GSR

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A Not So Invisible Hand

Deep Within the Lebanese Black Market

Appendix

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Report Appendix

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Economic perspective

To understand the Lebanese black market, one must remove many assumptions within economic models. Firstly, most businesses are unregistered to evade taxes, as the country has gradually slipped into a shadow, unregulated economy. The legal market still plays a significant role in economic activity, despite being minimal within the overall Lebanese economy. This appendix endeavors to familiarize us with new models that depict the dynamics of the interaction between the black and legal market.

The Lebanese people have been stuck in a paradox, where, despite the crisis, it seems that US printed dollars are becoming very abundant within the hands of the people. Evidently, traditional economic theories were not able to explain this phenomenon, and clearly failed to provide an empirical modeling of the situation. No one expected the black market of a given nation to have such magnitude, and its abundance and clear presence facilitated the understanding of its dynamics. It was not so invisible after all.

The Lebanese economy can be allegorized with an iceberg; while the GDP and state are only aware of its tip, there are millions of transactions happening beneath the surface. The hidden part of our economy is currently significantly larger than the legal sector. This appendix will serve as a handout for the new relations that we have identified and will be referenced from time to time to justify our cause and effects analysis further on.

1.1) A shadow economy:

The concept of a shadow economy was first introduced in the 1970s, as the black market and tax evasion became more and more common. It became popular after the Allingham and Sandmo publication of a Theoretical Analysis of Tax Evasion.[1] Nowadays, the shadow economy refers to transactions and economic activities that are happening 'under the radar' that cannot be directly traced and registered. [2]

However, for accuracy, one must understand how this shadow economy interacts with the surface economy. The shadow economy has many similar axioms with the legal economy, yet the only true difference is within the demand curves for shadow goods[3]. Although non-satiation, completeness, and transitivity are still present, our current economic analysis fails to state the inter-effect of both economies. The black market and legal market each have their independent prices, cash flow, and exchange rate[4]. However, since money is originally printed and injected into the legal market, the shadow has to interact with the surface in order to have its own cash flow. We can conclude that these two economies are not as independent of each other after all.

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[1]Michael G. Allingham and Agnar Sandmo, "Income Tax Evasion: A Theoretical Analysis," *Journal of Public Economics* 1, no. 3–4 (1972): 323–338.

[2] Friedrich Schneider, "Shadow Economies Around the World: What Do We Really Know?" *European Journal of Political Economy* 21, no. 3 (2005): 598–642.

[3] Vito Tanzi, "The Underground Economy in the United States: Annual Estimates, 1930–1980," *IMF Staff Papers* 30, no. 2 (1983): 283–305

[4] Edgar L. Feige, The Underground Economies: Tax Evasion and Information Distortion (Cambridge: Cambridge University Press, 1989).

1.1.1: Wheel Visualization

To understand the dynamics between the surface and the shadow, we had to visualize two wheels. Each wheel has a certain amount of paper or coin money flowing within it at a certain multiplier. These two represent the black and legal market, however, money can be taken away from one wheel to another, which brings us to the idea of inter-affection.

Taking it in a real life scenario, the shadow is always nurtured by the surface. Since the money has been printed and registered by a specific central bank, this legal tender is derived from legal and governmental entities. However, illegal transactions were able to create a new shadow market. This gave birth to the black market wheel, a hidden economy that interacts with our current wheel. As mentioned before, the money spinning in each wheel is independent from the other. However, whenever someone commits an illegal transaction, they remove some money from the legal wheel and insert it into the black one, thus bringing more money to use in the shadow and less in the surface.

Money however would not be of any use if it circulated only within the black market. Whenever criminals, for example, purchase luxury goods, or even a chocolate bar, they are taking some shadow revenue and injecting it into the legal market. In this analysis, we generalize the concept of money laundering by defining it as any legal transaction that has been achieved using black market revenue, including opening a black market bank account. This simplified visualization can be seen in the following model.

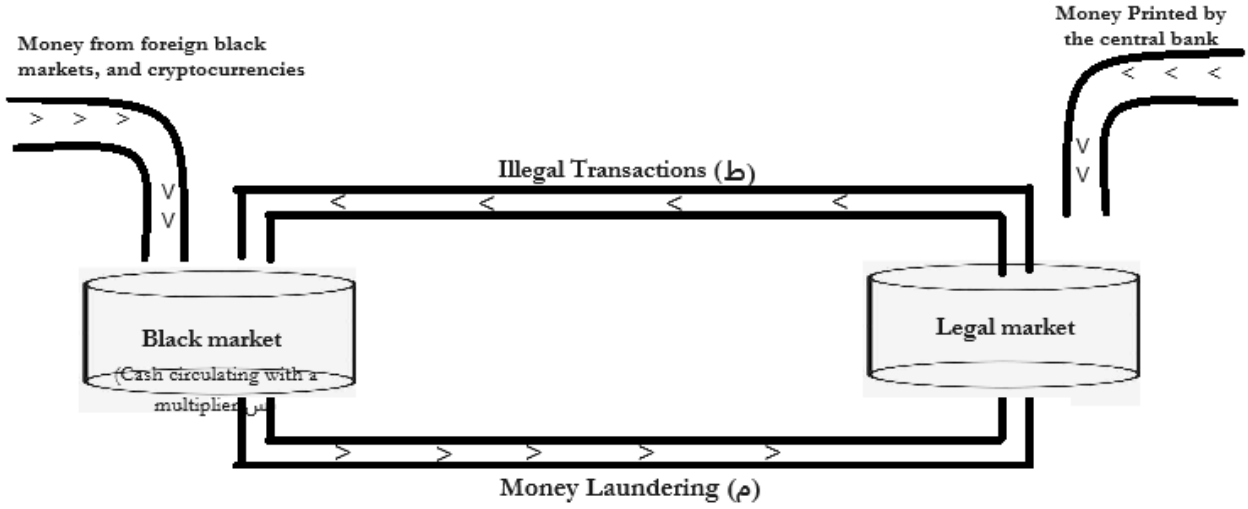


Figure 1.1: Visualization of the interaction between the shadow and the surface, contributed by Elie Joe J. Akiki (Head-Researcher), Leen S. Jannoun (Head-Researcher), and Samer W. Sayyour (Senior Researcher)

The black market however, finds alternative ways to get nourished, especially with the introduction of cryptocurrencies and its borderless network with other countries. In the end, black market households interact with each other from every corner of the world. The above model will

be elaborated further on, going into the specific details of each variable. However, the simplification of the scenario opened up new conclusions to the monetary base dependencies.

1.1.2: Monetary base contrast

In traditional economics, we have learned that the monetary base of a certain economy is determined by the central bank[5]. However, it was not accounting for the shadow economy and its effects. Now that we have established the relation between the two economies, we can deduce that the monetary base of the surface is dependent on a certain ratio of money laundering and illegal transactions. We can visualize a box that can provide us with some coordinates, and the aggregate direction of the money flow.

The طام ratio can be visualized within a box, limited by the monetary base of the surface and the shadows and depicting 4 extreme scenarios:

1) No money laundering nor illegal transactions.
2) Full money laundering (100% =م) and no illegal transactions (0% =ط).
3) Full illegal transactions, and no money laundering.
4) Full money laundering and illegal transactions.

Maximal money laundering would correspond to the monetary base of the black market, and optimal black market would align with the MB of the surface, as there is no more cash in either of these extreme scenarios.

Moreover, طام would have a neutral effect alongside the 'red line' as the ratio would be equal to one (y=x), and thus, the monetary base of the surface would actually be decided by the central bank. Below the red line would mean an illegal transaction rate larger than a money laundering rate, causing the flow of money to aggregately move from surface to shadows. Therefore, the expected MB would be larger than the actual MB. However, above the red line would be scenarios where money laundering would possess a higher magnitude than illegal transactions, causing the actual MB to be bigger than the expected one, as the money flows aggregate shift from shadow to surface. This would explain the hyperinflation and calculations fallacies that happened in Lebanon during the devaluation of the Lebanese lira. The closure of the banks in 2019-2020 nullified the risks of money laundering, thus causing massive cash outflow going from shadow to surface and creating an actual

[5] Frederic S. Mishkin, *The Economics of Money, Banking, and Financial Markets*, 12th ed. (New York: Pearson, 2019).

monetary base within the surface way higher than expected.

