability of $ funds, section 2 examines BDL's sources and uses of $ funds during the period 2009-2019.

1 Henceforth, "$" stands for all foreign currencies (FX), though the US$ is the dominant currency in all the banking sector's FX accounts and transactions.

Section 3 presents the case that Government policies, best illustrated by its budget outcomes since 1993, have been mainly responsible for the severe depreciation of the Lira. Section 4 concludes by proposing fundamental policies for recovery in Lebanon, focusing on the need first to regain its sovereignty.

1. BDL's and banks' policies led to banking failure

The prevailing discourse in Lebanon, throughout the media and the financial and political establishments, is that the banking collapse and currency collapse in Lebanon, without distinction, are due to BDL's and the banks' financing of the Government's deficits and debt. This is incorrect. The immediate and principal cause of the unprecedented banking failure is the banks' decision to shift most of their $ liquidity from their correspondent banks abroad to $ illiquidity as deposits with BDL. The incentive for the shift was the unusually high interest rates, and profits, that were offered by BDL over a number of years on those $ deposits, as part of its so-called "financial engineering" policy. Table 1 presents the resulting danger signals that were increasingly blinking at least since 2015 until September 2019, just before the collapse.

Table 1

Danger Signals, 2015-2019

(In $ billions and %; end period)

	Average 1975-90	...	2015	2016	2017	2018	Sept. 2019
Banks' $ liquidity	89.1%		11.8%	10.5%	9.8%	9.8%	7.3%
Banks' $ deposits at BDL	0.0		37.5	51.1	62.8	67.1	86.0
as % of $ deposits at banks	0%		38%	48%	54%	55%	70%
BDL's $ net reserves	1.2		-1.9	-11.2	-21.7	-31.5	-55.5
(excluding gold)							
Memo							
$ deposits at banks	2.6		98.3	107.0	115.7	122.4	123.2
Banks' $ reserves	2.3		11.6	11.2	11.3	12.0	9.0
BDL's $ gross reserves	1.2		36.7	40.7	42.0	36.5	32.9
BDL's gold holdings	1.0		9.8	10.7	12.0	11.8	13.7
BDL's other $ liabilities	0.0		1.1	0.8	0.9	0.9	2.4

Sources: BDL, International Monetary Fund (IMF) Article IV Reports. For banks' $ deposits at BDL: Auditors' Report, Banking Control Commission (BCC) and the author's estimates (see Gaspard (2017)).

Notes: 1- Some figures may be different than in (Gaspard, 2019, 2017) owing to updated data.

2- Banks' $ liquidity ratio is equal to their $ reserves divided by their $-deposit liabilities.

3- Banks' $ reserves are their own $ deposits with correspondent banks abroad.

4- BDL's $ gross reserves, excluding gold, are net of Eurobond holdings.

5- BDL's $ net reserves are equal to its $ gross reserves less all its $ liabilities, mostly banks' $ deposits at BDL.

The danger signals were clear, even blunt. Since before 2015, the financial condition of BDL and of banks was unhealthy and deteriorating. Banks' $ liquidity was falling since 2010 (then at 23%) until it reached less than 10% towards the end of 2017. In parallel, banks' $ deposits at BDL were also continuously increasing, to the extent of 70% of the total $ deposits at the banks themselves. By any standard, the risks to the whole banking sector had reached dangerous levels: very low $ liquidity for banks and negative $ net reserves for the central bank.

This is unprecedented as commercial banks in Lebanon have historically been conservative in terms of their liquidity management. Indeed, even during the long war period of 1975-90, their average $ liquidity was close to an extraordinary 90%. That was the same level of $ liquidity during 1984-88 when the Lira's $-exchange rate strongly depreciated by more than 98% during the period. Importantly, despite the Lira's severe depreciation, the banking sector then remained financially strong and continued to operate fully and freely, without controls, as in the past. In other words, the Lira's current collapse need not be accompanied by a banking collapse, as confirmed by Lebanon's recent financial history.

