The Impact of U.S. sanctions on the Lebanese Economy

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Introduction

Let me first thank Al-Bank Wal-Mustathmer Group for organizing this conference at a time when the impact of United States (U.S.) sanctions on the Lebanese economy is taking a critical stance. It is not news anymore to say that there is a new draft law being discussed by the U.S. congress regarding the tightening of sanctions on Hizbollah and its allies.

Since the financial crisis of 2008, the U.S., followed by the OECD and Basel, have been imposing lots of regulations on the financial sector targeting not only terrorism but also tax evasion, financial corruption, and financial soundness. The U.S. had issued the Foreign Account Tax Compliance Act or FATCA in 2010, which increased the compliance costs of banks. The OECD followed recently with the Global Account Compliance Act or GATCA also known as Common Reporting System. Moreover regulations have been issued to try to counter any future financial crisis, which comprised more restrictions on the work of financial institutions and required higher standards regarding adequacy and other ratios.

Hence the compounded impact of these regulations with the sanctions had a large impact on banks as they had to increase their capital, along with their increased costs in order to comply with all the new regulations. Banks worldwide suffered from the tightening regulations and had to take drastic measures in order to comply. In Lebanon the central bank issued several circulars to align the Lebanese regulations with international standards and banks had to gradually take the necessary steps to comply with the latter.

Sanctions goals

Putting aside tax evasion and other issues, sanctions goals can be to force a country to change its behavior or to alter the behavior of some individuals, and can have different levels and targets. Sanctions can target a country as a whole, as in the case of an embargo on a country's exports (e.g. U.S. sanctions on Cuba). They can target specific industries, such as an embargo on the sale of weapons or of petroleum.

Sanctions may also target individuals, such as political leaders or large businesses in order to cause financial difficulties for these individuals rather than impacting a country's population. An example is when the U.S. targeted Putin and businessmen in his inner circle following the Crimea crisis. This type of sanction strategy is most likely to be used when there is a clear identification of the targeted individuals who constitute a small circle that holds control of political and economic power in the concerned country, and which has worldwide financial interests.

Literature overview on the impact of sanctions

There is a large literature covering the economic impact of sanctions, but we will only list few. “Wood (2008) provides empirical evidence that the imposition of sanctions increases state-sponsored repression and suggests that these sanctions contribute to worsening humanitarian conditions of the civilian population. Peksen and Drury (2009, 2010) find that the imposition of economic sanctions curtails political and civil rights of the citizens, thereby resulting in deteriorating democratic freedom while Drury and Peksen (2014) highlight the economic vulnerability of women as a result of economic sanctions. Ali and Shah (2000) find that the United Nations (UN) sanctions on Iraq resulted in more than doubling its effect on infant and under-five mortality rates. Garfield and Santana (1997) on the other hand, find that the US sanctions against Cuba contributed to a fall in nutritional value, rising infectious diseases, and violent deaths for the adult and aged population”. As a result of these various impacts, different segments of the population may suffer varying degrees of income loss under economic sanctions.

Even if sanctions have a deleterious impact on the targeted country or entity, like increasing inequality and pushing up inflation, sanctions never fulfilled the intended goals by themselves. Always a military action has followed when there was American vital interest. We will mention few examples: sanctions didn’t make Iran abide by international law, didn’t make Russia withdraw from Ukraine, and didn’t take down Fidel Castro. Sanctions also didn’t weaken Gaddhafi, and didn’t make Saddam withdraw from Kuwait but they impoverished the populations of both countries.

Studies found the sanctions increase anti-American sentiment among the population directly hit by these measures. The problem is that when sanctions are imposed, political leaders will not get hit personally but they will curtail freedom and adopt a different system to survive, which will have a negative effect on the whole economy, by increasing income inequality and creating monopolies and oligopolies.

Overview of sanctions impacting Lebanon

The US congress has approved a law in 2015 to tighten the grip on the financing of Hizbollah. In fact, US President Barack Obama signed the Hizbollah International Financing Prevention Act of 2015, on Dec. 18, 2015, imposing sanctions on foreign financial institutions that deal with Hizbollah and its affiliated Al-Manar TV channel. The Office of Foreign Assets Control issued a list comprising around 100 names that the U.S. consider as related to Hizbollah with addresses in Lebanon.

The U.S. has designated Hizbollah a terrorist organization since 1995. The group remains on Foreign Terrorist Organization and Specially Designated Terrorist lists. The first large victim of the U.S. sanctions was the Lebanese Canadian Bank. It was one of the top five banks in Lebanon when the U.S. designated the bank as laundering money for terrorist organizations, namely Hizbollah. An organized acquisition of the bank was orchestrated by the central bank with the buyer being Société Générale.