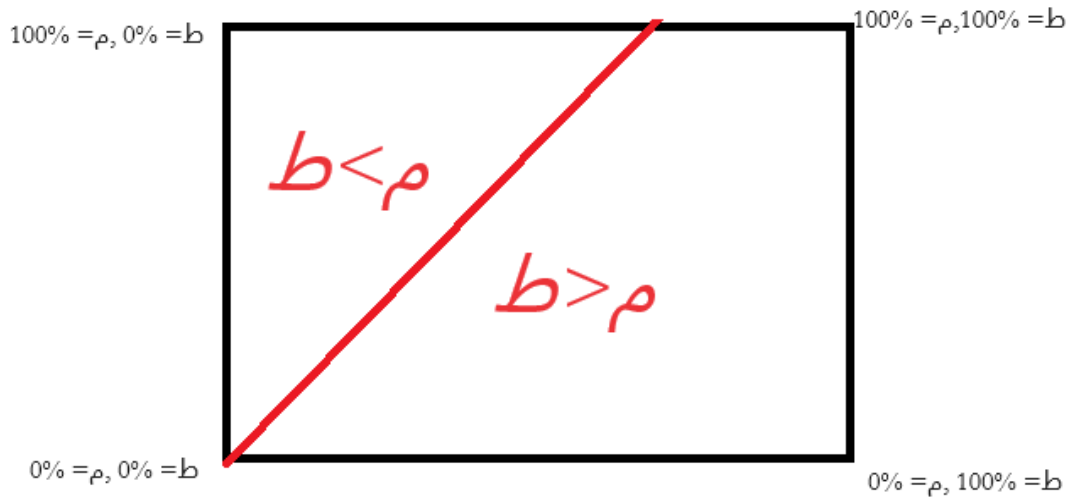


Figure 1.2: The box was designed by Elie Joe J Akiki (Head-Researcher), creating new coordinates to figure out the aggregate direction of money

1.1.3: Cash outflow

When we talk about the shadow, we are referring to transactions that are hardly traceable. This narrows our study to the purchasing power held in cash, as overall bank deposits would be easily traced and conventionally part of the surface.

People have a certain aggregate cash over deposit ratio, which shows how much of the current population holds money in cash, and thus how much money is vulnerable to the shadow. Banks give us data on how much our population tends to save through the marginal propensity to save. By knowing their income and their saving rate, we can derive new equations that consider interaction with the shadow.

Let us denote 'cir' as the cash over income ratio, which would give us how much money is vulnerable to the shadow. We know that cir + dir = 1, where dir is the deposit over income ratio, as all income is either deposited in bank accounts or held in cash.

The vulnerable amount of money would be cir * I , where 'I' is denoted as income. Now this cash held by households can either be saved, which can be determined using the "marginal propensity to save" of the population, or can either be consumed, either legally or illegally. However, our current days depict the type of transactions in the legal market, so the transactions in cash are benignly registered. While we have an idea about how much the population is saving and consuming legally, where does the remainder go? To the shadow…

Our final equation of the cash outflow dynamics (using micro-level data from Census, PSID, and CCF) shows us the amount of money getting into the shadow:

cir*I = MPS*cir*I + ط + ل

where

- ل would be the variable of the aggregate legal transactions done using the cash economy, and
- ط would be the remainder, which if not legal consumption or saving, represents money entering the shadow economy annually.

1.1.4: A new kind of multiplier

Now that we have completely concretized the relation between the shadow and the surface, let us analyze what is going on within the shadow. Economic concepts are applicable to the shadow, as it is considered a complete laissez-faire economy. However, the shadow does not possess any kind of legal entity like the banks or the federal reserve. Just like households keep some deposits and there is a certain reserve ratio, the black market operates in a parallel way.

With the rise of cryptocurrency, we must get in the shoes of some kind of cartel lord to understand how the shadow creates reserves. It is either with commodities or self-reserved cryptocurrencies. While bitcoin serves as both a saving and a transaction tool, its non-regulation can lead to making it more of a transaction than a store of value.

So here we have it: We know that the money multiplier is the money supply over the monetary base. However, in this case, the monetary base would be the integral crypto-currencies (B), and shadow cash ©. The money supply would seem like an infinite chain of exchanging legal tenders, but the ratio of commodity purchasing and the cryptocurrency would give this multiplier an endpoint, despite actually being huge.

We denote س as the black market multiplier, and would define how many times a certain paper money would be used as a medium of exchange, or in other words, how dirty a 100$ bill can get.

$$س = (C + B)/ (C + B + G)$$

where G would be a commodity reserve. As we can see, the multiplier is more of a dividend rather than a multiplier as it may reduce the cash flow, in case.

1.2) Towards maximal utility:

Two aggregate economies have turned out to be interacting within each other, though the exact premise of their relationship remains unclear. This section endeavors to analyze how the individual would interact with both markets, and how much they would lean towards one versus the another. Using utility curve analysis, we can get an idea on how the population of a certain country chooses between the surface and the shadow, with a study on the overall costs that they would endure and the benefits they would get.

In these kinds of scenarios, costs are mostly an allegory of any type of risk; the higher the risk, the higher the cost. In a real life scenario, we can assume that certain individuals would lean towards the shadows if it is more profitable and the government is not doing anything about it. We

would start with a new idea of budget constraints and introduce new concepts that were derived from current classical economic theories to finally assess how we make our choices between shadow and surface.

1.2.1: Concretizing a Cobb-Douglass indifference curve

The Cobb-Douglass indifference curve has been the main model used by economists to easily assess how people make decisions. Let us define black market goods as C, and the legal market goods as L.

f(C,L)= L^a * C^ (1-a) where a is the share of economy being legal, and the rest being shadow 0<a<1

The model would be constrained by the whole money flowing in the economy. Assuming maximization of utility (because why would they not?), we can have a certain idea about the percentage share of the black market in the whole economy.

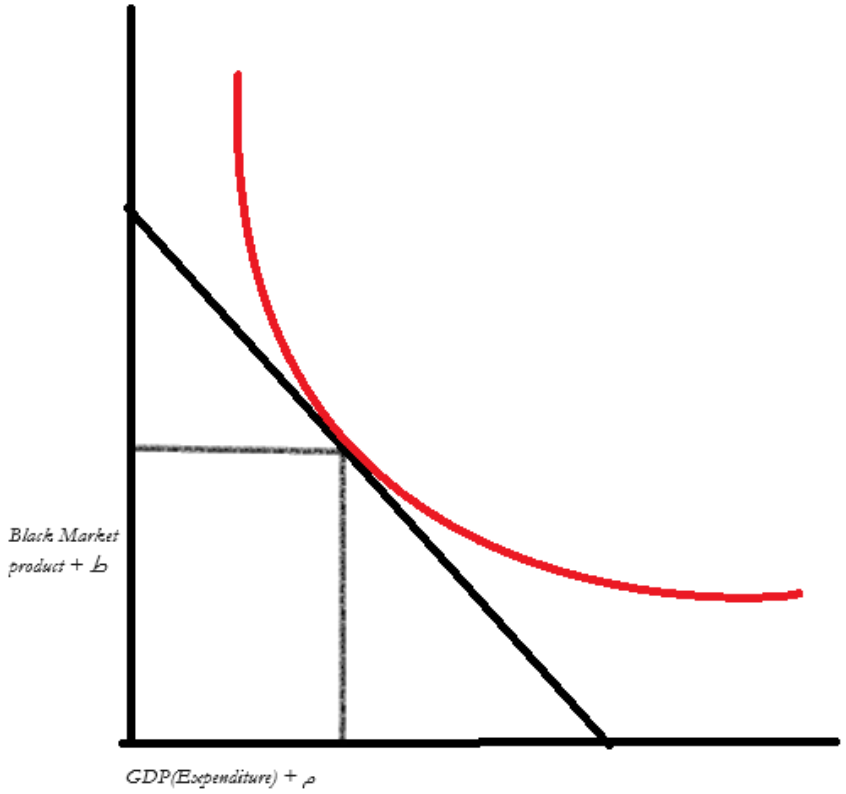


Figure 1.3: The aggregate indifference curve of a certain population leaning towards black and legal market.

The above model shows us the constraint and highlights how we can define the midpoint and the maximal utility point further on in our studies. This part is essential to assess how we can make people lean more towards the surface than the shadow.

1.2.2: 3d relation of money market

Economic models have long studied how much we save and how much we consume based on utility analysis. With the introduction of the shadows, we can now have a 3d assessment with an individual indifference curve being dependent on their savings (S), their legal consumption (L) and illegal consumption (C).

This aims to study the population on a micro-level to give maximal data assessment and then make groupings to understand how to target every particular group.

The utility function would be in the model f(S,C,L)= L^a * C^b * S*(1-a-b) where 0<a<1 and 0<b<1 and 0<a+b<1

The indifference curve would have the following model and would give us each person's marginal propensity to save and to consume.