BDL's monetary policy has understandably focused on accumulating $ reserves to defend the exchange rate peg. BDL significantly augmented that policy in the summer of 2016 with its proclaimed "financial engineering", which practically consisted in borrowing ever larger $ amounts from banks at ever higher and generous interest rates. The average spreads, or margins, paid by BDL over international reference rates such as the 6-month $-Libor, was more than 5% and at times even exceeded 9%. These are quite unusual margins to pay in an interbank market, especially by a central bank that should instead pay only a fraction of 1% as a margin, noting that banks have very few open alternatives for the use of their $ funds[2]. These attractive interest rates even induced banks to liquidate credit to the private sector and shift the funds to BDL: from end 2017 to end September 2019, bank credit to the resident private sector (in $ and LL) in fact declined by more than the equivalent of $15 billion.

Nonetheless, not a single declared objective of the "financial engineering" policy was achieved. On the contrary, BDL's $ net reserves continued declining in negative territory, the balance of payments remained in deficit and, above all, banks' $ liquidity continued to deteriorate. Even BDL's gross debt started exceeding Government's gross debt, and its interest payments also became significantly higher, especially on the $ component of the debt.

BDL's and the banks' irresponsible and unchecked policies have led to the failure of the banking sector. This historical failure could not have occurred without, in parallel, a political failure. In this regard, the important question is: where were the various regulatory authorities?

Clearly, the BDL could not have stopped the ongoing

2 For details on BDL's borrowing costs see Gaspard (2017), especially section 1.

dangerous process since it was itself its main instigator (BDL's Central Council, officially responsible for monetary policy, is responsible whether through its approval or silence), while banks were imprudently abandoning their $ liquidity to BDL in exchange for unusually high interest rates and profits, which turned out to be toxic for all. On the official side, the Banking Control Commission (BCC) was silent or ineffective; the Ministry of Finance, which has an oversight authority over BDL, Government and Parliament also were silent and taken by other presumably more important matters. In addition, almost all the written and visual media had forgotten their primary raison d'être as early warning vehicles or critics of power and its excesses since they were repeatedly praising the exceptional talent and competence of BDL's Governor[3].

What should BDL have done? As it previously did in similar circumstances. In early 1987, when BDL's foreign reserves, excluding gold, reached a low level of less than $400 million, worth only a couple of months' of merchandise imports, BDL simply stopped intervening in the foreign exchange market. The Lira's exchange rate then started depreciating substantially, but the banks remained financially strong, and economic growth quickly rebounded the following year. Had this BDL not resorted to its irresponsible "financial engineering" of considerable $ borrowing from banks, and had the banks not rushed to join in what turned out to be a national

3 Even during the war period, in the 1980s, Parliament would invite BDL's Governor to explain and comment on monetary developments and its monetary policy. This did not happen again since 1993.

financial suicide, the banking sector would have certainly survived, and would have been fully operational today, free without controls.

The banking collapse in Lebanon was a monetary and not a fiscal affair. It is the direct result of a sustained disastrous monetary policy and not of a lax fiscal policy. Left unrestrained, BDL and the banks followed their primitive motivations, which led to the bankruptcy of Lebanon's banking sector and brought a relatively advanced economy down to its current status of mostly a cash economy. The first culprit is BDL, with its hubris and power, which was accumulating without restriction over a 26-year period, supported by its largesse in favor of the financial and political classes and the media. The other culprit is the banks, with their professional negligence and mismanagement, and short-sighted surrender to easy and quick profits at the expense of their own survival and the lifetime savings of millions of depositors.

2. BDL's $ funds: where it came from and where it went

If the direct cause of Lebanon's banking failure is BDL's massive borrowing of $ funds from banks, which turned the banks' $ liquidity into illiquidity, where did these $ funds go? Alternatively, did BDL's borrowing in $ essentially finance Government operations, as usually claimed? Table 2 provides an answer.

