

Turning War Economies into Peace Economies: Lessons from Lebanon & Beyond

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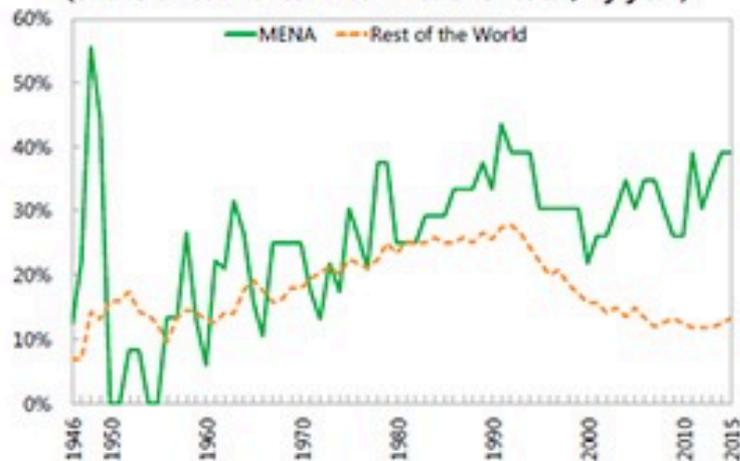


Agenda

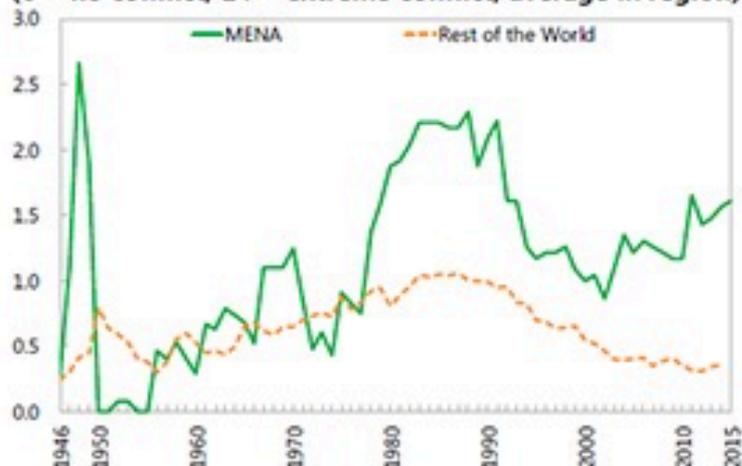
- **Economic consequences of conflicts & post-conflict reconstruction**
- **Lebanon short history, 1920-2020**
- **Moving Lebanon to a Peace Economy**

MENA conflicts: Frequent, Intense and Durable

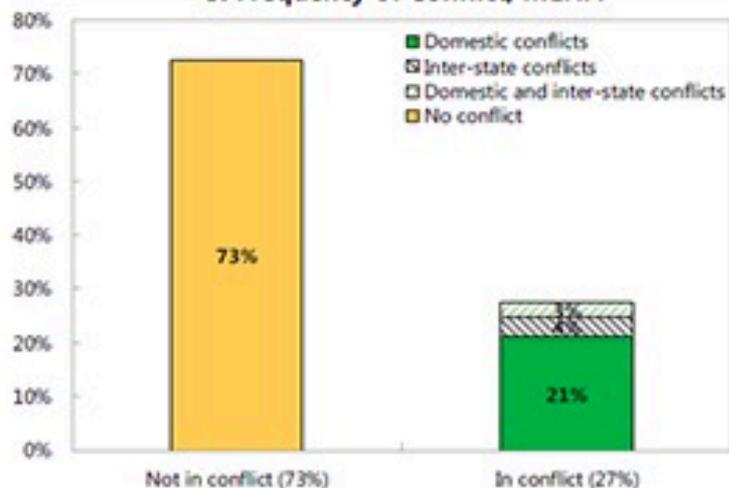
1. Frequency of Conflict, by Region
(Share of countries in conflict over total, by year)



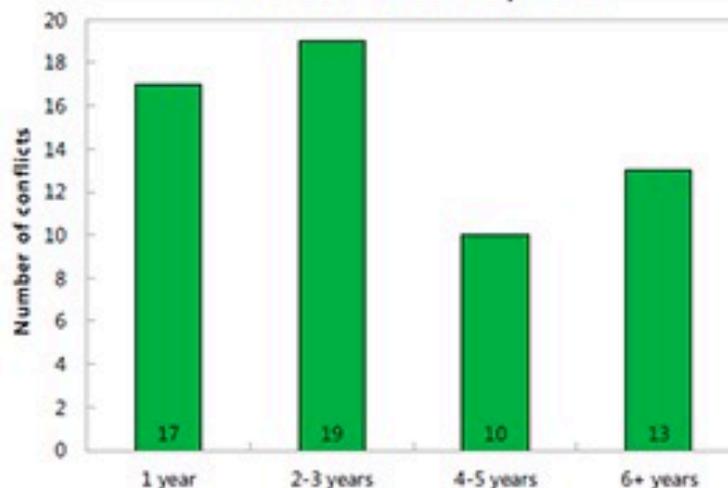
2. Average Intensity of Conflict by Region
(0 = no conflict, 14 = extreme conflict; average in region)