The U.S. has imposed sanctions on Syria too, and it has issued several executive orders to widen the scope of these sanctions. In addition to the fact that Syria was put on the blacklist of countries sponsoring terrorism since 1979, executive orders have been issued starting 2004, to widen the scope of these sanctions. In 2004, the executive order implemented the Syria Accountability and Lebanese Sovereignty Restoration Act of 2003. When the war erupted in Syria in 2011, the U.S. administration added "calibrated sanctions in order to increase the pressure on the Syrian regime and its officials prohibiting the exportation or sale of services to Syria by U.S. persons, prohibiting the imports of petroleum or petroleum products of Syrian origin, and prohibiting U.S. persons from involvement in transactions involving Syrian petroleum or petroleum products". Recently, during the Trump Administration, the U.S. has more than doubled the number of individuals and entities sanctioned since the start of the Syrian conflict pursuant to Syria-related executive orders.

Impact of Sanctions

Many reasons stay behind the large impact of these sanctions on the Lebanese economy. First Syria is a neighboring country and therefore trade and economic relations between the two countries are historically strong. Second Hizbollah and its supporters are part of the Lebanese society. Third, because of the previous two reasons, the U.S. has its eyes wide open when it comes to applying these sanctions in Lebanon while they didn't put too much emphasis on other countries like Turkey or GCC countries.

For Lebanon, the financial sector was concerned with all these laws and had to absorb in a record time these sanctions, in addition to the FATCA and GATCA. Therefore the cost of compliance of banks has ballooned and their "Know Your Customer" (KYC) forms have become a hassle for their customers with increasing paperwork and continuous additions and changes with the need of customers' signatures at each change.

As mentioned in the literature review, sanctions will have an impact on economic growth. Growth will decline as people hit by the sanctions may move their businesses to other parts of the world. Of course when the sanctions are against a country and multi-lateral, the economic impact will be maximized. When sanctions are against individuals and unilateral, the economic impact will be lesser.

Because of the sanctions on Syria, Lebanon could not benefit from the capital and business outflows out of Syria after the eruption of the Syrian war in 2011. Starting that year, businessmen began to flee Syria with all the cash and wealth they could bring in order to establish their businesses elsewhere. Unfortunately, U.S. sanctions came in March of 2011 and another batch was added in August and therefore Lebanese banks were reluctant to accept any transfer or deposit from Syrian nationals. Lebanese banks applied the sanctions even before their correspondent banks. Hence the Lebanese economy had to bear the negative impact of the war in Syria, including the refugees' crisis and the decline in tourism, while at the same time the economy was unable to benefit from the inflow of wealthy Syrian individuals, who were more than welcomed in other countries in the region.

Why the Lebanese banks were very keen on quickly abiding by the sanctions? Simply because the Lebanese economy is dollarized and Lebanese banks could not function without their U.S. correspondent banks. 65% of deposits in Lebanon are in US dollars, and 72% of loans are denominated in U.S. dollars. Therefore Lebanese banks are in need of correspondent banks in the U.S. to clear their transactions in U.S. dollars.

Sanctions and other regulations that have been adopted following the financial crisis of 2008 contributed to the weakening of the concept of banking secrecy. Of course the latter remains but the area covered by the banking secrecy is shrinking to the benefit of more transparency.

Another repercussion of the sanctions is the expansion of the informal economy. As we saw with money laundering regulations, people and businesses hit by the sanctions will use informal means to transact and preserve their businesses. Some will be more creative and find other ways to launder their money and get it back to the formal system.

Regulations are always trying to catch up with innovations. Let us face reality; regulators will never be able to close all the doors of money laundering. It is comparable to the financial regulations that ensued following the financial crisis with the main goal to prevent future crises from happening: do we really think that financial crises will never happen again? Nobody is so naïve to think so.

Differentiation between U.S. and European Union (E.U.) sanctions

It is important to differentiate between the E.U. and the U.S. sanctions against Hizbollah . The EU seems to have been more realistic and knows better the specificities of the Lebanese situation. The EU applied the sanctions on the armed wing of Hizbollah while the U.S. applied the sanctions on the whole Hizbollah party and related businesses.

Knowing that there is a large support for Hizbollah especially among the shia community and an involvement of the party in the political activity, any widening of the sanctions to comprise more individuals and entities could have disruptive impact on the Lebanese economy as a whole. Hizbollah is a political party having ministers in the government and members in the parliament, which gives more importance to differentiation between the armed wing and the political one.

Conclusion

In Lebanon it depends how the last round of discussions about sanctions on Hizbollah and its allies will evolve in the U.S.. The more the sanctions expand, and the more their impact on the economy, because they may eventually increase unemployment if some companies were obliged to close down. They may also disrupt the trade chain in the country and will increase compliance costs on banks.

Hence the importance for the Lebanese authorities at all levels, in addition to the Association of banks to lobby for toning down these sanctions. Dialogue with the U.S. administration and congress is the only way to try to explain the Lebanese situation and the importance of preserving stability in the country. Explaining the Lebanese system and the specificities of the situation will help as it did the previous law of 2014-2015.