Table 2
Banque du Liban:
Sources and Uses of $ Funds, 2009-2019

(Cumulative flows, in $ billions)

Sources of $ funds	**94.0**	Data sources:
Banks' $ deposits at BDL	69.3	Auditors' Report, BCC and estimates
Interest on BDL's $ reserves	7.2	At 6-month LIBOR, and US 10-year TBs for securities
Eurobonds exchanged for LL-TBs	17.5	MOF-unpublished
Uses of $ funds	**54.8**	
Interest on banks' $ deposits	23.3	At 5.5% till 2015, then rising to 7% average in 2019
Other interest cost	1.6	At 5%, on other FX liabilities
$ overdraft to Government	13.0	MOF-unpublished
Change in gross reserves	12.9	IMF Article IV Reports (excluding Eurobonds)
Change in Eurobond holdings	4.0	Estimate, based on BDL and IMF data
$ funds unaccounted for	**39.2**	
(+ is $ outflow from BDL)		
Memo (2009-2019 period)		
(all payments & receipts in $)		
Fuel imports for EDL	17.5	MOF budget outcomes
PTT transfers to Treasury	14.2	MOF budget outcomes
Imports for Government	2.5	MOF budget outcomes
Balance of payments (BOP)	-6.3	BDL

Sources: BDL, Ministry of Finance (MOF), IMF Article IV Reports. For banks' $ deposits at BDL: Auditors' Report, Banking Control Commission (BCC) and the author's estimates (see Gaspard (2017)).
Notes:
1- Interest received by BDL is based on international market rates. For details on

interest paid by BDL, see the previous section and Gaspard (2017).
2- Imports for Government are estimated from Budget outcomes as the amount of imported services plus half the Government's consumption of goods.
3- PTT is the Ministry of Telecommunications. Transfers to Treasury were effected in both $ and LL, with about two thirds in $.

It should be noted, in this context, that the emphasis here is only on $-denominated funds with regard to the operations and accounts of Government, BDL and banks because the LL-component of government debt, and of deposits and transactions has little impact, if any, on the banking failure per se. Excessive credit in LL by banks or BDL to Government or the private sector affects the value of the Lira but not necessarily banks' $ liquidity, which mainly depends on the banks' prudential management. Discerning the factors behind the banking failure therefore requires focus on $-denominated accounts and transactions, especially since the critical element leading to that failure has been the $ shortage that resulted from the parting of banks with most of their $ liquidity to BDL.

Table 2 shows that the major source of BDL's $ funds was banks, while the main outflow was interest cost to the banks themselves and unaccounted-for outflows that largely were also in favor of banks, as explained below.

Some explanations of major items in Table 2 are in order. Other than the banks' $ deposits, an important source of $ funds for BDL has been its long-standing operation of regularly exchanging with the MOF its holdings of LL-TBs with Eurobonds, which are TBs issued by the MOF and denominated mostly in $, which BDL subsequently sold in the market. In other words, it was the MOF that was in fact supplying BDL with $ funds, to the tune of $17.5 billion until 2019, rather than the other way round. So BDL's LL-financing of government debt through its holdings of LL-TBs was, importantly for BDL, a mechanism to obtain $ funds from Government through its regular exchanging of these LL-TBs for Eurobonds that it subsequently sold to banks.

As for the $ overdraft lending to Government, it represents the net result of all $ advances by BDL to Government during 2009-2019 for various operations such as fuel imports, $-interest payments, imports, etc.[4] It should be noted that this $-overdraft debt by Government to BDL has already been fully paid, simultaneously with the relevant operations, but with LL funds. However, it is included in the Table above because we need to account for uses by BDL of $ funds only.

Two outstanding, and remarkable, results emerge from Table 2. First, it was Government through the MOF that was financing BDL in $ rather than the other way round. It issued $17.5 billion in Eurobonds specifically for BDL during 2009-2019 while the Government's borrowing in $ from BDL during the period (though fully paid in LL) was only $13 billion, a net lending by Government of $4.5 billion. Even accounting for the change in Eurobond holdings by BDL of $4 billion during the period leaves

4 The $13 billion noted in Table 2 is the difference between the outstanding overdraft of $16.1 billion and $3.1 billion at end 2019 and 2008, respectively.

the MOF-Government as a net creditor of $ to BDL[5].

So the dominant and recurring discourse in Lebanon that the banking collapse is due to the banks' and BDL's financing of government debt is incorrect and unsubstantiated. Worse, without the exchange of Eurobonds for LL-TBs, Lebanon's $ debt in Eurobonds would have been lower by at least $25 billion (the exchanged amount plus accumulated interest) to about $5 billion only at end September 2019. The upshot would have been that, had it not been for BDL's exchange operation, Lebanon's first ever default could then have been avoided, and the whole financial landscape would have been today radically different for the better.