1.2.3: Introducing marginal leniency

Just like marginal utility has been introduced in order to define preference of a good over another, marginal leniency towards black (MLBM) or legal (MLLM) markets would be defined similarly.

As we aggregately derived the indifference curve of a certain population, its derivative based on C gives us an idea on how much they would lean towards the black market, while its derivative based on L quantifies how helpful the legal market is to them. The many factors that may affect these two will be defined later on in the econometric variables. Most importantly, the marginal leniency tool is more than essential to assess many new variables according to the laws of opportunity cost.

1.3) Money laundering and illegal transactions relations:

So here we have it, people make decisions on whether to invest in surface or shadow markets depending on the amount of satisfaction obtained. However, the laws of opportunity costs define the amount of money laundered and the level of illegal transactions committed aggregately.

As we dig deeper into this section, we will have a more concrete idea on the various rates of currencies going in and out of the surface. We will also come to discover how the surface can make itself the powerplant of the shadow, constantly affecting it and exploiting it for its own benefits.

1.3.1: The laws of opportunity costs

Opportunity cost in economics refers to the loss of potential gain from other alternatives when one alternative is chosen. Using our derivations of marginal leniency towards the black market (MLBM) and marginal leniency towards the legal market (MLLM), we can find the opportunity costs in the black market by equating them to the money laundering and illegal transaction rates.

By equating MLBM =م , (our illegal transaction rate), we can estimate the opportunity cost of illegal transactions. This calculation allows us to understand the potential gain that could have been achieved if these funds were invested in legal and productive activities, providing a new perspective on the economic impact of illegal transactions.

By equating MLLM =ط , (our money laundering rate), we derive the opportunity cost of money laundering. This can be interpreted as the trade-off that a criminal organization makes when they launder money. Making such illicit gains appear legitimate outweighs the potential costs, such as the risk of detection and the financial penalties associated with being caught.

1.3.2: Budget constraining

Considering we introduced an idea about the opportunity cost relating to the utility of both the legal and black markets and are further developing the leniencies towards the shadows and the surface, we can start budget constraints and create a transaction frontier between the shadow and the surface. Figure 1.2 gives us the context on the طام ratio, and knowing the laws of opportunity cost, a new frontier will show up with the exact same indifference curve as figure 1.3.

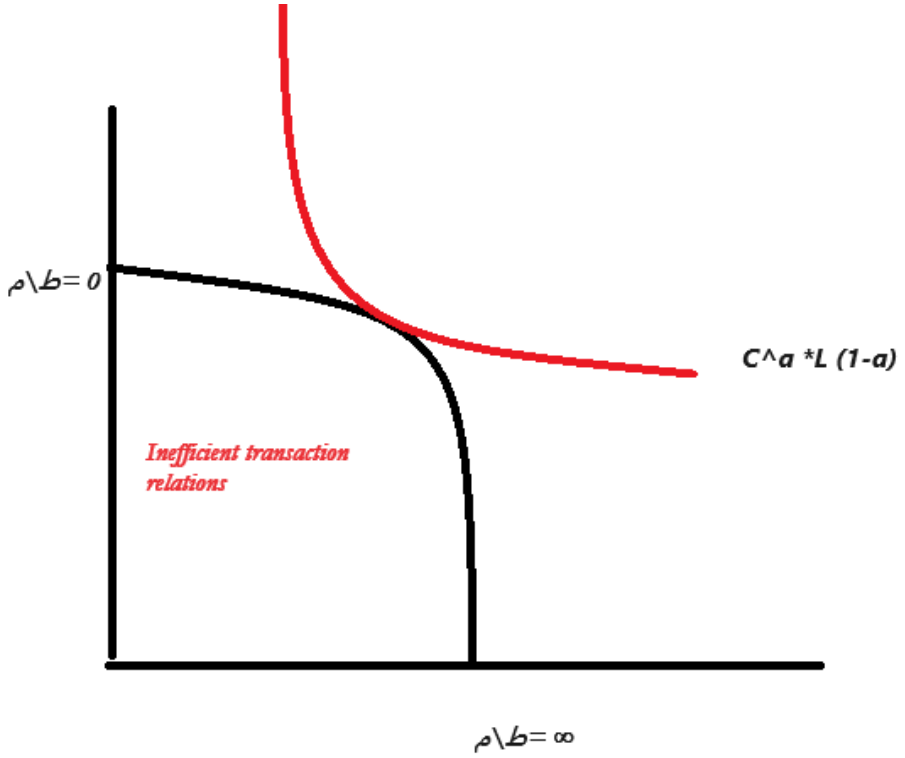


Figure 1.4: Design of the utility maximization based on the illegal transaction and money laundering rate. Designed by Elie Joe J. Akiki (Head-Researcher)

Figure 1.4 shows us the constraint of the طام ratio to maximize utility, and thus, we can deduce a certain placement and continue concretizing a black market index. Knowing that the slopes must be equal to each other to maximize utility, this can be done through a direct Lagrange theorem.

1.3.3: Black Hole and devaluation rate

Now that we have witnessed the various dynamics between the shadow and the surface, we can finally affirm that the black market is not as independent from our current legal market.

Moreover, the cash economy circulating is coming from a certain legal entity, which has absolute control over it. Currencies have been introduced to society to measure someone's purchasing power. In the end, money is nothing more than ink and paper. If it came without an order from above that defines this typographic object as happiness of the highest good, then it would be rendered valueless. So in the end, can the surface actually influence the shadow monetary base?

Let's take the example of Lebanon in 1998. While the government maintained the same currency with the same values back then, it decided to change the money's markings and overall design. This meant that the papers that were circulating in the shadows were no longer the symbol of the Lebanese pound, and thus, the overall black market lost part of its monetary base. This brings us to a final conclusion.

The black market is a black hole full of purchasing power, whether it be gold, currencies, or cryptocurrency. However, there is a certain devaluation rate in the world that reduces the overall currency circulating in the economy. In an extreme scenario, if the whole world devalues and cryptocurrency loses its currency value, this would force the shadow to sell its savings in commodities to reintroduce paper and mediums of exchange in the black market.

The black market needs money spinning in order to survive. Let us denote the devaluation rate as ق , where the black market monetary base would actually be قxMB. Within the following scenarios, we can assume some proportionalities.

A rise in ق would lead to a rise in illegal transactions which means a decrease in money laundering, and vice versa.

1.4) Measuring leniency towards legal and black market:

This section specifically tackles the junctures between legal and black markets. Through using econometrics models, we are therefore able to identify the multiple indicators which reveal the proportional dynamics and interactions pertaining to formal economic structures and illicit economics, which is observable from multiple focal points. Whether it is observed through corruption index, cash ratio, or overall security and prosperity, all of these measures are equivalent to the "external costs of a leniency". We can deduce here the many graphs which can later be used to quantitatively assess how we can make the country more legal and the economy more prosperous. With the defaulting of both the central banks and the government, this part will also introduce the confidence index, designed to capture levels of anarchy and the perceived credibility of the legal market.

1.4.1: Econometric relations

Regression Models for Market Participation Rates

Model 1: *Black Market Participation Rate Regression*

Variables:

- Corruption Index: Reflects the level of corruption in the police force and other authorities, proxied by Transparency International scores or similar metrics.
- Average Authority Salary: Represents the salary progression levels of police and other relevant authorities. Higher salaries are hypothesized to correlate with lower black market participation.
- Frequency of Authority Audits: Showcases the frequency at which authorities are checked for discrepancies, potentially reducing corruption and black market activity.
- Severity of Punishments for Black Market Activities: Assesses the average prison sentences or fines for participating in the black market.

Model Equation:
Black Market Participation Rate = $ß_0$ + $ß_1$ Corruption Index + $ß_2$ Average Authority Salary + $ß_3$ Frequency of Authority Audits + $ß_4$ Severity of Punishments + ε

Model 2: *Legal Market Participation Rate Regression*

Variables:

- Economic Growth Rate: Encourages more participation in the legal market.
- Investment Rate: Elevated investment levels indicate a more conducive environment for legal businesses.
- Tax Rates: Competitive tax rates can incentivize businesses to operate within the legal framework.
- Availability of Financial Incentives for Legal Businesses: Encompasses subsidies, grants, or other support mechanisms available to businesses in order to encourage legal business activity .

