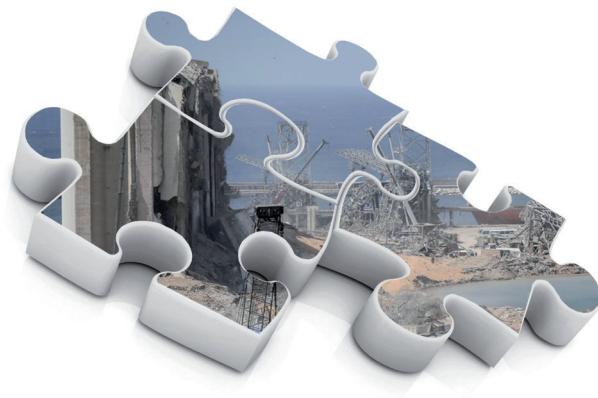




How International Aid Can Do More Harm than Good

The Case of Lebanon

Valentina Finckenstein



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Prior to the countrywide protests which hit Lebanon in late 2019, the country had long sat on the periphery of the world's attention. The political uprising and the detonation of 2750 tons of ammonium nitrate at Beirut's port on August 4th, however, have brought eyes back onto a nation that has long been in a process of decay. The devastating explosion which killed more than 200 people, injured 7000, and left 300,000 homeless struck at a time when Lebanon was already experiencing an unprecedented economic crisis that has left more than half the country living below the poverty line. To add to the misery, the country declared bankruptcy in March and its soaring debt-to-GDP ratio, which reached 194% in 2020, makes it among making it the most indebted country in the world in relation to its produce.

When, if not now, should the international community step in to lessen Lebanon's suffering? The shocking images of the explosion evoked a swift international response: Emmanuel Macron hosted a foreign aid conference just four days after, vowing to unlock \$350 million if strict reforms were enacted. In statesmanlike posturing that stood in crass contrast to the paralysis of Lebanon's leaders, the French President brought forward an ambitious reform plan. Its deadlines were remarkably unrealistic, however, in the eyes of those familiar with the numerous political bottlenecks of Lebanon. Repeating what previous reform plans suggested already, the tight time frame seemed to disregard any experiences with previous aid packages for the country.

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It is a familiar pirouette for any spectator of Lebanon's political dance: the country is in crisis, as a result the international donor community meets and promises money in return for reforms that often lack proper oversight and implementation. Indeed, Lebanon is no stranger to big aid packages. Next to substantial reconstruction inflows, the international community met in several major aid conferences for Lebanon—among them the Paris I, II and III conferences. The fourth one in this row, in an attempt to avoid the same name, was named CEDRE (Conference for Economic Development and Reform through Enterprises). Hosted in 2018, the funds remain locked to date due to the evident lack of reforms.

The Lebanese government's answer to the destruction of August 4th was one which had been rehearsed for decades—the very first speech of prior Prime Minister Hassan Diab being, first and foremost, a call for international help.

After the Civil War (1975-1990), Lebanon received a high volume of financial assistance, sometimes from its allies in the Gulf, at other times from the West or Iran. It is estimated that in the post-war period between 1993-2012, Lebanon absorbed up to \$170 billion of capital inflows. To draw a comparison, this is a greater figure than the entire Marshall Plan—the historic reconstruction package Europe received after World War II.¹ The data on foreign aid is hard to track, as it was (and is) not unusual for global players to channel money directly to their local allies, rather than going through official state bodies (where it is already difficult to trail all financial movements).

These sobering numbers stand in stark contrast to the country's poor infrastructure and withering economy. The Lebanese state is infamous for not being able to deliver the most basic services to their population. The capital provides no more than six hours of electricity daily. The train service has stood still since the Civil War, and apart

from a small fleet of mini-buses, there is no public transport for the 6.5 million citizens to get around the country. Lebanon possesses more water than any other Middle Eastern country, yet suffers from constant water shortages and high pollution levels. Lebanon has a young, highly educated population, but fails to increase domestic productivity. It also has access to the sea, is strategically located and sustains good international relations with most global players.