The second outstanding finding is that the net result of all the $ inflows to and outflows from BDL during 2009-2019 is estimated as a net outflow from BDL of close to $40 billion that cannot be totally accounted for. As BDL deals essentially with banks only, most of these funds must represent transactions with banks. However, some of these transactions may represent interventions by BDL in the foreign-exchange market for balance-of-payments (BOP) purposes, which accumulated a deficit of only $6.3 during the period in question, plus private transfers of funds abroad during the last months of 2019.

5 Even if BDL decides to redeem directly from the MOF its current holdings of Eurobonds of about $5 billion nominal value, the MOF can simply reverse the original exchange operation and pay BDL in equivalent LL funds rather than in $ that BDL never paid to MOF. In other words, BDL cannot claim its Eurobond holdings as a $-liability on Government.

Notwithstanding methodological issues[6], and taking into account these qualifications, a final residual of the unaccounted-for $ outflows is conservatively estimated at around $30 billion. These $ funds largely correspond to bank profits (in both $ and LL) that mainly originated from BDL's "financial engineering" operations, and where the LL-part was converted into $ through BDL and transferred abroad.

Banks' profits largely are the mirror image of BDL's losses. BDL has been continuously incurring losses, at least since 2002 when it stopped publishing its profit and loss statements, contrary to what it has been regularly doing since its foundation in 1964[7]. The main reason for BDL's losses is that the interest rates it paid for borrowing $ funds from banks were much higher than the international rates it received on those funds, in addition to the high bonus interest rates paid to banks, averaging 7% for nominal LL deposits by banks[8].

6 Strictly speaking, we cannot add all of BDL's possible financing of the BOP deficit to uses of $ funds by BDL, as in Table 2, because already some items in the Table such as, for instance, interest on BDL's $ reserves, are elements of the BOP.

7 It is unusual and unfortunate that a central bank publicly gives false or contradictory information about its financial situation and profits/losses. In its reply to the author's paper (Gaspard, 2017) that mentioned BDL's losses and weak financial condition, BDL stressed "BDL's solid financial position … [and that] BDL has been and continues to generate sustained and substantial profits …" (BDL, 2017, p. 4, item 5b). At the same time, and more seriously, BDL had been declaring in the Official Gazette, where it is legally required to publish its annual summary balance sheet, that annual "results-profits" during 2002-2018 were "zero" every single year of those seventeen years! (See various Official Gazette issues).

8 The bonus interest worked like this: For every 1$ borrowed, BDL extended to the lending bank 1.25 as a LL-loan at 2%, which the bank simultaneously deposited at BDL at 9%. The LL-loan and corresponding deposit principals cancel each other but the bank received a net 7% on the notional LL amount, a net profit in LL for lending the $ funds to BDL.

In short, the dominant and recurring discourse in Lebanon that the banking collapse is due to the banks' and BDL's financing of government debt is incorrect and unsubstantiated. Focusing on $ financing, which is what matters in this context, most of the banks' $ liquidity was voluntarily deposited at BDL, and the remarkable finding is that no borrowing by BDL of $ funds since 2009 has served to finance Government's $ operations or debt. On the contrary, it was Government that was in fact financing BDL in $ funds.

On the other hand, more than $62 billion in bank profits and interest income, or about 90% of banks' $ lending to BDL, went back to banks as interest and profits.

3- Government policies led to the collapse of the Lira

The collapse of the exchange rate of the Lira is a separate matter from that of the collapse of the banking sector. In fact, as noted above, this is exactly what happened in the 1980s in Lebanon. From end 1984 to end 1987, the Lira's market exchange rate dropped from LL8.9/$ to LL455/$, a depreciation of 98%, and further dropped to LL1,858 at end 1992. Yet, throughout the period, banks continued to enjoy very high $ liquidity and to operate fully freely without any controls.

The key to understanding a currency's collapse, apart from political shocks, is whether the country has been long living beyond its means. The major indicators for that excess are the budget deficit and the balance of payments.

Table 3 summarizes Government's budget operations since 1993.