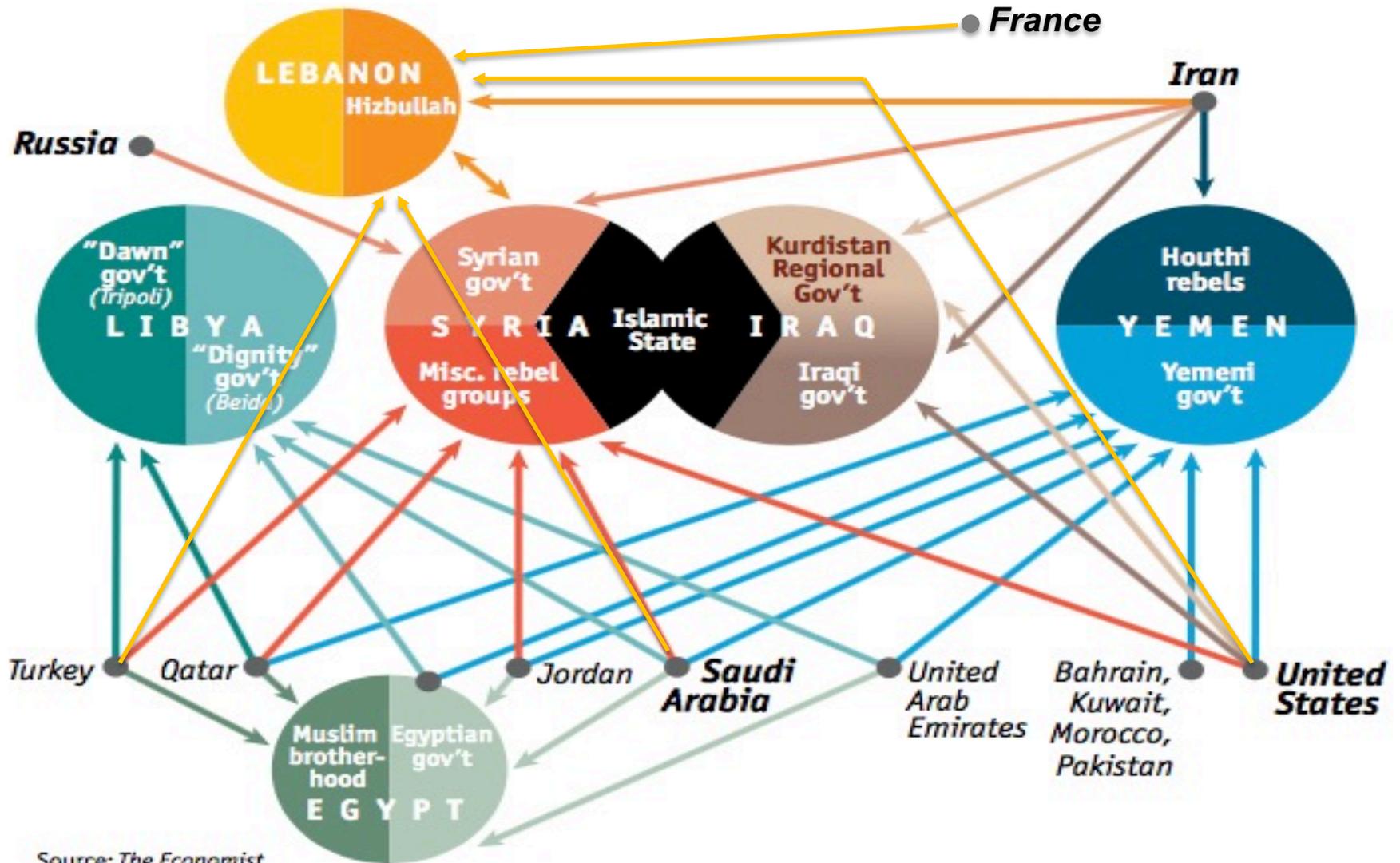
3. Frequency of Conflict, MENA



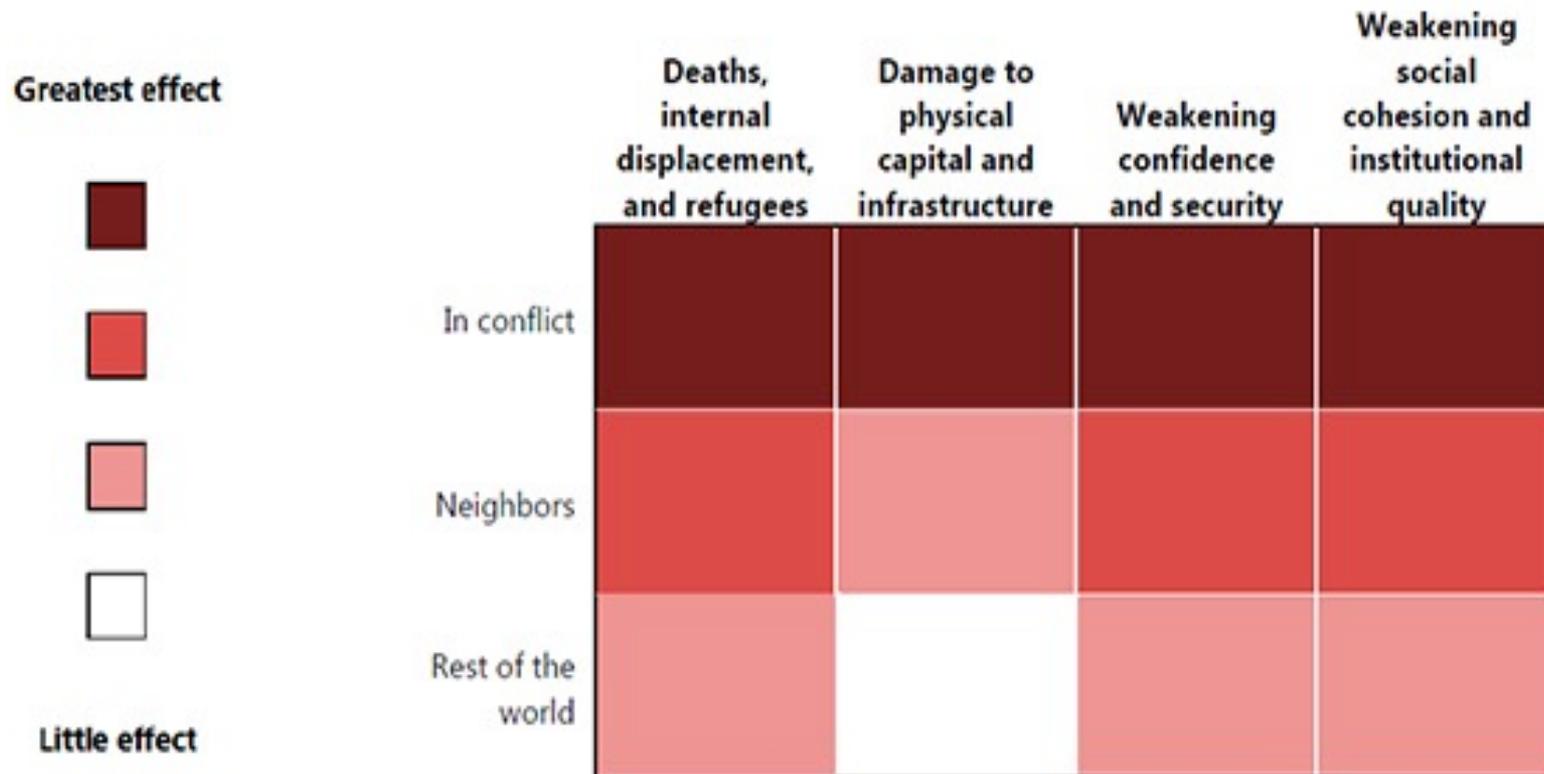
4. Duration of Conflict, MENA



Region's conflicts reflect many 'fault lines': governance, inequality & confrontations over energy, religion, ideology, ethnicity



Intense conflicts & human displacement have had massive & persistent economic costs