This calls into question the assumption that Lebanon is unable to function simply because it lacks the resources. It is a common narrative which is frequently applied by political players seeking international assistance who claim that the Lebanese state is ill-equipped to bear the weight of both the refugee and local population without it. This, however, is an overwhelmingly reductive argument.

1. Questioning the effectiveness of international aid

The above casts considerable doubt on the efficacy of all these aid inflows.² It touches on the popular dispute that has been going on between practitioners and academics alike for decades—Is development aid actually helping? Critics insist on foreign aid producing mostly reverse effects for developing countries—despite intending to help, the rich world may actually hurt the countries' economies and contribute to state corruption. This camp includes

prominent voices like Economic Nobel Prize winner Angus Deaton, a fierce opponent of most forms of development aid.

The latest empirical findings conclude that long-term foreign aid correlates with a surge in development.³ But such findings can be misleading, as working with cross-country aggregate data leads to a fallible overgeneralization. The immense gap in outcomes of similar development projects implemented in different country contexts is telling proof for this. Esther Duflo and Abhijit Banerjee, the Nobel Prize winners for economics in 2019 and two dominating figures in development economics, make the case that this debate cannot be solved in theoretical models, but must be assessed case by case.⁴ They are being joined by a growing group of researchers. As for the case of Lebanon, Deaton's assessment unfortunately appears to be more accurate than the argument of continuous progress through international help.

2. Sustaining the unsustainable

The past year has revealed, more than ever before, that the Lebanese political and economic systems are unsustainable. There are several indicators that suggest that foreign aid has postponed necessary reforms. Knocking on their international friends' doors to ask for money was the go-to-move every time the country was heading towards a new crisis. It became the main policy whenever financial instability was looming.

2.1 The delay of the economic crisis

The first big aid flows were funnelled to Lebanon in the aftermath of the 15-year Civil War ending in 1990. Reconstruction and aid projects were not a mere act of compassion: Donors could pursue their own strategic goals through carefully prioritizing regions, sectors and methods of aid disbursement. Funding development was one foreign policy instrument for external actors to strengthen and protect their allies on the ground.⁵

In the first years between 1992-1997, the priorities were set on reconstruction projects largely in Beirut. From 1997 onwards, however, Lebanon entered into a second phase where funds were redirected from reconstruction needs to fiscal stabilization. In other words, the money was mainly used to finance the government's negative balance of payments, to intervene in the foreign exchange market in order to stabilize the currency, and to reduce interest rates on public debt instruments. The constant foreign financial inflows allowed the government to lend credence to its economy. It increased international and domestic trust in the country's banks, thus allowing the continuation of carefree borrowing. This created a critical effect: a dependency on foreign aid for the stabilization of the Lebanese economy.⁶ In order to stock up its foreign reserves and continue with its unsustainable policies, international aid became a necessity.

In November 2002, the international donor conference Paris II unlocked billions of aid just before Lebanon was entering a financial and currency crisis, delaying the need for genuine structural reforms. In April 2018, CEDRE promised as much as \$11 billion only a few weeks before Lebanon's first elections in 9 years, as a result implicitly throwing their weight behind the incoming government and political class despite all signs of economic unsustainability. When the protests broke out in October 2019 and the extent of the broken economy became evident, resurfaced Prime Minister Saad Hariri made a Gulf tour to ensure—unsuccessfully—foreign aid.

2.2 Prolonging the game of corruption

Foreign aid has also played a role in keeping this entrenched Lebanese political structure alive. Ministries often function as ways to redistribute the budgets to the voting base of the different confessional-political groups in Lebanon's power sharing system. The various parties fill the gaps where the state does not provide social services, infrastructure, or education. As a result, they manage to sustain support and ensure re-election. Yet by filling them, they maintain structural deficiencies in Lebanese governance, creating a vicious cycle of disrepair and decay. By redirecting funds from the public budget towards their voters, they effectively hollow out the state, which in turn cannot provide any services to the citizens, therefore increasing the political capital of the confessional parties in power.