Table 3

Government Expenditures, 1993-2019

(Cumulative expenditures, in equivalent $ billions and %)

Expenditures	**260.6**	**100.0%**
Interest on debt	85.4	32.8%
Wages & benefits	91.0	35.0%
Capital expenditure	20.9	8.0%
EDL –transfers	24.3	9.3%
Other transfers	32.1	12.3%
Other	6.9	2.6%
Memo		%GDP
Gross debt -end 1992	3.0	50.0%
Gross debt -end 2019	75.3	147.6%
@ official exchange rate	(91.6)	(171.0%)

Source: Compiled from MOF publications, at www.finance.gov.lb.
Notes:
1- Data are for consolidated general government, including Treasury operations and net Annex Budgets, whose allocation among expenditure categories is estimated by the author based on budget information.
2- Expenditures are at equivalent market $-exchange rates. For 2019, at LL 1,584/$ annual average and LL2,100/$ at end year. Daily market $-exchange rates since November 2019 are from www.lebaneselira.org.
3- EDL is Électricité du Liban.

There are very few rules in economics, but a "golden economic rule" states that governments should borrow only to spend on capital investment, e.g. on physical and human infrastructure, not on current items. Table 3 above indicates that more than two thirds of government spending during the past twenty-seven years were allocated to current spending, simply on interest on debt and on wages and associated benefits.

The share of expenditure on capital, however, including waste and inefficiencies, was only 8% of the total. So, although government debt was very high by normal fiscal standards, the fundamental problem was not in the high level of debt but rather in its long-standing origin in current rather than capital spending. That spending has financed the swelling public sector with political appointments and various transfers for political purposes, and the many expensive projects that have been executed to satisfy personal and political objectives. The source of corruption is obvious. Practically all corruption practices are financed by public money. And corruption practices have usually resulted from policies or decisions approved by officials in political authority.

The other key indicator for showing that Lebanon has been living for long beyond its means is the balance of payments (BOP). The BOP has been in deficit and steady decline since 2011, indicating that more $ funds were continuously exiting Lebanon than entering it[9]. This is unprecedented because, since independence in 1943, Lebanon had not witnessed any period of more

9 The BOP briefly showed a surplus only in 2016, when BDL's financial engineering started in earnest.

than two consecutive years of BOP deficit, until 2011 to date.

The striking deterioration in the BOP is mainly due to the deterioration in Lebanon's relations with Arab Gulf countries, following Hezbollah's participation in the war in Syria and military intrusions in Arab countries. Hezbollah is a Lebanese religious party that openly vows ideological, political and military allegiance to Iran. The Arab Gulf countries historically have played a significant positive role in the Lebanese economy. In addition to large official aid in times of crisis, they have for decades welcomed hundreds of thousands of Lebanese workers, and constituted a backbone of Lebanon's tourism and direct investment in the country. A turnaround occurred after 2011, following the war in Syria. Compared to 2005-11, the recent period 2012-19 witnessed an average current account deficit increasing from 13% to 23% of GDP. Positive income and current transfers, mostly from Arab Gulf countries, significantly dropped even in absolute terms.

Beyond the financial collapse, an unhappy consequence of the various Governments' damaging policies is the present condition of the public sector. Instead of attending to its natural function of providing services to the public, independently of political considerations, the public sector in Lebanon has become an instrument for advancing personal political power and fortunes, with a large number of public servants, especially in senior positions, now owing their loyalty to politicians who appointed them rather than to law and the public at large.

4- Recovery, without sovereignty?

It is said that the basic characteristic of any functioning State, let alone its prosperity, is its monopoly of the means of destruction and the means of consumption, i.e. its monopoly of the military and economic policy. Lebanon has lost both monopolies. The loss of sovereignty is the most harmful for there is no hope of any recovery without regaining one's sovereignty over national territory and policies.

Lebanon has lost its political and military sovereignty to Iran through the Lebanese party Hezbollah, which holds sway over Lebanon's Government and openly runs a large army of its own that has been for years conducting military operations in Syria and other Arab countries. The party's leader has publicly asserted that they are ideologically and politically subservient to Iran, and that they receive all their armaments and financing from Iran as well. This makes Lebanon effectively subservient to Iran through Hezbollah. In fact, the UN General Assembly, the International Criminal Tribunal and the International Court of Justice are associated with the view taken by the International Red Cross that "...occupation could be exerted through local armed groups enlisted by a foreign army, who would be acting as de facto agents of another State"[10].