Model Equation:
Legal Market Participation Rate = $ß_0$ + $ß_1$Economic Growth Rate + $ß_2$Ease of Doing Business Index + $ß_3$Tax Rates + $ß_4$Availability of Financial Incentives + ε

Model 3: *Black Market Exchange Rate Regression*

Variables:
Dependent: black market exchange rate
Independent: Official Exchange Rate, Inflation, Unemployment, GDP

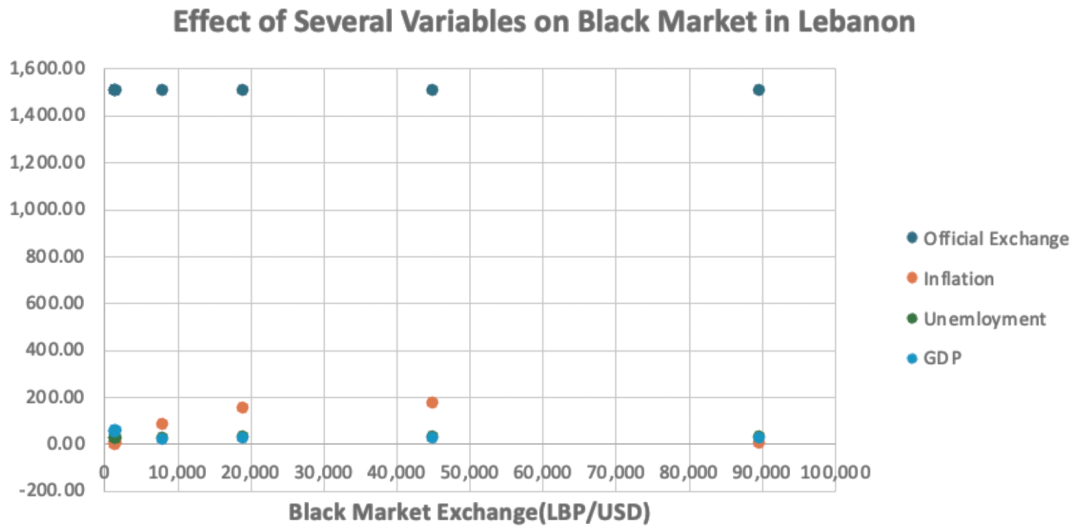
Equation: Y = β0 + β1OfficialExchange + β2Inflation + β3Unemployment + β4GDP

Year	Black Market Exchange Rate (LBP/USD)	Official Exchange Rate (LBP/USD)	Inflation Rate (%)	Unemployment Rate (%)	GDP (USD Billion)
2023	89,700	1,507.50	0	30.3	21.5
2022	45,000	1,507.50	171.2054913	29.6	23.1
2021	19,000	1,507.50	154.756096	27.5	21.8
2020	8,000	1,507.50	84.86433305	25.7	19.2
2019	1,600	1,507.50	3.005389494	25	55
2018	1,507.50	1,507.50	6.076989079	24.8	57.7
2017	1,507.50	1,507.50	4.321352183	24.5	53.7
2016	1,507.50	1,507.50	-0.7833596244	24.3	52
2015	1,507.50	1,507.50	-3.749145248	24	51.8
2014	1,507.50	1,507.50	1.854604213	23.8	53

Regression Statistics	
Multiple R	0.9935041599
R Square	0.9870505157
Adjusted R Square	0.9766909282
Standard Error	4434.085953
Observations	10

	df	*SS*	*MS*	*F*	*Significance F*
Regression	4	7493162049	1873290512	95.27894039	0.00006617035613
Residual	5	98305591.17	19661118.23		
Total	9	7591467641			

	Coefficients	*Standard Error*	*t Stat*	*P-value*	*Lower 95%*	*Upper 95%*	*Lower 95%*	*Upper 95%*
Intercept	-299199.2967	33641.61961	-8.893724505	0.0002990796	-385677.833	-212720.7604	-385677.833	-212720.7604
Official Exchange Rate (LBP/USD)	0	0	65535	0	0	0	0	0
Inflation Rate (%)	-212.8865856	31.53180512	-6.751487418	0.05	-293.9416711	-131.8315001	-293.9416711	-131.8315001
Unemployment Rate (%)	13028.20263	1069.02967	12.18694205	0.0000657657	10280.17438	15776.23089	10280.17438	15776.23089
GDP (USD Billion)	-313.7118494	180.7634624	-1.735482632	0.1431761195	-778.3791223	150.9554235	-778.3791223	150.9554235



Interpretation of results:

Based on the obtained regression results, the 2 most significant variables influencing Lebanon's black market activity are inflation and unemployment rate, as both have p-values less than or equal to 0.05, indicating statistical significance

The official exchange rate and GDP, although included in the model, exclusively display non-significant P-values, suggesting they do not significantly impact the black market rates based on this dataset.

The negative coefficient associated with inflation implies that when inflation rises, the black market exchange rate falls, contrary to expected norms. We can therefore infer that the inverse relationship is attributed to the surge in demand for US Dollars during periods of elevated inflation, directly placing downward pressure on black market exchange rates. Conversely, the positive coefficient indicates that greater unemployment rates are substantially correlated to elevated black market exchange rates, most likely because economic hardship drives more individuals to participate in the black market.

1.4.2: Measuring magnitudes

Model 1:

It is designed to analyze factors influencing black market participation

Model 1 Variables: Corruption Index, Average Authority Salary, Frequency of Authority Audits, and Severity of Punishments are selected based on their potential impact on the perceived risk and attractiveness of engaging in illicit market activities.

Model 2:

It aims to understand the drivers of participation in the legal market.
Model 2 Variables: Economic Growth Rate, Investment Rate, Tax Rates, and Availability of Financial Incentives, all of which are likely to affect the profitability and appeal of engaging in the legal market.

Both models help identify critical determinants influencing market participation, providing a basis for guided resource allocation and regulatory focus. These models are used to simulate potential impacts of policy changes on market participation rates, aiding in informed decision-making. The goal is to provide actionable insights to policymakers to design strategies promoting legal market activities whilst curbing black market transactions.

1.4.3: Lack of confidence and rise of the Black market

The country currently faces extensive economic challenges such as high debt levels, fiscal deficits, and weak governance, all of which have directly led to a loss of investor confidence and hindered economic growth[6]. As a result , the IMF has repeatedly stressed on the urgent need for structural reforms to address Lebanon's economic vulnerabilities and restore macroeconomic stability[7].

Studies by research organizations such as the Malcolm H. Kerr Carnegie Middle East Center have shed light on the rise of the black market. These studies attribute the proliferation of the black market to factors such as currency devaluation, inflation, and a shortage of essential goods, in addition to a multitude of other studies pertaining to the rise of illicit trade at the Lebanese border, specifically looking at Captagon expansion at the border and regionally.[8] Thrown together, these issues have collectively harnessed public discontent and eroded confidence in the formal economy. [9]Furthermore, media reports from outlets like Reuters have documented instances of illicit trading and price gouging in Lebanon's underground economy, providing firsthand accounts of the challenges faced by ordinary citizens.[10]

1.5) Policy inefficiency:

As we can see, current economic theories are leading to major fallacies in Lebanon's policymaking, as the country possesses a larger and more dominant shadow than a surface. Policies will not meet their intended outcomes, nor yield accurate results if they fail to consider the constant interaction between the black and legal market.

Nevertheless, our current models offer various perspectives to encourage higher engagement in legal transactions. However, fixing the economy will be complex and take time, especially as the black market may continue to play a role, albeit a limited one, in regulating the economy. It seems

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[6] World Bank, *Lebanon Sinking into One of the Most Severe Global Crises Episodes*, Lebanon Economic Monitor, Spring 2021.
[7] International Monetary Fund, *Lebanon and the IMF: Frequently Asked Questions*, 2021.
[8] Malcolm H. Kerr Carnegie Middle East Center, *Double Dealers: Lebanon and the Risks of Captagon Trafficking*, 2021
[9] Chatham House, "Lebanon's Currency Collapse and the Rise of Informal Markets," Middle East and North Africa Programme Report, 2021.
[10] Reuters, "Inside Lebanon's Black Market Currency Trade," 2020.

that black market benefits can be plotted in a biconcave curve, in that case, there would be an optimal, non-zero level of participation that allows the economy to function most efficiently.

1.5.1 Cash over deposit ratio

The cash over deposit ratio is a crucial indicator of how much wealth is vulnerable to the shadow economy. In Lebanon, it is no secret that this ratio surged during the economic crisis due to a widespread lack of confidence. Policy efficiency is closely tied to public trust, the more people trust in either the central bank or the government, the more likely they are to comply with the policy.[11]

After the default of Lebanese banks, people could no longer trust government institutions. Whether it was with their money, security, laws, or authority, Lebanon found itself in chaos, as it transitioned into a nearly complete cash economy. Economists agree this shift stems from a complete lack of confidence between the depositors and the banks.[12]

All in all, why would anyone put their money in banks, even with an interest rate, if they don't trust them? This demonstrates the cash over deposit ratio as a reflection of the people's confidence in banks, and serves as an indirect indicator of monetary policy efficiency. The higher the trust, the less cash circulating, leaving less vulnerable wealth to the shadow. [13]

1.5.2 The rule of maximizing utility

In both the legal market and the black market, the rule for maximizing utility is the same: individuals should consume up to the point where the marginal benefit of consumption equals the marginal cost. This rule, however, may be complicated by additional factors in the black market, such as legal risks, quality uncertainty, and limited consumer protections.

