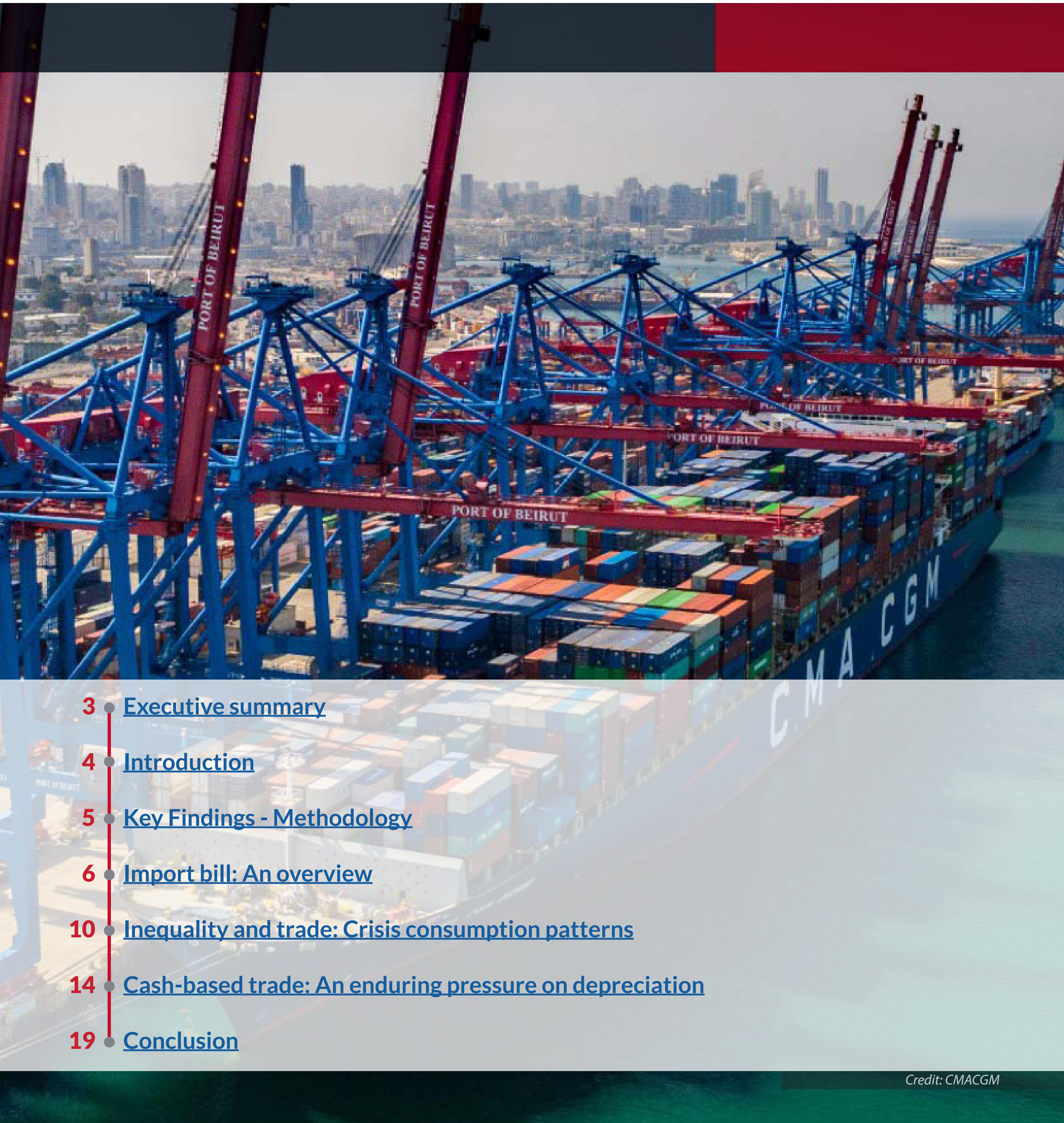
Thematic Report

Lebanon's Import Bill: Jewelry Before Baby Formula

July 2023



Credit: CMACGM

The Lebanon Crisis Analytics Team (LCAT) provides reactive and in-depth context analysis to inform the aid community in Lebanon. The information and analysis contained in this report is therefore strictly to inform humanitarian and development actors and associated policymaking on Lebanon.`

This study/report is made possible by the support of the American People through the United States Agency for International Development (USAID) and European Union Humanitarian Aid. The contents of this report are the sole responsibility of the LCAT and do not necessarily reflect the views of USAID, the United States Government, or the European Union.