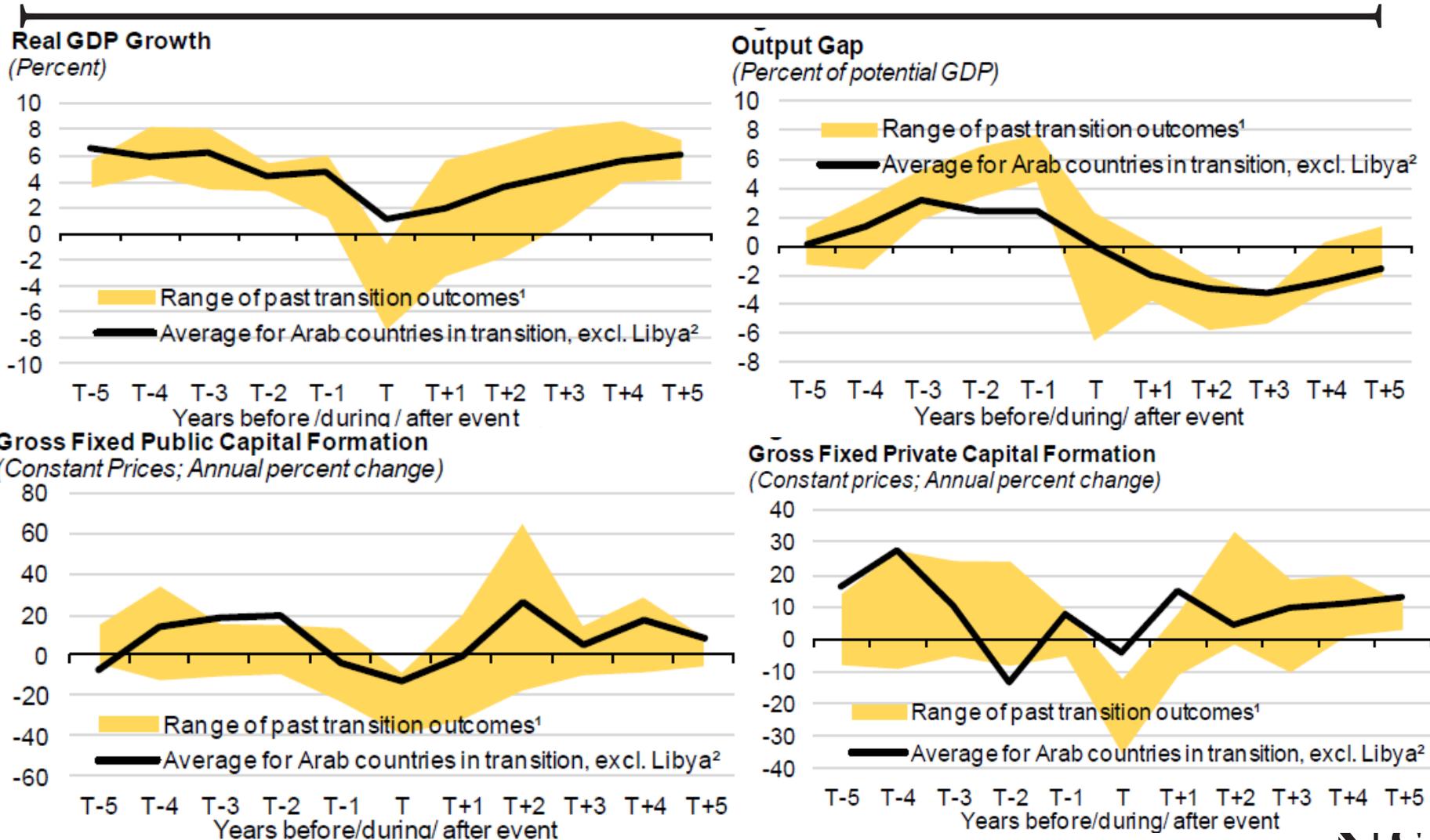
Main challenges:

1. Protecting the effectiveness of economic & social institutions
2. Fiscal policy: focus on protecting human life & limit rising deficits
3. Monetary and exchange rate policies to help maintain stability

Stylised Facts from Political Transitions suggests Slow Economic Recovery

- **Real GDP declines by more than 4% on average**; output remains below potential for 4 years after initial drop, takes ~5 years for recovery.
- **Unemployment rates rise by about 1–1½ ppts on avg**, during first two years after start & take between 4-5 years to recover to pre-crisis levels.
- **Public & private investment declines by about 20% on avg** during event year & remains low; takes ~5 years to return to pre-crisis levels.
- **Fiscal positions worsen & recover slowly**: overall fiscal balances deteriorate by about 1% of GDP on avg during event year & continue to deteriorate in subsequent two years by a cumulative **1.75% of GDP**. Fiscal balances return to pre-crisis levels only in year T+4 with adverse impact on government debt
- **Over medium term, external current account deficits improve**: Reserves recover slowly, returning to pre-crisis levels in about 4 years
- Deterioration in fiscal balance & GDP => rise in **public debt**
- **Investor confidence** suffers: lower asset prices & inward FDI

Economic Impact of Political Transitions Span Half a Decade

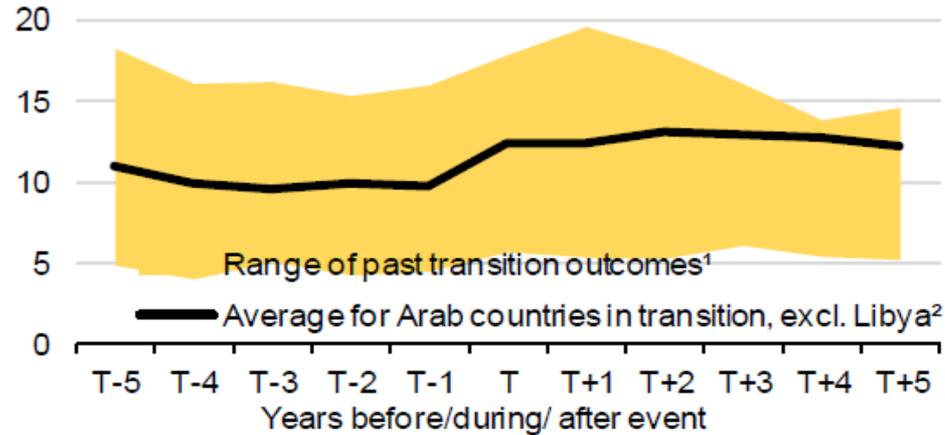


Source: Khandelwal, P., Roitman, A. (2013): "The Economics of Political Transitions: Implications for the Arab Spring", IMF Working Paper, March 2013