For instance, in the legal market, consumers typically have access to regulated products and services, transparent pricing, and consumer protection laws. These factors tend to increase the predictability of both marginal benefits and costs, making it easier for consumers to optimize their decisions.

On the other hand, the black market introduces risks and uncertainties that can affect the perceived marginal benefit and cost. Legal risks, such as fines or imprisonment, can increase the marginal cost of consumption. Quality uncertainty, due to lack of regulation and standards, can lower the perceived marginal benefit. Limited consumer protections may also increase the potential cost in cases of fraud or disputes. As a result, consumers in the black market often need to adjust their consumption behavior to account for these additional risk factors in order to maximize utility.[14]

1.5.3 Effect on the foreign exchange reserve

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[11] World Bank, *Lebanon Economic Monitor: The Great Denial*, Fall 2020.
International Monetary Fund, *Lebanon: Staff Concluding Statement of the 2020 Article IV Mission*, IMF Country Report, 2020.
[12] *Ibid*
[13] Friedrich Schneider, "Shadow Economies Around the World: What Do We Really Know?" *European Journal of Political Economy* 21, no. 3 (2005): 598–642.
[14] Chatham House, "Lebanon's Currency Collapse and the Rise of Informal Markets," Middle East and North Africa Programme Report, 2021

As we have observed, the طام ratio directly influences the money supply of the economy. It shapes many proportionalities within the exchange rate of the local currency. It is no mystery that the black market has a direct impact on the money supply. An increase in illegal transactions reduces the amount of money circulating in the official economy which would decrease the money supply. This reduction can place downward pressure on prices, making money more valuable. In turn, nominal interest will rise as the currency becomes scarcer on the surface, and more powerful.

Meanwhile, an increase in money laundering rates would mean more money coming out of nowhere into the surface, making the currency more common. This would increase the price level, which would directly increase the exchange rate.

Despite seeming ethically questionable, an increase in illegal transactions could actually strengthen the currency, which explains the long-term maintenance of the Lebanese lira. This corresponds with the sharp rise in the black market participation from the 1990s until late 2019. Briefly, and as a final conclusion, we can say that an increase in the طام ratio would directly decrease the nominal exchange rate, and vice versa.[15]

1.5.4 Using the black market to strengthen our economy.

As Lebanon's economic crisis is characterized by a significant informal sector and pervasive government corruption, in this context, leveraging the black market through non-governmental actors could potentially contribute to economic stability and social resilience.

Lebanon's economic crises have deepened systemic challenges, including political instability and corruption. These issues have contributed to widespread unemployment, inflation, and social unrest. A significant portion of the country's economic activities is conducted within the informal sector, fueled by public distrust in formal institutions and absence of viable alternatives. Our hypothesis posits that non-governmental actors, such as NGOs, international organizations, and donors, can play a pivotal role in harnessing the potential of the black market to mitigate the effects of the crisis and promote economic resilience. We suggest a variety of approaches:

The establishment of informal taxation systems facilitated by NGOs. By working closely with stakeholders in the black market, NGOs can develop voluntary tax schemes that incentivize businesses to contribute a portion of their profits towards local development initiatives. These funds can be directed towards essential services, infrastructure projects, and social welfare programs while bypassing corrupt government channels. NGOs can also provide oversight to ensure transparency and accountability in the allocation of these resources, fostering trust and cooperation within the informal economy.

Non-governmental actors can facilitate the integration of informal businesses into the formal economy through innovative initiatives. Microfinance institutions supported by international organizations can provide much-needed capital to small businesses operating in the black market, enabling them to expand their operations and access formal markets. Vocational training programs funded by donors can equip individuals in the informal sector with valuable skills, enhancing their

[15] Vito Tanzi, "Uses and Abuses of Estimates of the Underground Economy," *Economic Journal* 109, no. 456 (1999): 338–347.

employability and productivity. By legitimizing and formalizing certain aspects of the black market, these initiatives have the potential to stimulate economic growth and alleviate poverty in Lebanon.

Political Perspective

The rise of the black market in Lebanon has been highlighted through an economic perspective. However, it seems that Lebanon provided the ideal environment for Black market participants. This section endeavors to analyze the political dynamics that led to the rise of the shadow economy.

Lebanon has been known as a haven for corruption. The bypass of many political laws has been achieved through the means of the shadow economy, crime, and the normalization of bribery. Lebanon's allotment era gave space for a cartel way of thinking, as the country is delving deeper into an unregulated system that benefits only a few. This perspective gives the broader vision of the interaction of politics within black market economics and how political dynamics encouraged the pavement of the shadow economy. Further understanding requires an overview of bribery, administrative hollow out, and cartel governance.

2.1: Political Dynamics of Lebanon's Black Market

2.1.1: Governance Challenges and Regulatory Gaps

Lebanon's key sectors are paralyzed due to deficient governance and weak regulation, providing fertile ground for black market activities to flourish. Governance shortcomings and corruption vulnerabilities have made it nearly impossible to stabilize the state's macro economy and provide accurate data. [16]

Initially planned to aid citizens, subsidy programs often fall prey to exploitation in such an environment, with essential goods being resold at exorbitant prices[17]. In some cases, these goods fail to meet promised quality standards or may even be tampered with. For instance, amid the ongoing economic crisis, access to prescription medications has become scarce or prohibitively expensive.[18] Patients, desperate for necessary treatment, are forced to turn to illegal markets without any guarantee of product quality. The spread of fake or adulterated pharmaceuticals poses significant risks, with many individuals experiencing fatal consequences from counterfeit medication. [19]

Similarly, while capital controls were initially implemented to mitigate financial hardship, they inadvertently created opportunities for black market activities. To overhaul the country's financial infrastructure, it is imperative to monitor and enforce better capital controls, as well as establish comprehensive restructuring laws.[20]

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[16] Paul Salem, *Lebanon's Political System and the Crisis of Governance*, Carnegie Middle East Center, 2019.
Transparency International, *Corruption Perceptions Index 2021: Lebanon Country Profile*
[17] International Monetary Fund, *Lebanon: Staff Concluding Statement of the 2020 Article IV Mission*, IMF Country Report, 2020.
[18] Human Rights Watch, *Lebanon: October 2019 Protests and State Response*, 2020.
[19] World Health Organization, *Substandard and Falsified Medical Products*, 2021
[20] IMF, *Lebanon and the IMF: Frequently Asked Questions*, 2020.
World Bank, *Lebanon Economic Monitor: The Great Denial*, Fall 2020.

It is an open secret that the entrenched political elite, wielding power, also monopolizes the private sector, thereby perpetuating rampant corruption that only serves to bolster the black market. [21]Opacity surrounding government contracts facilitates bribes and the misappropriation of funds, particularly within sectors such as construction materials, notably the cement industry. [22]Furthermore, businesses operating unlawfully may engage in bribery of law enforcement or government officials with whom they share political affiliations. Consequently, officials personally involved in such activities lack the incentive to restrict them, as evidenced by instances of fuel smuggling. [23]

2.1.2: Weaknesses in Legislative Frameworks

The Lebanese economy's dependence on the black market is driven by its oligopolistic structure and its *Laissez-Faire* nature, where a few firms dominate and state-owned monopolies control vital sectors, limiting fair competition[24]. Moreover, the main causes behind these problematics are the numerous weaknesses found in the legislative framework. [25]

That said, Lebanese law, through Law 73/83, prohibits restrictive agreements, with Article 14 specifically targeting cartels or agreements that "limit competition... resulting in an artificial increase in prices or in preventing prices from falling." However, this legal prohibition is weak because it places the burden of proof on demonstrating that such agreements lead to an "artificial" price increase or prevent prices from falling—criteria that are inherently difficult to define and prove, thus undermining the law's effectiveness.[26] Hence, this legal ambiguity allows oligopolistic firms and state-owned monopolies to engage in anti-competitive practices with minimal risk of enforcement. Consequently, these entities can maintain high prices and restrict supply, prompting consumers and smaller businesses to turn to the black market for more competitive pricing and availability. [27]