Executive summary

Lebanon's import bill is disproportionately high considering the country's dire economic situation. Import values exceeded public foreign currency reserves in 2022, an imbalance not observed since the end of the civil war. Import data for 2022 reveals several other worrying trends. Importers took advantage of low customs tariffs on non-subsistence goods, leading to overstocking of inventories, while discrepancies in import values between essential goods and non-subsistence products like jewelry and cars raise questions about resource allocation and prioritization. These practices, among others, threaten to unleash a wide range of negative social impacts which underline the need for aid actors in Lebanon to better understand import dynamics when planning or administering aid programming. Accordingly, this study examines the impact of recent import practices on the Lebanese pound (LBP) and the overall economy.

At the macro level, heavy reliance on imports and unwise resource allocation is straining Lebanon's limited foreign reserves which would be better used targeting essential products. Concurrently, a growing informal, cash-based economy is eating into the state's tax base, hampering long-term economic recovery. A pressing concern for LBP-dependent wage earners is their diminishing purchasing power in an increasingly dollarized and import-dependent economy. Meanwhile, the gap between US dollar and LBP earners continues to grow, as reflected in the unprecedented increase in imports of precious metals, jewelry, collectors items, and other luxury goods. As wealth and income inequality increases, the most vulnerable portions of the population will continue to depend on humanitarian assistance.

Introduction

The collapse of Lebanon's financial sector in the fall of 2019 has had a dramatic effect on trade financing in a country heavily dependent on imports. Data on Lebanon's import levels for 2022 shows that a perplexingly large amount of foreign exchange was spent on imports, even as the country contends with a devastating macroeconomic collapse. In other countries experiencing economic decline and severe currency fluctuations, imports tend to decline because they become too expensive. Meanwhile, local production increases and consumption behavior adapts. Economies affected by the Asian financial crisis of the late 1990s illustrate this pattern, with a sharp drop in imports followed by export-driven growth.[1]

While the latest Lebanon import data may lead some to conclude that an economic recovery is underway or that available economic resources are greater than previously assumed, such conclusions are likely incorrect. Upon closer inspection, 2022 import data is worrying and reflective of an economy that operates based on a perverse set of incentives and negative coping mechanisms benefiting a minority of the population. Among these coping mechanisms are leveraging sizable tax breaks on luxury goods (leading to overstocking of inventories by some importers, notably cars and jewelry) ahead of expected tax increases, inefficient consumption of fuel products to provide electricity, and importing expensive machinery to cope with the collapse of centralized electricity provision. Humanitarian actors can also discern worrying trends from import data regarding the relatively low amount spent on, for example, medicines or infant formula and baby milk.

These practices result in Lebanon spending inordinate amounts of its limited foreign reserves, likely portending far worse economic conditions in the future than if the country had been able to adapt in a more manageable and sustainable manner to the current economic and monetary environment. Key informants interviewed for this report claim that imports are commonly paid for using wire transfers of funds sourced in hard foreign currency from an increasingly cash-based economy.[2] Alternatively, importers can also rely on offshore bank accounts.

This report's findings and observations tackle several key issues that demand further examination and scrutiny, including how Lebanon is able to afford such a high level of imports, namely luxury goods; how import behaviors affect Lebanon's economic crisis and how this contributes to Lebanese pound (LBP) depreciation; how importers have adjusted their business models and trade practices in response to the crisis; and how these insights inform humanitarian and aid priorities in the country. By examining these issues, this paper aims to shed light on the intricate dynamics of Lebanese imports and the country's complex economic crisis.

[1] IMF Staff, Recovery from the Asian Crisis and the Role of the IMF, June 2000.
[2] In its estimation of the size of Lebanon's cash economy, the World Bank identified the following six sources of USD cash for the period 2021 to 2022: "Withdrawals of pre-crisis foreign currency denominated deposits and BdL foreign exchange (FX) interventions from remaining reserves, including through the Sayrafa platform, as dictated by various BdL circulars"; USD "remittances from abroad"; USD "cash hoarded at homes since the onset of the financial crisis"; USD "cash entering via official and unofficial entry points"; "humanitarian and development cash assistance provided by international organizations"; and "post-crisis bank deposits" in USD, "i.e 'fresh' [USD] deposits that are not subject to the bank-imposed informal capital controls." World Bank, Lebanon Economic Monitor, Spring 2023: The Normalization of Crisis is No Road for Stabilization, May 2023.