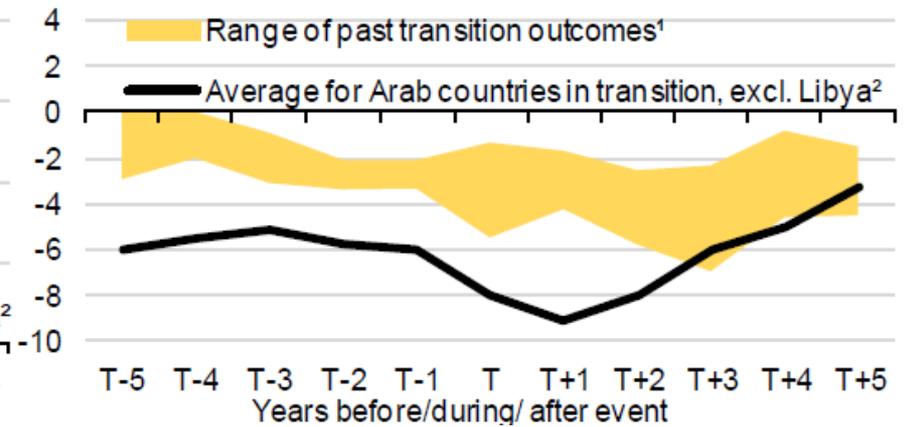
Economic Impact of Political Transitions

Span Half a Decade II

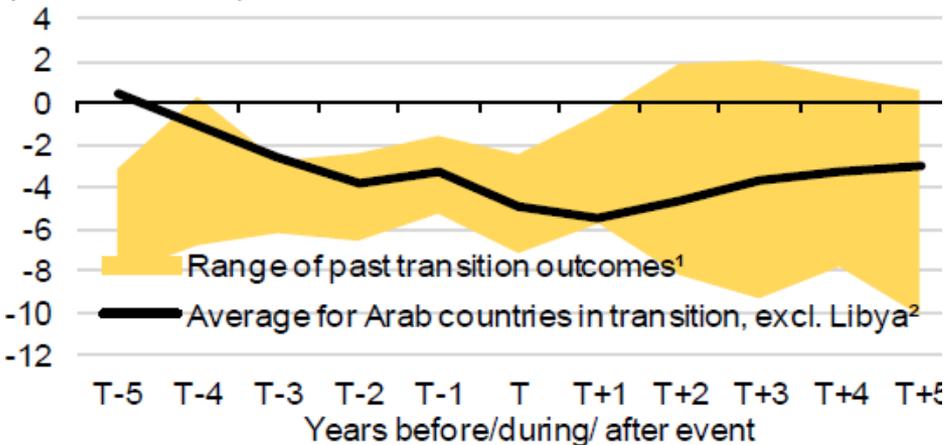
Unemployment Rate
(Percent)



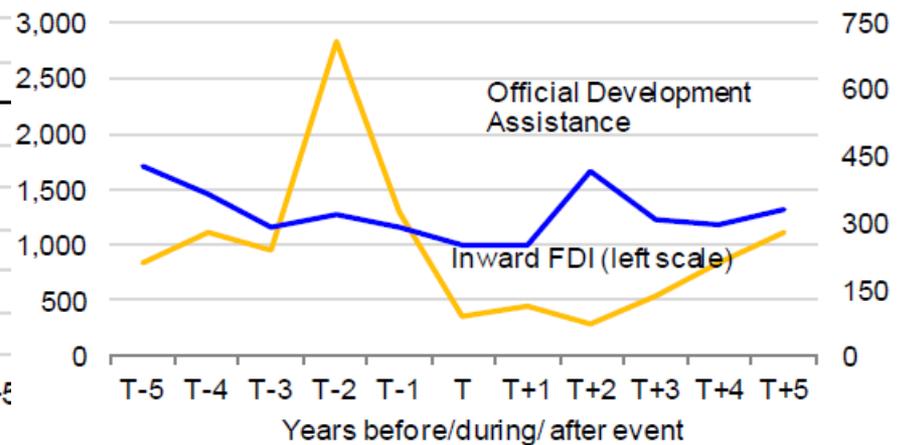
Overall Fiscal Balance
(Percent of GDP)



Current Account Balance
(Percent of GDP)



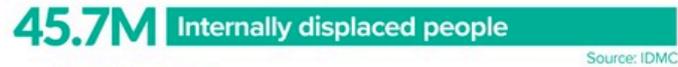
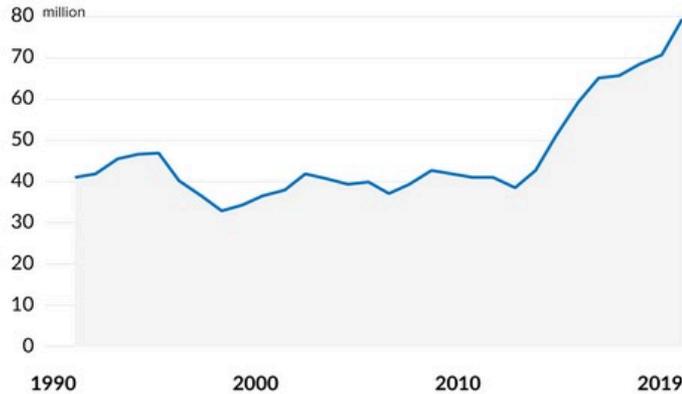
Selected Financial Flows
(Millions of U.S. dollars, in constant prices)



Population Displacement & Refugees

Source: UNHCR / 18 June 2020

79.5 MILLION forcibly displaced people worldwide at the end of 2019



4.2M Asylum-seekers

3.6M Venezuelans displaced abroad

Syria continues to have the largest forcibly displaced population of any country, with 6.6mn international refugees & more than 6mn internally displaced people



1% of the world's population is displaced



80% of the world's displaced people are in countries or territories affected by acute food insecurity and malnutrition

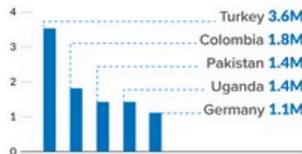


73% Hosted in neighbouring countries *

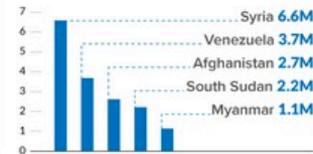


68% Came from just 5 countries *

TOP HOSTING COUNTRIES



TOP SOURCE COUNTRIES



* Data includes UNHCR refugees and Venezuelans displaced abroad



40% of the world's displaced people are children



85% Hosted in developing countries *



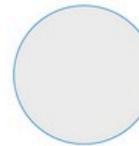
4.2M Stateless people



2M Asylum applications (in 2019)