On another note, Lebanon's Law n°105/1999, which permits the import, export, and trade of gold and other precious metals, has inadvertently opened a legal door for black market activity. [28]The law enables the legal movement of high-value, easily concealable commodities, ideal for smuggling and evading detection. The difficulty in tracing physical gold transactions facilitates money laundering, tax evasion, and sanction circumvention. This legal trade is also exploited for trade-based money

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[21] Reinoud Leenders, *Spoils of Truce: Corruption and State-Building in Postwar Lebanon* (Cornell University Press, 2012).
[22] Transparency International, *Corruption Perceptions Index 2021*.
Minkara, et.al. "Unfair Game:Lebanon's Rigged Markets are Killing Competitions", Triangle, Nov. 2020.
[23] Reuters, "Inside Lebanon's Black Market Currency Trade," 2020
[24] UN ESCWA, *Survey of Economic and Social Developments in the Arab Region 2019–2020*, United Nations, 2020.
Minkara, et.al. "Unfair Game:Lebanon's Rigged Markets are Killing Competitions", Triangle, Nov. 2020.
[25].Chatham House, "Lebanon's Currency Collapse and the Rise of Informal Markets," Middle East and North Africa Programme Report, 2021.
[26] Salem, *Lebanon's Political System and the Crisis of Governance*, 2019.
[27] World Bank, *Lebanon Economic Monitor: The Great Denial*, 2020.
[28] OECD, *Measuring the Non-Observed Economy: A Handbook*, Paris: OECD Publishing, 2002.

laundering, transferring illicit funds under the guise of legitimate transactions, thus exacerbating black market dynamics in Lebanon.[29]

Furthermore, Lebanon's Law n°133/1999, which expands the Central Bank's role in regulating payment systems and electronic transfers, inadvertently boosts black market activity amid the banking crisis. The severe restrictions on withdrawals and electronic transactions limit access to funds, driving individuals and businesses to the black market for cash and unregulated transactions. This alternative is especially appealing for those seeking to avoid the scrutiny of official channels, thus exacerbating the reliance on the black market.

In addition, Lebanon's gun control law suffers from weaknesses that fuel black market activity. Government discretion, lack of stringent criteria for permits, inadequate enforcement, and legal complexity contribute to the problem.[30] These flaws create opportunities for illegal firearms acquisition, posing serious threats to public safety and security.

From a political standpoint, instability in Lebanon and its region has increased the Lebanese economy's reliance on the black market. Primarily, it must be noted that the mismanagement of Lebanon's diverse and complicated political system was one of the main reasons behind the quick and sudden emergence of the black market in 2019. This mismanagement, compounded by the weaknesses of the legislative framework, resulted in the miserable collapse of the economy, where the national currency lost more than 100% of its value[31]. The ineffective laws and regulations failed to address the economic instability and corruption, further exacerbating the crisis and facilitating the rise of unregulated and illegal markets.[32]

Additionally, the Syrian refugee crisis has been aggravated by the lack of reliable border security laws and the ineffective application of refugee laws, particularly affecting unregistered Syrians in Lebanon. Thus, regionally, the influx of Syrian refugees, specifically unregistered ones, into Lebanon following the Syrian conflict in 2011 has significantly impacted Lebanon's black market. This situation arises because Syrian refugees often transfer their "Fresh Dollars"—which come in the form of grants and support—outside Lebanon, primarily back to Syria.[33] This outflow causes a scarcity of the highly demanded dollars in the Lebanese money market, thereby further empowering and expanding the black market in Lebanon. With all that being said, it can be concluded that Lebanon's Political instability makes it difficult to implement and sustain effective Legislative measures combating the Black Market Economy.

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[29] Chatham House, *Lebanon's Currency Collapse*, 2021.
[30] UNODC, *Global Firearms Trafficking Report*, 2020. International Crisis Group, *Lebanon's Revolution*
[31] International Crisis Group, *Lebanon's Revolution and the State Collapse*, Middle East Report No. 219, 2020.
[32] Transparency International, *Corruption Perceptions Index 2021*.
[33] UNHCR, *Syria Regional Refugee Response: Lebanon Country Update*, 2020.

To wrap up, Lebanon's legislative framework contains numerous loopholes, ultimately enabling corrupt officials and citizens to manipulate the rules to their advantage and thereby facilitating the proliferation of black market activities. Furthermore, the absence of an effective preventative strategy within this framework significantly impedes the government's ability to curb or even mitigate black market operations. Consequently, Lebanon continues to grapple with the pervasive and detrimental influence of the black market on its economy.

2.1.3: Risks of Corruption

Given the entrenched dysfunction of Lebanese politics, corruption has become a lifestyle. From the mere bureaucrat taking bribes to fulfill his public duties on time to the upper echelons of the political class that use corruption as a means to sanction their agenda, political programs, and garner riches at the expense of the public sector, corruption is ubiquitous on all scales.[34] However, this isn't necessarily because individuals live and breathe lawlessness, rather it is an amalgamation of the political woes of Lebanon mixed with its current state of political stagnation.[35]

An individual seeking to follow the laws of the country will inevitably have to acquiesce to corrupt acts in order to go about his life as a citizen. For example, a person looking to obtain a driver's license would have to bribe public workers and sometimes the administration itself so that their license is even considered to be issued, and an additional amount is due to be paid for speed and efficiency[36]. This portrays the depth by which corrupt acts have become ingrained in Lebanon.

On the other side of the spectrum, corruption is also used as a political tool to further even the most benevolent of projects. Suppose a new highway is set to be built to link the capital with the South, officials would need bribes and favors met to even allow the generation of this new project, amongst all others. The latter shows the propensity of the Lebanese to fall into corruption not necessarily to benefit themselves or their respective group, but merely to live as a citizen with rights and duties in their country.[37] Corruption in Lebanon works like a web; someone would need a favor or some finances in order to allow something to happen in their domain, such as bank managers during the beginning of the banking crisis who let some individuals take out their deposits and in return would take a certain percentage to allow that to happen. This highlights corruption not only as the tool of the corrupt politician, but also as that of the well-meaning citizen.

2.2: Crime

2.2.1: Intersection of Political Interests and Criminal Networks

Politics are known to be quite heterodox in nature in Lebanon, especially when it comes to crime or what is acknowledged internationally as crime. Lebanon is notorious for being a haven for

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[34] Reinoud Leenders, *Spoils of Truce: Corruption and State-Building in Postwar Lebanon* (Cornell University Press, 2012).
[35] Paul Salem, *Lebanon's Political System and the Crisis of Governance*, Carnegie Middle East Center, 2019.
[36] Transparency International, *Global Corruption Barometer: Middle East and North Africa*, 2019.
[37] Paul Salem, *Lebanon's Political System and the Crisis of Governance*, Carnegie Middle East Center, 2019.

organized criminal activity mostly pertaining to drugs, trafficking, drug manufacturing, etc… This stems from the widespread corruption that plagues Lebanese society as well as politicians who serve criminal organizations and individuals for mutual benefit. For instance, an individual looking to expand his businesses beyond the legal market might look into the manufacturing of drugs as well as its sales. In order to successfully run their respective operation, funds are needed not only to finance the project, but also to grease the right palms to turn a blind eye to the illicit activities. Not only that, but bribes – for lack of better word – can take on other forms such as favors.[38]

A certain municipal leader who oversees his domain of the Bekaa Valley, for example, might cooperate with drug dealers to secure trafficking routes and amnesty if and only if caught by authorities. In return, criminals such as the latter guarantee monetary prizes as well as personal favors to maintain the power of said politician. Political interests in Lebanon rest on corrupt acts more than legal ones, warranting the help of individuals and organizations that don't necessarily see eye to eye on the rule of law. In some cases, politicians directly run their own criminal network, whether it be the trafficking of goods into Syria or the laundering of money. It is also crucial for politicians to garner as many political favors from important individuals, community leaders, or in the case of Lebanon – criminals. [39]

Having these favors at hand will surely guarantee the exponential rise in power of a politician or even just his humble preservation of his position, mostly resting on the back of the criminal underworld. Lebanon suffers from this conundrum not only because of political issues, but also because of the economic struggles that the nation faces. Because, after the economic crisis hit, the black market started reaching new heights time and time again, and because it started the flow of money and dollars in the country, everyone wanted a piece of the pie but access was impossible without the right connections.