Through political appointments in the public sector, civil service bodies turn into patronage departments. This dynamic creates a strong incentive to keep the state small in order to make a voter base dependent.

The donors found themselves in a difficult situation. As big aid projects can hardly circumvent the government and the ministries in charge, foreign money often has to be funnelled through state institutions. In the game of soaking up resources, aid has been served to nurture the political system ever since the Civil War. Some donors are now vowing to bypass the state, which is often not possible, and rather increases challenges in coordination and effectiveness.

The tendering system in Lebanon leaves multiple opportunities for corruption as it lacks transparency and independent audits. Contractors inflate costs and bills for works that were performed at a substandard level—or never at all. Contracts are being amended or extended, while money drains away into pockets of political networks without being traceable. The banking secrecy law and the inaccessibility of data have compounded the problem. The Public Accounting Law (PAL) officially prohibits the creation of private accounts for any ministries or public administrations. This has not prevented several institutions from creating their own sub-accounts with which they are able to receive aid from donors. These practices complicate transparent reporting of international aid projects further.

It is hard to measure and identify corruption in aid given its covert and collusive nature. Nonetheless many indicators hint towards large scale corruption—not least the vast gap between aid influx on one hand, and the state of infrastructure and economic development on the other. Both the Office of the Minister of State for Administrative Reform in Lebanon (OMSAR) and Council for Development and Reconstruction (CDR), key government bodies in administering international aid and public funds, raise doubt on the competitiveness of

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their tendering over the last 10-year period, as the same names reappear on their lists. CDR's records, for example, show that they allocated the biggest share of projects to the same 10 companies in Lebanon.⁷ This practice indicates that bids are not fully open and exclude competitors.

The embezzlement of around \$30 million funded by the EU for recycling and compost factories is a good example to give an idea of this kind of aid corruption. An 18-month long investigation contends that this recycling management project was not only poorly implemented, but also produced considerable negative environmental effects.⁸ It claims that the invested money has not produced a single compost plant able to produce compost good enough to use for farmland. By commissioning companies to produce inoperable machinery at a fraction of the officially stated costs, parts of the funds are likely to have been diverted to political networks.

It is not uncommon for donors to lack interest in overseeing the reform progress after handing out money. The last big package of grants and soft loans made available, Paris III, proves this point: Although the Lebanese government enacted merely 22% of all promised reforms, the donor community unlocked more than half of all promised funds.⁹

3. Creating the wrong incentives?

The readiness of donors to help out so easily and swiftly whenever the Lebanese government asked for it sent a clear signal. It fed into the Lebanese self-perception of exceptionalism—that the international community will never leave behind the bastion of free speech, diversity and democracy in the Middle East. The easy availability of money created a negative incentive for the government not to enact real reforms. In this way, international commitment to Lebanon increased confidence that the state would not fail, which in turn attracted further investors and lenders.

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International donors and organizations in Lebanon provide basic services to the public such as building infrastructure and implementing waste and water management, often doing the job required (but ignored) by ministries or municipalities. This raises the question of how far development projects can also create a negative incentive for the government to step up to its state responsibilities and thus reduce state accountability.

The case can be made that donor countries have exacerbated Lebanon's governance gaps and indeed bear responsibility for keeping a government afloat by providing resources for its clientelist system. While intentions might have been well-meant, and undoubtedly many development projects served parts of the population, the long-term effects tend to look questionable. Development aid seems to have, at least to some degree, lessened the incentives for reforms, encouraged poor governance, and kept unsustainable institutions alive. This applies particularly to foreign funds coming from countries with very few accountability requirements, but also from donors with presumably high compliance standards such as the European Union.