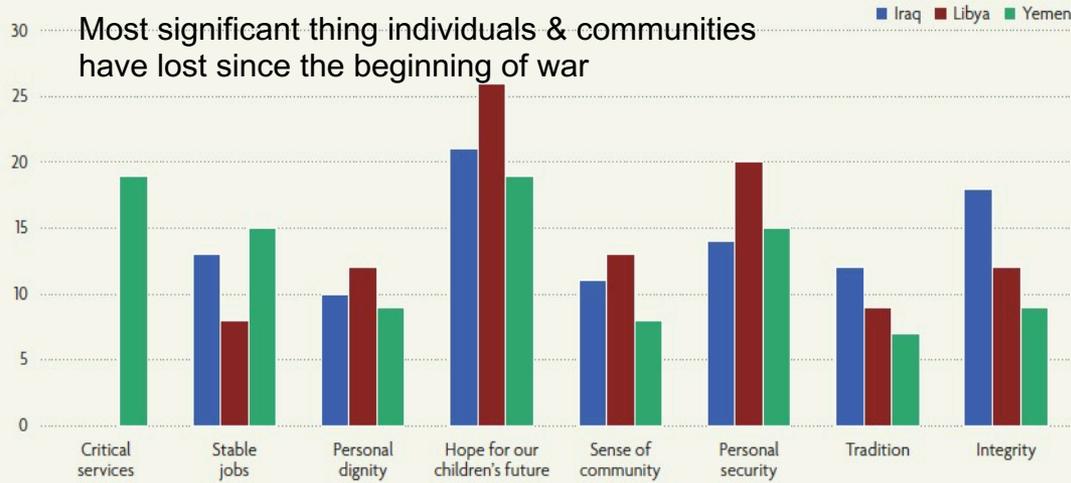
107,800 Resettled to 26 countries (in 2019)



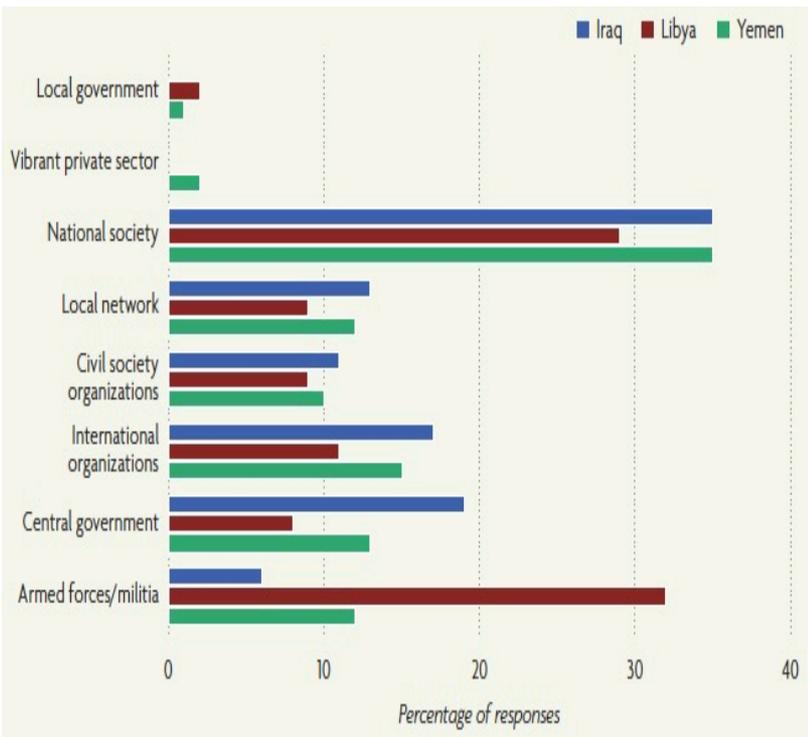
5.6M Returnees (in 2019)

People's Perspective on War & Peace

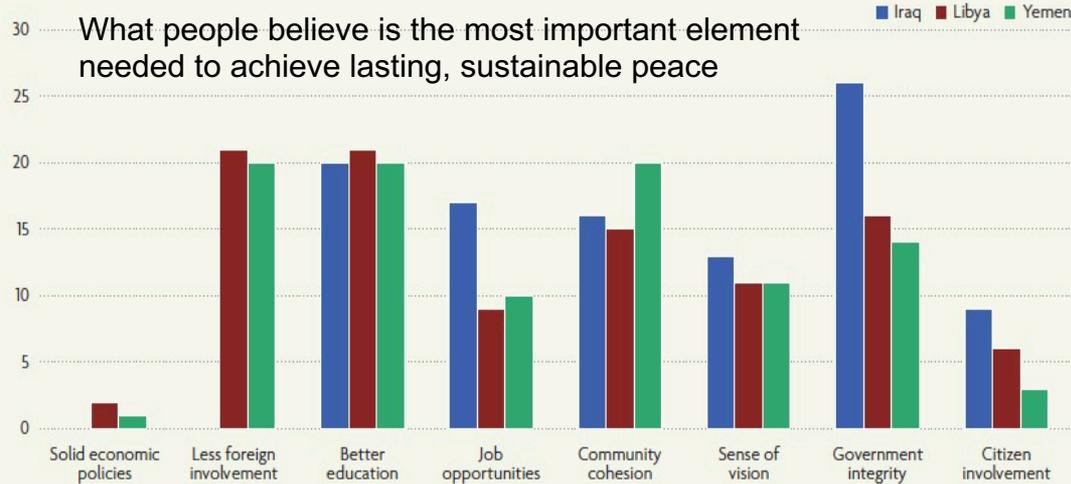
Percentage of responses



Who is most trusted to improve the economic situation for individuals & their families



Percentage of responses



Challenges & Risks Policymakers face when implementing reconstruction & peacebuilding