2.2.2: Influence of Political Figures in Illicit Trade

In the shadowy realms of illicit trade in Lebanon, political figures wield a formidable influence in a familiar fashion, blurring the lines between governance and clandestine networks, orchestrating intricate schemes of corruption and criminality. Presently, amidst the decline across various sectors, black market activity is proliferating in diverse forms, a trend exacerbated by the encouragement and involvement of these corrupt political elites. This reality is underscored by numerous examples illustrating the extent of this phenomenon in Lebanon. [40]

Moreover, such instances are exemplified by the control over crucial ministries, notably the Ministry of Finance and the Ministry of Agriculture, particularly by figures affiliated with Hezbollah. This control enables the manipulation of state resources and legal frameworks to facilitate illicit trade activities, including arms trafficking, drug trade, and smuggling of counterfeit goods. Furthermore, exploiting state resources and institutions, such as Hezbollah's control over the Ministry of Agriculture, furthers their illegal endeavors. This allows for the falsification of transport paperwork to legitimize illicit goods as agricultural seeds, thus perpetuating their unlawful

[38] Chatham House, "Lebanon's Currency Collapse and the Rise of Informal Markets," 2021
[39] UNODC, *Captagon Trafficking in the Middle East*, 2021. Leenders, *Spoils of Truce*, 2012.
[40] Transparency International, *Corruption Perceptions Index 2021*.

operations. Additionally, institutionalized nepotism within the customs administration and widespread corruption provide fertile ground for political figures to sustain black market activity through patronage networks and clientelist relationships, leading to tax evasion, smuggling, and bribery. To add, manipulation of legal frameworks grants political figures impunity, exemplified by Hezbollah's control over state institutions and the exemption of certain imports from taxes and customs fees, thus facilitating the unchecked flow of goods through Beirut's ports. Lastly, by engaging in money laundering, leveraging border control, and exploiting electoral processes through vote trafficking, political figures entrench their hold on power, perpetuating socio-political inequalities and undermining democratic principles within Lebanese society. [41]

In essence, if not dealt with accordingly, this deep-rooted corruption may cast a long shadow over the future prosperity of Lebanon.

2.2.3: Policies on Illegal Trade

One of the policies that could be used in order to shift people towards the legal market rather than the black market is to implement the strategy of market diversification. A main reason as to why people shift into the black market is due to the unavailability of goods that they want in the legal market. How can there be a limit on this? By making the market more diverse. In doing so, consumer choice would increase in the economy and businesses will have more exposure on an international scale.[42]

Here's how market diversification can fix some of the negative impacts that result from the black market:

The Lebanese economy relies on many sectors such as banking and finance, tourism and hospitality, and real estate. Due to the high levels of corruption and hyperinflation, some sectors are witnessing a decline in their field, and a significant percentage of the Lebanese economy functions in the black market, evading taxes. So, by diversifying the market (sector wise), we are distributing tax revenue across different sectors. In case one sector fails, such as the banking sector in Lebanon today, there are other sectors that can compensate for the loss of tax revenue, like the booming sector of tourism and hospitality. On a scale of the economy as a whole, diversifying the market increases consumer choice and economic growth as well as decreases the collapse in tax revenue because one industry's collapse is contrasted with a number of growing industries.[43]

When an economy is diversified, new industries rise, paving the way for job opportunities, but it doesn't end here. It's not only about job opportunities, but also about division of labor and specialization. When employees are specialized and labor is divided, firms and the market as a whole become diversified. Specialized labor gives people more chances to join the workforce since there is a place for everyone to showcase their skills and abilities. The new job opportunities would cause

[41] Carnegie Middle East Center, *Hezbollah's Political Economy*, 2020.
[42] ESCWA, *Survey of Economic and Social Developments in the Arab Region 2019–2020*, United Nations, 2020.
[43] World Bank, *Lebanon Economic Monitor:*

unemployment to decrease and the black market curve to shift left, as businesses would be less likely to shut down and jobs would be more available.

If the market is diversified, new businesses will emerge, leading to increased exposure and broader consumer choice. With more market diversification, competition increases, in turn elevating work and production incentives, eventually leading to a booming economy rather than businesses being planted with fear of risk or shutdown imposed by the black market.

Market diversification decreases crimes, because as previously discussed, it leads to new job opportunities which will provide legitimate means of securing an income. Additionally, with market diversification and the expansion of the economy, governments will be able to spend more on security and law programs. Evidently, most illegal activities take place in the black market due to the absence of rules and regulations, so with the diversification of the market, dependence on the black market decreases and people are less encouraged to engage in illicit activities.

Market diversification increases safety in the economy as more rules and procedures are applied. With diversification comes competition, as more firms strive to be the best in the market. They are motivated to boost the quality and safety of goods, which they will have to maintain to meet consumer demands.

2.3: Geopolitical Factors Shaping Black Market Dynamics

2.3.1: Smuggling Routes

Situated at the crossroads of Europe and Asia, Lebanon has been bestowed the title of "The Bridge Between the East and the West." Its fruitful geographical position serves as a vital trade hub and transit point bridging between eastern and western markets. Lebanon's Machiavellian government, fostered and enforced by domestic and foreign issues, was able to tarnish its historical reputation of trade by turning its maritime and land routes into drug routes.

The Captagon trade has grown significantly in size in the last decade or so, originating mostly from Syria and, to a slightly lesser degree, the Beqaa valley. [44]The product is mainly intended to pollute opponents of the Syrian regime (the Gulf and Jordan) and Hezbollah, who have gained the reputation of becoming the largest drug patrons in the Levant. Recent media inquiries and political discussions have focused heavily on the amphetamine-like stimulant due to its direct connection to Hezbollah and the Syrian regime. Hezbollah's involvement in drug trafficking through smuggling routes in Lebanon, including both maritime and land routes, not only facilitates the trafficking of narcotics, but also streamlines the process for individual drug smugglers and enables the smuggling of other illicit products. This involvement creates a network that not only fuels the drug trade, but also enables the trafficking of a variety of illicit goods beyond narcotics.

[44] Reuters, "Lebanon Army Seizes Captagon Factory in Hermel," June 2025.
Al Jazeera, "Syria Seizes 11 Million Captagon Pills Smuggled from Lebanon," October 2025.

Prior to 2011, illicit items from Lebanon made their way into Syrian communities near the border, like Madaya and Serghaya. Those items included tobacco, alcohol, leather, electronics, apparel, and fuel, depending on where it was cheaper. After that, the products would be shipped to Damascus and sold there, including at the well-known smuggling market in Qaboun, which is close to the Syrian Special Forces headquarters. [45]Following the start of the Syrian revolution, the West put harsh sanctions on the Syrian regime, severely impairing its financial resources. This caused the situation to shift. Reliance on Lebanon increased as time went on, and the Syrian conflict continued. Syria's portal to the outside world, along with its Lebanese allies, became the Lebanese ports, mainly the port of Beirut, which was deeply affected by the port explosion on the 4th of August, 2020. Front organizations and land-based supply chains were set up to withstand the international blockade aimed at the progressively isolated government.[46]

The politically volatile region of the Levant can be exemplified as an incentive for illegal and illicit trade. New dirt roads between the Lebanese-Syrian borders allowed individuals to carry out their smuggling endeavors easily, especially with the absence of authority and the rule of law in Lebanon. The average individual can simply drive through Hezbollah-controlled Lebanese borders, such as Ras Baalbek, Qasr, Qaa', and Akkar, to smuggle items into Syrian territories and vice versa. If the individual was stopped by Hezbollah personnel, a simple bribe of $100 would allow them to pass..[47]

2.3.2: Impact of International Relations on Informal Trade:

The rise of the black market has led to the overall cripple of the quality of Lebanese products, as the shadows have no framework to abide by, and thus the idea of the stamp being inspected became a hypocritical concept for the International community. Overall, the Syrian Captagon trade led to even more damage, as countries like Italy, Saudi Arabia, or Kuwait started to take precautions with Lebanese exports, with measures reaching the extent of the complete closure of trade in extreme cases.[48]

The IMF predicts the greylisting of the Lebanese Republic by October 2024 if the authorities do not take firm stands on the shadow economy and aggregate corruption within the administration and the private sector, ultimately leading the country to an increase in investment risk.[49] Economically speaking, the NX curve of Lebanon, based on the real exchange rate, continues to shift leftwards, as a lack of trust in its products is being expressed.

The impact of the black market on the international relations of the country are extremely detrimental. With the rise of the open market economy, it seems that domestic shadows are pushing Lebanon into the shadows of the world, as the informal trade is closing the economy more and

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[45] International Crisis Group, *Captagon and Power in the Levant*, Middle East Report No. 240, 2024.

[46] Chatham House, "Lebanon's Ports and Illicit Trade After the Beirut Explosion," Middle East Programme Report, 2021.

BBC News, "Lebanon's Port Explosion: Supply Chains and Smuggling Routes," August 2020.