The political structure in Lebanon is one of the major obstacles for effective development aid—and it is deeply entrenched. If there is one key takeaway, it is that Lebanon's ruling class has learned how to make superficial, small concessions to maintain their grip on power. One year after the protests, the same political

elite remains—Hariri is reinstalled as Prime Minister, while the former Foreign Minister and other known faces gamble for ministerial posts, delaying the cabinet formation that is of utmost importance. In November, the independent auditing firm Alvarez & Marsal withdrew as the Central Bank was not allowing a transparent, forensic audit. Lebanon finds itself in a deadlock, unable to reform, while heading towards state failure. The international community is not completely free of responsibility in this downward spiral. If they wish to help, as indeed they do, they must reflect on the lessons learned: abstain from funding development unless real reforms are implemented.

4. Next steps

The road to Lebanon's recovery—from the tragic explosion on August 4th and from the government's perennial mismanagement—will be long, and it is important for the international community to conceive of a strategic direction before rushing to embrace particular initiatives. This strategic direction must revolve around leveraging foreign support for domestic reform, and withholding it until these reforms are being implemented. Without tough but necessary conditionalities on aid, there can be little hope for lasting progress.

First, in order to see to proper domestic reforms and governance improvements, donors must permanently recalibrate their relationship with the Lebanese state. Many

donor countries and institutions have toughened their stance and are refusing to unlock any aid—a lesson learned that hopefully will not be forgotten anytime soon. Sovereign donors, and particularly international organisations, have the responsibility to play a much more diligent role in the funding and assessment processes of their projects. This includes insisting on transparent and coherent reporting, independent audits, and reforming broken bidding systems.

Given that the international community must first press for reforms which are not likely to be implemented any time soon, the second priority of the new strategic direction should prioritise direct humanitarian aid and abstain from convoluted development projects. Furthermore, it will be important for donors to find ways to bypass political elites by working with and through NGOs. Supporting NGOs and fostering greater communication, coordination, and data sharing between them will be necessary to get aid directly to Lebanese citizens and to circumvent the corruption and state capture that has absorbed so great a percentage of foreign aid.

The third priority ought to be improving coordination and knowledge sharing between donors themselves. Given the large number of sovereign, multilateral, and non-state aid actors in Lebanon, there is always a risk of redundant and overlapping projects. Creating platforms to promote greater collaboration between donors themselves will help to both set and pursue consistent development goals. Furthermore, donors should encourage the government to create a unified agency in charge of coordinating all aid efforts and integrating them into the government's own policy agenda.

The fourth and final priority, though perhaps the most important, is to increase consultations with civil society. The tragedy of Lebanese governance is, above all, the harm that has been done to the people. Lebanon's young, educated, and politically active civil society is the country's greatest resource. In order for any foreign donors to have any hope of success, they must do more to engage with and learn from the Lebanese people themselves. ■

NOTES

- 1 The Marshall Plan consisted of over 15 billion US-Dollars, approximately 142 billion US-Dollars at 2012 prices.
- 2 In the following, the term aid will refer to financial and material assistance in forms of gifts, soft grants and loans.
- 3 Radelet, Steven, The Great Surge: The Ascent of the Developing World (2015).
- 4 Banerjee, Abhijit, and Duflo, Esther, Poor Economics: A Radical Rethinking of The Way to Fight Global Poverty (2011).
- 5 While generally Western states and institutions would make financial assistance available for governance projects, Arab and Gulf State donors would prefer physical reconstruction projects, Hamieh, Christine and Ginty, Roger, A very political reconstruction: Governance and reconstruction in Lebanon after the 2006 war (2009), pp.103-23.
- 6 Ghassan Dibeh, Foreign Aid and Economic Development in Postwar Lebanon (2007), in: UNU-WIDER Research Paper 2007/37.
- 7 "In five governorates, two firms secured at least 45% of the total project value, and in three of those, the share of the top two firms exceeded 55% of total project value", Attalah, Sami et al., Public Resource Allocation in Lebanon: How Uncompetitive is CDR's Procurement Process? (July 2020), in: LCPS.
- 8 Jay, Martin, Growing Link between Lebanon's Cancer Surge and EU Abetted Corruption (May 2019), in: International Policy Digest.
- 9 Attalah, Sami, et al., CEDRE Reform Program: Learning from Paris III (November 2018), in: LCPS.

THE AUTHOR

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