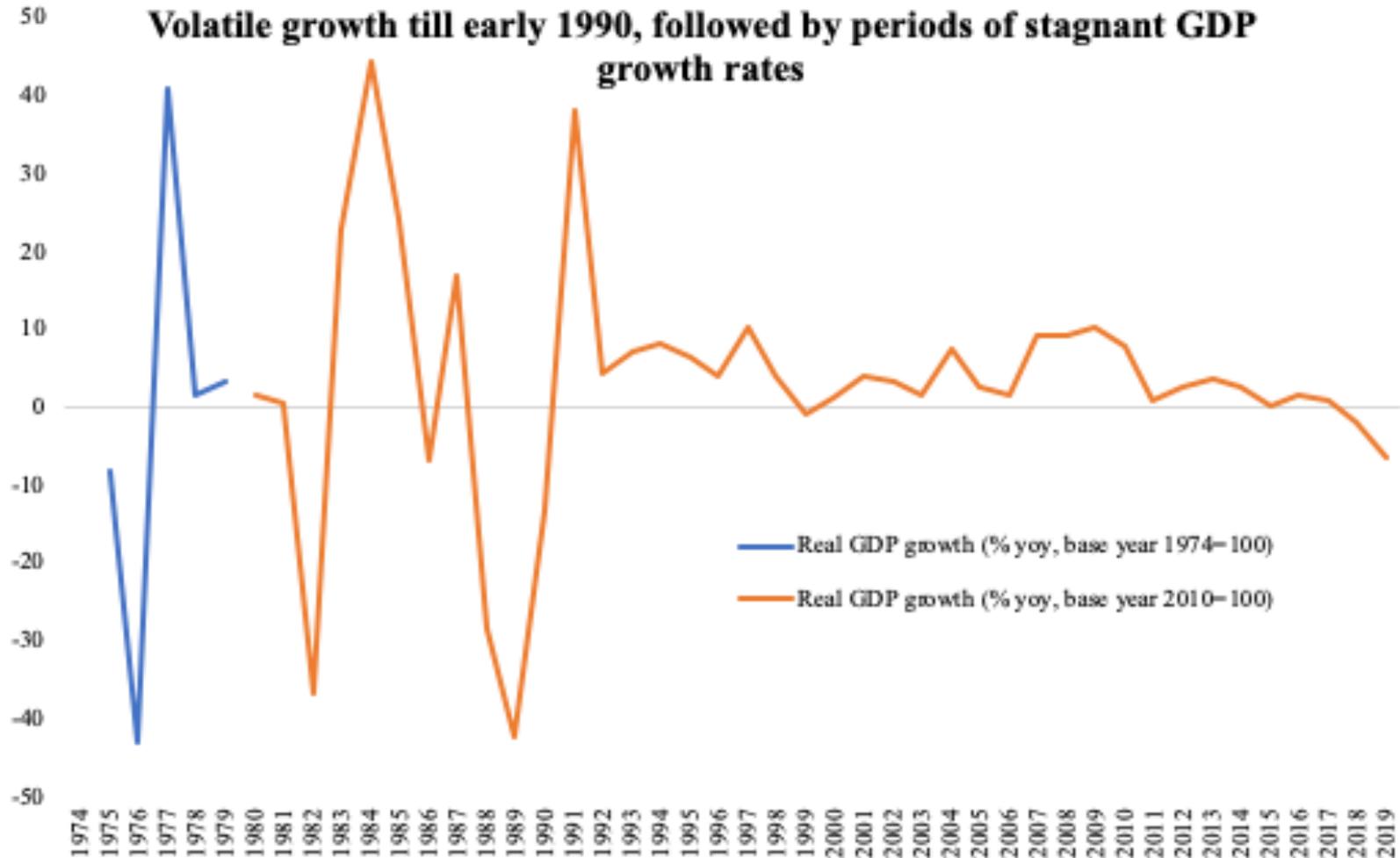
1. **Silo-driven project approaches** can drive mismanagement & corruption
 2. **Fragmented & incoherent govt systems & institutions**
 3. **Little understanding of nature of the regime**, character of the state & incentives of interest groups that shape the political dynamics.
 4. **Flawed /negative incentive structures**: failures to handle disarmament demobilization, and reintegration appropriately - that'll take decades to undo, as institutional inertia and incentives for violence continue.
 5. Inadvertent **support for the illicit criminal economy**
 6. **Elite capture of resources meant for reconstruction**, peace building & development, preventing redistribution of wealth & power, perpetuating inequalities
- ⇒ Move beyond rebuilding destroyed infrastructure & physical capital
 - ⇒ Mend the destroyed socioeconomic fabric of the war-torn communities
 - ⇒ Change in focus toward existing assets that have survived the conflict or that have emerged as coping mechanisms in response to the conflict.

Lebanon: Historical Milestones

- Sykes-Picot agreement (May 1916)
- Traité de de Lausanne -French Mandate- Independence, 1920-1943
- 1943-1975 Influx of Palestinians (1948, 1970); 1958 political crisis
- 1975-1990 Civil war. Syrian intervention/occupation 1976
- Taef Accord 1989: Second Republic
- 1992-2005: enshrined sectarianism. End of Israeli occupation in 2000. Rafik Hariri assassination 2005 & Syrian withdrawal
- Syrian refugees and displaced, 2011-2020
- 2005-2019: increased political polarization into 2 political camps and growing, episodic, violence 2006, 2007, 2008



Lebanon Real GDP Growth 1974-2019: highly volatile and increasingly negative



Source: Data 1975-79 from Saidi, N. (1986): "Economic Consequences of the War in Lebanon";
Data from 1980 onwards IMF WEO database (Apr 2020)

Macro Consequences of Lebanon's Civil War, 1975-1990

- Sharp reduction in level & growth rate of real GDP + an even sharper reduction in investment spending
- Destruction of wealth: unprecedented destruction of human & non-human capital stock => large loss of productivity
- Segmentation of markets (esp. labour) & economic activity => low domestic labour mobility + increased costs + reduction in efficiency
- Brain-drain & outmigration of human capital=> increased inequality
- Reduction in quality of human capital given the reduction in the number & quality of finished years of schooling, on-the-job training & apprenticeship
- Reduction in ratio of males to females in resident population & labour force
- Large increase in relative size of government compared to private sector
- Emergence of large & growing unsustainable public sector budget deficits; sharp increase in public debt and debt service
- Sharp acceleration of money growth arising from BdL financing of govt budget deficits => sharp acceleration of inflation + depreciation of the LBP