Key Findings

- Lebanon's import bill totalled 19.5 billion US dollars (USD) in 2022, returning to pre-crisis levels. Although the overall quantity of imports decreased, rising world commodity prices and logistics costs led to an increase in import value.
- Lebanon's import-to-GDP ratio rose to 90.7% in 2022, indicating a growing import-dependency trend.
- Imports of luxury items like cars and jewelry surpassed essential goods like medicines and infant formula in 2022.
- Despite weaker private consumption and limited foreign currency reserves, imports of cars and vehicles significantly increased in 2022.
- Medicine imports significantly declined in 2022, with pharmaceuticals dropping by half. This decrease is attributed to the collapsing healthcare system and bureaucratic complications with subsidy programs.
- Importers are part of the "war of attrition" over USD banknotes in the market as intense competition for USD banknotes not only places immense pressure on importers but also affects the overall stability of the Lebanese economy.
- Food imports increased by 22% in 2022 but remained below pre-crisis levels, reflecting changing consumption patterns and a shift towards cheaper goods.
- Lebanon's cash-based economy, estimated at 45.7% of GDP by the World Bank, is placing pressure on the LBP and is complicating importer payments to suppliers. Trading outside the banking system is now common because commercial banks are not fulfilling their role as financial intermediaries.

> **"Importers are part of the 'war of attrition' over USD banknotes in the market.**

Methodology

This paper employs a mixed methodology approach using official trade data and key informant interviews (KIIs) with over a dozen stakeholders, including importers, bankers, and representatives of business associations.

Photo by Sipa USA

Import bill: An overview

Lebanon has an extensive history of promoting free trade and market liberalization. Customs tariffs equal to or less than 5% per value[3] apply to over 83% of imported goods.[4] Lebanon has been an observer at the World Trade Organization since 1999, and while no progress has been made in its accession process, Lebanon secured trade liberalization agreements with the European Union (EU) and multiple Arab countries. The Euro-Mediterranean Partnership agreement went into effect in April 2006, enabling reciprocal free trade applying to a broad range of agricultural and processed food products. Furthermore, various Arab countries' goods are also exempt from customs fees under the Greater Arab Free Trade Area agreement.[5]

According to official Lebanese Customs data compiled by LCAT, Lebanon's import bill totaled USD 19.5 billion in 2022, reaching pre-crisis levels. Decreased import values in previous years – totalling USD 11.3 billion in 2020 and USD 13.6 billion in 2021 – result from the economic and financial crisis, a drop in consumption, and the global economic effects of the COVID-19 pandemic. Compounding this, the Central Bank opened lines of credit for specific subsidized products in 2020 and 2021 due to commercial banks applying capital controls on business accounts, complicating import processes upon which many sectors rely. These practices heavily contributed to limiting the flow of goods into Lebanon to a few subsistence commodities, namely, fuel, medicines, and essential foods. LBP depreciation led to a slight increase in exports, up from USD 4 billion in 2018 to USD 4.5 billion in 2022, according to Lebanese Customs data. But the additional USD 500 million in Lebanon's current account far from covers the growing trade deficit that reached USD 15 billion in 2022.

While Lebanon's import bill increased in 2022 compared to 2020 and 2021, overall quantities of imported goods decreased, with 12 million tons of goods imported in 2022 compared to 20 million tons in 2019.

[3] Customs tariffs are calculated based on their import value, which varies depending on the nature of goods and their origin.
[4] United States Embassy in Lebanon, "Commercial Guide".
[5] In some cases, the Ministry of Agriculture imposes fruit and vegetable import restrictions to protect local fresh fruit and vegetable production.

This increase in value and drop in quantity is likely due to an increase in world commodity prices and logistics costs stemming from the Ukraine conflict and effects of the COVID-19 pandemic.[6]

Local economic dynamics must also be taken into account, specifically how an increase in Lebanon's import bill relates to the country's economic crisis, which is characterized by the emergence of a cash-based economy, sharp LBP depreciation, high levels of inflation, and a marked reduction in living conditions. In its latest report on Lebanon published in May 2023, the World Bank estimates that Lebanon's GDP contracted by 2.6% in 2022.[7] This left the country with a GDP valued at USD 21.5 billion in 2022, resulting in an import-to-GDP ratio of 90.7%, after reaching a low of 33.2% in 2020. Such a rate has not been recorded since the 1980s. The value of imports exceeded foreign currency reserves in 2022, the first year an imbalance was recorded since the end of the civil war in 1990. "Total Reserves in Months of Imports" is an index used by the International Monetary Fund (IMF) to monitor countries' monetary stability. While Central Bank reserves were estimated to cover 22 months in 2021, this dropped to six months in 2022.