[47] Carnegie Middle East Center, *Hezbollah's Political Economy and Illicit Trade*, 2023.

[48] Financial Times, "Lebanon Risks FATF Greylisting Over Corruption and Informal Economy," July 2024.

[49] IMF, *Lebanon: Article IV Consultation Staff Report*, 2024.

Association of Banks in Lebanon, "Greylisting Risks and Investor Confidence," Policy Brief, 2024.

more. As trust falters, the risk of investing in the country is rising, explaining the high interest rates given by Lebanese commercial banks. [50]

The elasticity of response to economic incidence within the country seems to be extremely high thanks to the shadow economy, as many foreign brands like American Eagle, H&M, and many others closed their branches in Lebanon due to recession expectations. The land that pictured itself a haven for investment and trade, bringing back phoenician history to prove its place in the trading and forwarding dynamics, saw itself hollowed out of the global open market due to a lack of trust in the cleanliness of its products as well as the non-credibility of its inspecting administration.

Finally, there remains a clear inversely proportional relation between informal trade and the shadow economy. As the shadows swallow more of the country's production, open market participation decreases. In the end, this monopolistic competition can be observed on a macroeconomic level, as quality plays a role in order to compete with other products, and the export of products is a strong political tool used in bargaining and creating international deals with neighbors and beyond.[51] So the shadows decrease our capability to compete in the open market, and thus decrease our bargaining power, and if our stamp of trust is not reliable in the economy, how can anyone trust our authorities for international deals, accords, or promises?

2.4: Political Economy of Informality

2.4.1: Informal Sector Support

In Lebanon, a sizable portion of the economy that functions outside of official government monitoring and taxation is referred to as the "informal sector." It includes actions that are not subject to government oversight or regulation, which leaves workers and participating firms without official documentation or legal safeguards. The informal sector is vital to Lebanon's job market, particularly for marginalized populations, but it also presents difficulties including low pay, unfavorable working conditions, and no social security benefits. It is estimated that Lebanon's informal economy contributes significantly to the GDP of the nation, therefore safeguards are frequently unavailable to workers within this unorganized economy.[52]

Due to the Lebanese pound's sharp decline in value, many people are looking for ways to exchange their quickly declining local currency for US dollars. The majority of people now only have access to the black-market to convert Lebanese pounds for dollars due to government crackdowns on legitimate currency exchange businesses.[53]

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[50] Reuters, "Foreign Retail Chains Exit Lebanon Amid Economic Collapse," December 2023.
[51] The National, "Lebanon's Informal Economy Surges as Pound Collapses," February 2024.
[52] ESCWA, *Survey of Economic and Social Developments in the Arab Region 2023–2024*, United Nations, 2024.
[53] The National, "Lebanon's Informal Economy Surges as Pound Collapses," February 2024.

These illegal black-market trades are being facilitated by unofficial money exchangers. They set up peer-to-peer transactions where clients can exchange Lebanese pounds for US dollars, frequently through messaging applications. Unofficial money changers are not authorized by the government and function outside of the established financial system, since they are unable to obtain dollars through legal channels. Companies that depend on imports such as merchants of luxury items and auto parts are also turning to the black market to obtain the hard currency they need to pay for their imports. This further increases the demand for the illegal currency trade.[54]

The informal sector has thus become a crucial enabler of the black market in Lebanon, providing a way for individuals and businesses to bypass the official financial system and access scarce US dollars. This informal network has expanded rapidly since the government crackdown on legal exchange shops.

The main industries in the informal sector in Lebanon are comprised of tangible essential services, most prominently agriculture, construction, and manufacturing. One must also acknowledge the effects of informal small-scale businesses that dominate the Lebanese market. With over 91% of informal firms having less than 4 employees, matched with the influx of Syrians who are considered as cheaper labor, comes a predicament for the Lebanese citizen.[55]

Informality is particularly high among elementary occupations and unskilled work, with a majority of non-Lebanese workers engaged in these roles. The influx of Syrian refugees since 2011 has contributed to the deterioration of conditions in the informal sector (whether its exploitation or incompetent governmental oversight), as the surplus of labor fostered competition in low-skilled occupations. This growing predicament can still be seen prevailing and increasing amongst unsettling internal politics and volatile geopolitical issues.[56]

2.4.2: Political Patronage and Market Distortions

The presence of monopolies and oligopolies is crippling the situation. It creates an unfair system characterized by the lack of competition and the rise of corruption and bribes. Here are some examples of monopoly atrocities, and confronting that would require heroic political commitment and competition law.[57]

50% of domestic products are oligopolistic and monopolistic. The authority has weak confrontation against anti-competition, considering it is benefitting as well. The consumer protection directorate is doing little to unfair pricing (200-500 fines per year).[58] This is exemplified by Lebanon being ranked 88th/141 on competitiveness, and 113rd/141 on institution competitiveness.[59]

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[54] *Ibid*
[55] Human Rights Watch, *Lebanon: Informal Work and Refugee Labor Conditions*, 2023.
[56] UNHCR, *Syria Regional Refugee Response: Lebanon Update*, 2024.
[57] Transparency International, *Corruption Perceptions Index 2024: Lebanon Country Profile*
[58] The Daily Star (Lebanon), "Consumer Protection Directorate Issues Hundreds of Fines," March 2019.
[59] OECD, *Competition Law and Policy in the Middle East and North Africa*, Paris: OECD Publishing, 2022.

Cimenterie nationale, LafargeHolcim, and Sibline, the three main manufacturing companies in Lebanon, joined forces to monopolize the market and are making around 300% profit. Since they have a monopoly, they refuse to comment on costs of production[60]. They have huge power on supply and demand that can threaten a whole country. The permit that is needed to produce cement, coupled with the close ties they have with the government are creating sort of an invisible barrier. Al Arz, the only competitor, got their license revoked due to harmful impact. Furthermore, high tariffs made no competition since supply exceeds demand. Due to their impact, building a house in Lebanon costs 3 times more than in Syria.[61]

The rise of these monopolies, especially over cement, has been artificially constructed through the bribery scheme. A double sided illegitimate clientelism was constructed after the Amnesty law of 1991, causing market distortions within the prices of the Lebanese economy.

The mere fact that the price of a house in Lebanon is 3 times higher than in Syria is a perfect example of the distortion in prices. The economy of Lebanon has led to unfair and rigged markets, preventing it from reaching its equilibrium.[62]

Private cistern companies of water are also affecting the market, as the few companies who hold monopolies are causing blockades over reforms in the freshwater sectors.[63] As the pipelines are still 40 years old, EBML is moving towards failure due to lack of expertise and overall aging of employees. With the underground deals of blockade, private cistern companies are rising their demands and overpricing for basic material like water.[64] Thus, to operate any type of capital, prices will tend to be higher, as the public sector is not able to supply the necessary quantity for the market. The illegitimate black market cistern companies benefited from and maintained the shortage with political ties to keep on profiting and overpricing, causing capital price to rise and thus distortions in the economy on the aggregate supply level. [65]

[60] Al Arabiya, "Lebanon's Cement Monopoly and Government Ties," August 2021.
[61] Reuters, "Lebanon's Cement Industry Monopolized by Three Firms," July 2020.
[62] Minkara, et.al. "Unfair Game:Lebanon's Rigged Markets are Killing Competitions", Triangle, Nov. 2020.
[63] The National, "Lebanon's Private Water Tanker Companies Exploit Shortages," June 2022.
[64] Reuters, "Lebanon's Water Crisis Deepens Amid Infrastructure Collapse," July 2021.
[65] ESCWA, *Water Sector Reform in Lebanon: Challenges and Opportunities*, 2021.

Limitations and Conceptual Scope

This appendix is intended as a conceptual framework to accompany the main report. Many of the models presented, such as the wheel visualization, the black market multiplier, and the opportunity cost equations, are deliberately framed in a storytelling style to make abstract dynamics more intuitive. These visualizations should be understood as heuristic devices, not empirical measurements.

Several limitations apply:

- Interpretive models: The frameworks simplify complex realities. For example, the wheel visualization illustrates flows between legal and shadow economies but does not quantify them.

- Non-standard formulations: Concepts like the "black market multiplier" or equating marginal leniency with transaction rates are exploratory constructs. They extend economic theory but are not conventional definitions.

- Historical examples: References to events such as the 1998 currency redesign are used narratively to demonstrate potential impacts. They should be interpreted as hypothetical scenarios unless supported by archival evidence.

By presenting these models in a story-like manner, the appendix aims to spark discussion and guide further empirical research. The main report provides the data-driven analysis, while this appendix serves as a creative lens through which to interpret Lebanon's shadow economy.