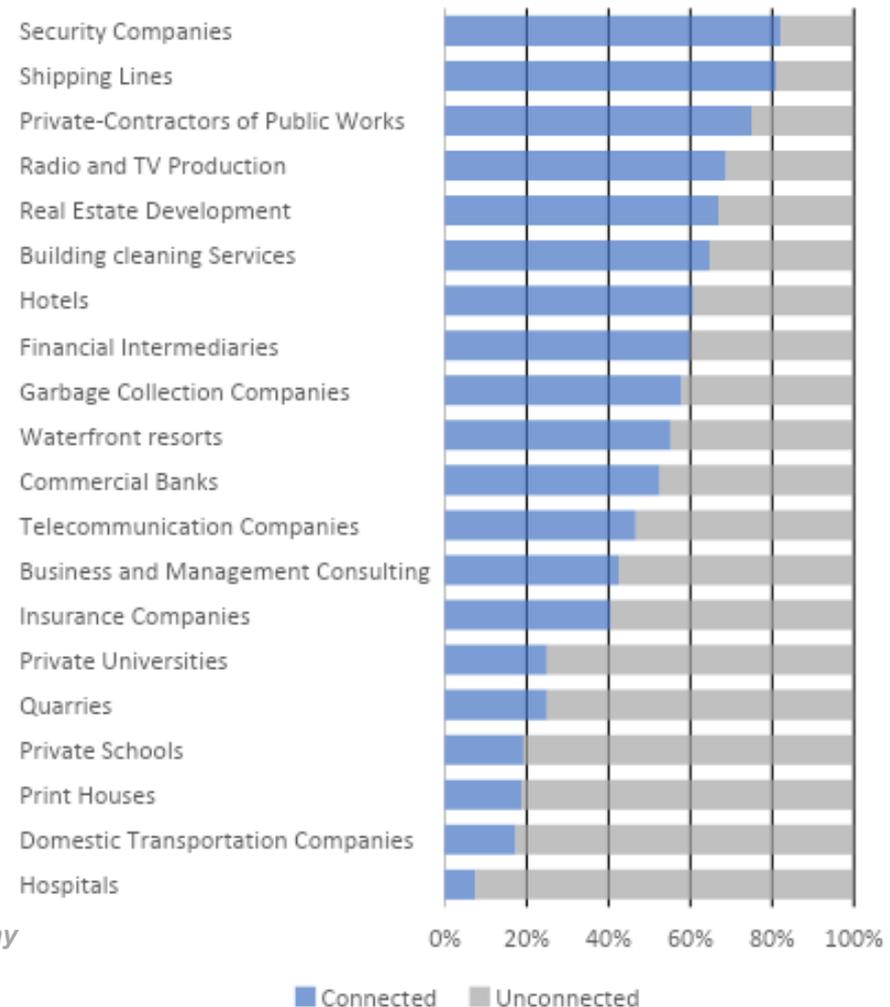
Power sharing arrangements in Lebanon from 1943

Period/Order	Dominant Coalition	Rent Extraction	Assessment
1943-early 1970s: National Pact	Maronite Christian community with merchant elites	Merchant republic facilitated by low taxes, macro stability, and trade monopolies	Introduction of redistributive policies during the Chehab era; strong foreign backing (France and the United States); brief descent into fragility during the 1958 crisis that fostered the rise of the Sunni community in socio-economic and political power.
Early 1970s- 1991: War Order	Changing dominations; ascendancy and decline of PLO as major economic and political power; foreign intervention (Syria and Israel)	War economy, remittances	Quick decent into fragility due to establishment of para-military units; frequent strikes and coalition building along class lines; legitimacy of state institutions undermined.
1992-2005: Post-War/Ta'if Order	Sunni-Shi'a coalition, controlled by the Syrian government and the 'Troika', multiple elites in each confessional group (re)emerge	State-led rent extraction mainly through real estate and reconstruction, as well as bank-financed government debt	Sectarian governance institutionalized stronger than in pre-war governance predi- cated on regional peace; Syrian presence de facto dictates political discourse; Rise of Shi'a communities in socio-economic power being part of ruling 'Troika' and backed by the Syrian government.
2005-2019: Modern Order	Tripartite coalition between Christian, Sunni, and Shi'a communities with multiple elites in each group	As state rents decline, rent extraction mainly based on private sector privileges	Polarized political discourse induced by regional geo-politics; Christian communities reascend to the dominant coalition; violence capacity insufficiently consolidated but balanced in the hands of Lebanese security forces and Hezbollah seeking domestic stability.

Politically Connected Firms

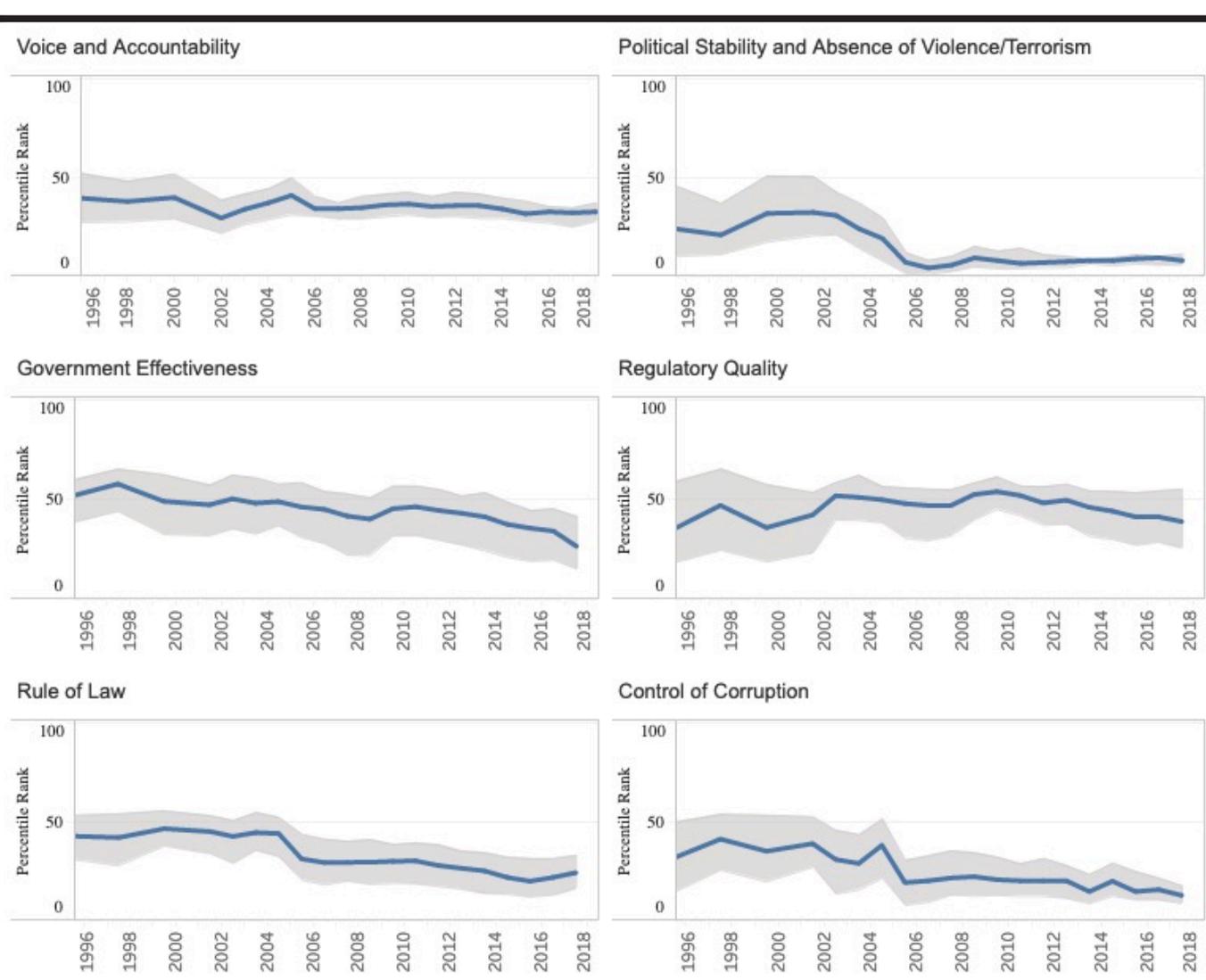
- Generally, of firms with 50+ employees, more than 44% are politically connected and have a board member who is a relative or close friend of a politician
- One of the most connected sector is banking: with 18 of the 20 largest banks politically connected, banks became Lebanon's *invisible hands*.
- Deep entrenchment of the financial sector with elites => legislation pertaining to public finance & financial institutions appear to be the only major policy area in which political polarization & gridlock does not significantly impact political collaboration!