No country, especially one with a collapsed banking sector, can hope to recover economically if it does not start by recovering its sovereignty. The current and

10 See ICRC, p.23.

deepening financial collapse in Lebanon, exacerbated by the recent massive explosion at the Beirut Port, has created new rules of the game, imposing the need to implement fundamental policies if even the beginning of an economic recovery is to materialize. Recovery policies after the collapse necessarily are radically different from reform policies before the collapse. A path to effective economic recovery would include the following essential steps that constitute a coherent minimal package of reforms that can pull the Lebanese economy out of its historical crisis, and set basic foundations for a new beginning.

1) Official military forces take effective and total control of all Lebanon's borders. Any military role by Hezbollah would be fully subservient to the Lebanese Army and in accordance with Lebanese laws and relevant Security Council resolutions. Lebanon would then be affirming its sovereignty and character of a "normal' state, failing which all other measures become ineffective. This step is necessary even for strictly "technical" reforms such as the recouping of billions of dollars in lost customs revenues through various smuggling channels.

The process of economic recovery can then, and only then, actually start. To make economic recovery politically and socially feasible, a basic equity principle of burden sharing needs to govern economic policies. Since recovery policies will entail economic and social costs, the costs or burdens entailed should be, and perceived to be, fairly distributed among the various groups. This would then make reforms acceptable and feasible. The relevant socio-economic groups that are identified for our purposes are: Government, the banks, and the people at large or mostly the low and middle-income groups.

2) Government should introduce a 3-year budget, say for 2021-23, with a gradually declining deficit to reach close to balance in 2023. This should constitute the first action, or signal, by Government in the process of economic reform. The corrective measures should include minimal increases in taxes and fees, and rely essentially on reducing much inflated or wasteful expenditures, and recovering unrealized budget revenues.

A related measure of importance in the financing of the deficit is to reinstate the Single Treasury Account, which consists in bringing back the cash deposits of all public enterprises from banks to the Ministry of Finance's account at BDL, which used to be the case in the past. During the last ten years, these accounts at banks (mostly in LL) have approximately averaged the annual budget deficit. So the deficit can be internally financed from these accounts for one year at least, with little need to borrow from the capital market.

These fiscal measures should be accompanied by various easy-to-implement structural reform measures that have already been identified and adopted in principle by Government, such as the appointment of new independent (rather than politically subservient)

Boards and regulatory authorities for EDL and Telecommunications. Government would then be sending to domestic and international markets, and to the IMF in particular, an important signal that it is indeed serious and intent on putting its fiscal house in order, and effectively implementing reforms towards economic recovery.

3) Recapitalize banks. No economic recovery is possible without a functioning banking system that would, above all, re-engage with normal business activity, such as opening letters of credit, and setting clear operational rules regarding deposits and transfers, etc. This normalization of banking operations, and economic activity in general, cannot take place without the recapitalization of banks whose consolidated equity is currently negative. Such recapitalization must include the injection of fresh $ funds by bank shareholders, in addition to the capitalization of excessive interest paid during 2015-19 to large depositors, say the equivalent of about 5% interest paid on the top 90% amount of deposits. This last measure could bring at least $20 billion in new capitalization in the form of a bail-in by large depositors. Bank shareholders would then have to inject an equivalent amount, about $20 billion, say over 2-3 years. This is financially feasible for banks, as indicated by section 2 and Table 2 above.

Lebanese bankers seem reluctant to even discuss the issue of recapitalization with fresh $ funds. This may be in part due to the abnormal absence to date of any encouraging reform process by the authorities, despite the magnitude of the crisis that erupted almost a year ago. If despite the implementation of reforms, as noted above, bankers remain reluctant to inject new capital, as current laws and accounting principles require, then new bank shareholders would be invited and/or a process of liquidation would take effect, as required by law.

In the end, one policy remains the necessary and sufficient condition for recovery. If at first Lebanon does not effectively regain its sovereignty over its borders and policies, then we will certainly continue on this current descent into economic and political disintegration.

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