Share of politically connected firms with 50+ employees in sectors with > 10 firms



Source: Mahmalat, M & Atallah, S. (2019): "Recession without impact: why Lebanese elites delay reform", ERF Forum

Institutional Reform is Integral to Change



The elitist, power-sharing system that kept the peace between the country's religions after the civil war has failed => **Need a separation of Religion from State**

Source: World Governance Indicators, World Bank. The solid blue line shows country's percentile rank on each of the 6 aggregate indicators; grey is the margin of error.

Need for Stronger Economic & Political Governance to rebuild the state & institutions

Focus on economic governance, not policies

Use aid to support private investment for job creation

Use international means of building resilience

Build institutions to support the private economy

Invest in urban infrastructure for energy and connectivity

Use domestic means of building resilience

Policy areas for post-war rent seeking & state capture

- Create inclusive institutions
Power sharing in Lebanon did not lead to inclusiveness
- Restore urban structures
- Promote economic opportunities
- Provide services
- Establish strong & independent banking, financial, telecoms, oil & gas, electricity & other regulators

NS

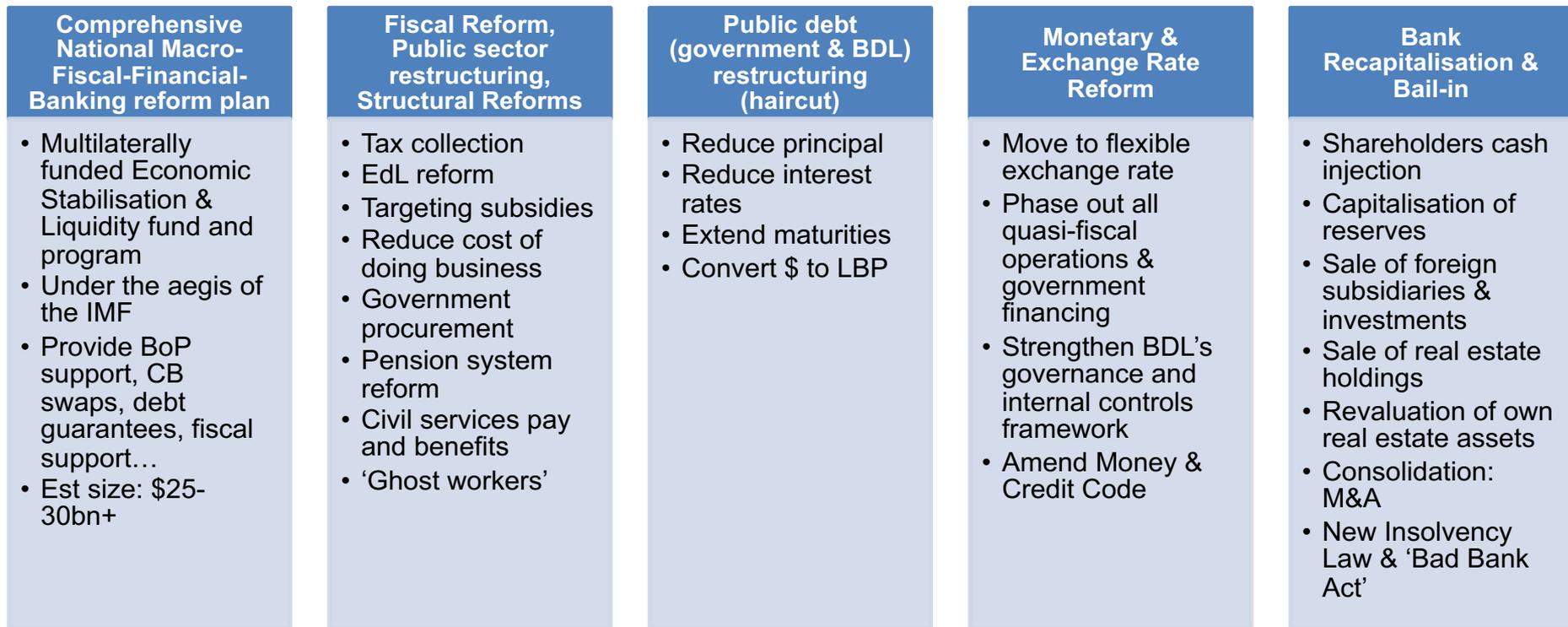
Lebanon: Macroeconomic Overview

Economy is collapsing: unemployment @ 35%; 80% currency depreciation; inflation @ 120%; Sharp fall in real wages & salaries; Poverty rate 50%+; Food poverty 25%+
Destruction of financial wealth

	2000-16	2018	2019	2020
Real GDP growth (%)	4.1	-1.9	-6.5	-20.0
Inflation (%)	2.3	4.6	2.9	115
Fiscal balance, % of GDP	-8.4	-11.3	-10.7	-15.3
Govt gross debt, % of GDP	n.a.	154.9	172.2	220
Gross external debt, % of GDP	173.1	192.8	196.3	240
Trade balance, \$ bn	-10.1	-15.1	-12.8	-5.6
Current account, \$ bn	-6.6	-14.7	-10.9	-6.8
Reserves, \$bn	20.9	36.5	31.8	18
GDP, USD bn	58.4	55.0	52.7	42

Source: IMF REO database, Apr 2020; no forecasts provided for 2021. Trade balance data extracted from IIF (May 2020).

Elements of a Credible, Sustainable Reform Program



Establish a National Wealth Fund to include all SOEs, GREs & future Oil & Gas Revenues

Anti-Corruption program and Stolen Asset Recovery Initiative (StAR)

Economic & Financial Governance

Establish a Social Safety Net

Political Governance; establish 3rd Republic

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