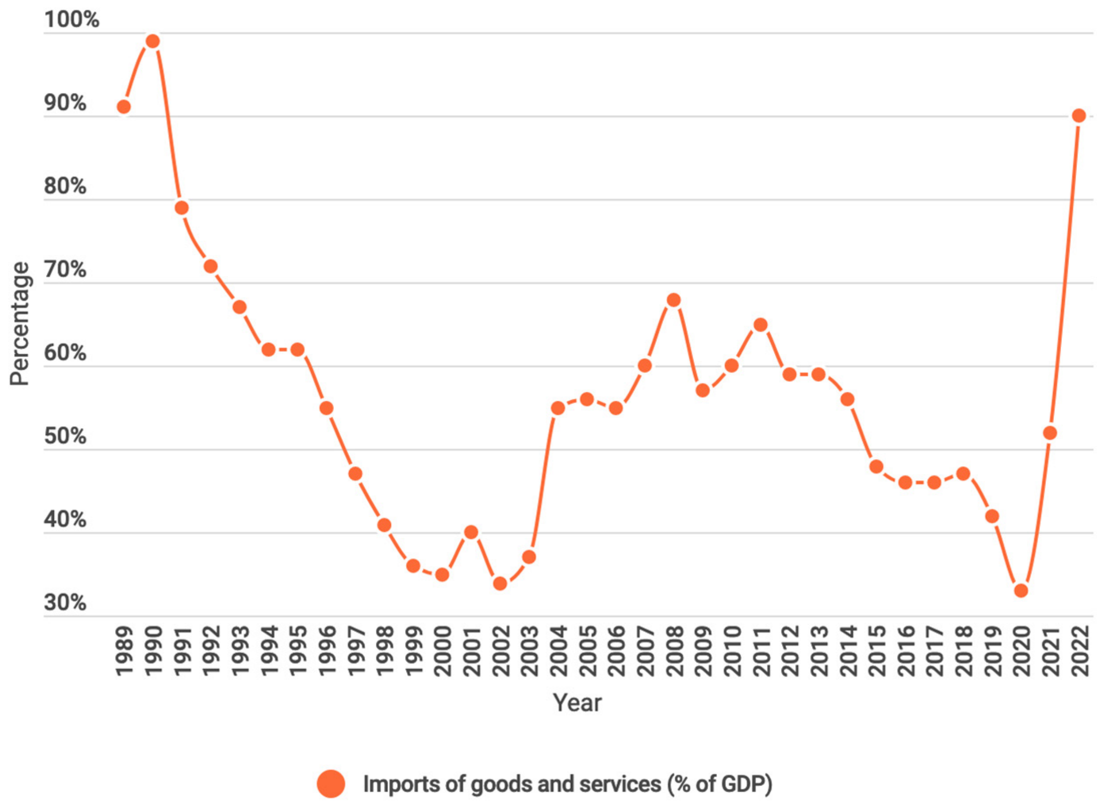


***Figure 1**: Imports of goods and services as percentage of GDP.*[8]

Increases in imports had marked repercussions on LBP depreciation. Subsidies on imports began to be lifted in September 2021, forcing importers to rely on the informal market to provide most foreign currency needed to make payments. Since subsidies were lifted on essential products and Sayrafa transactions were progressively limited to private customers, businesses have relied on the local cash-based economy by heavily amassing USD from the market. Over the last three years, many companies have also opened bank accounts abroad, circumventing capital controls imposed by Lebanese commercial banks.

[6] LCAT produced two reports on the impact of the war in Ukraine on Lebanon:
Mercy Corps Lebanon, Humanitarian Impact of Ukraine Conflict on Lebanon March 2022;
Mercy Corps Lebanon, Effects of the Ukraine conflict on Lebanon's economic and humanitarian crisis – one year on February 2023.
[7] World Bank, Lebanon Economic Monitor, Spring 2023: The Normalization of Crisis is No Road for Stabilization, May 2023.
[8] World Bank WDI and LCAT calculation for 2022.

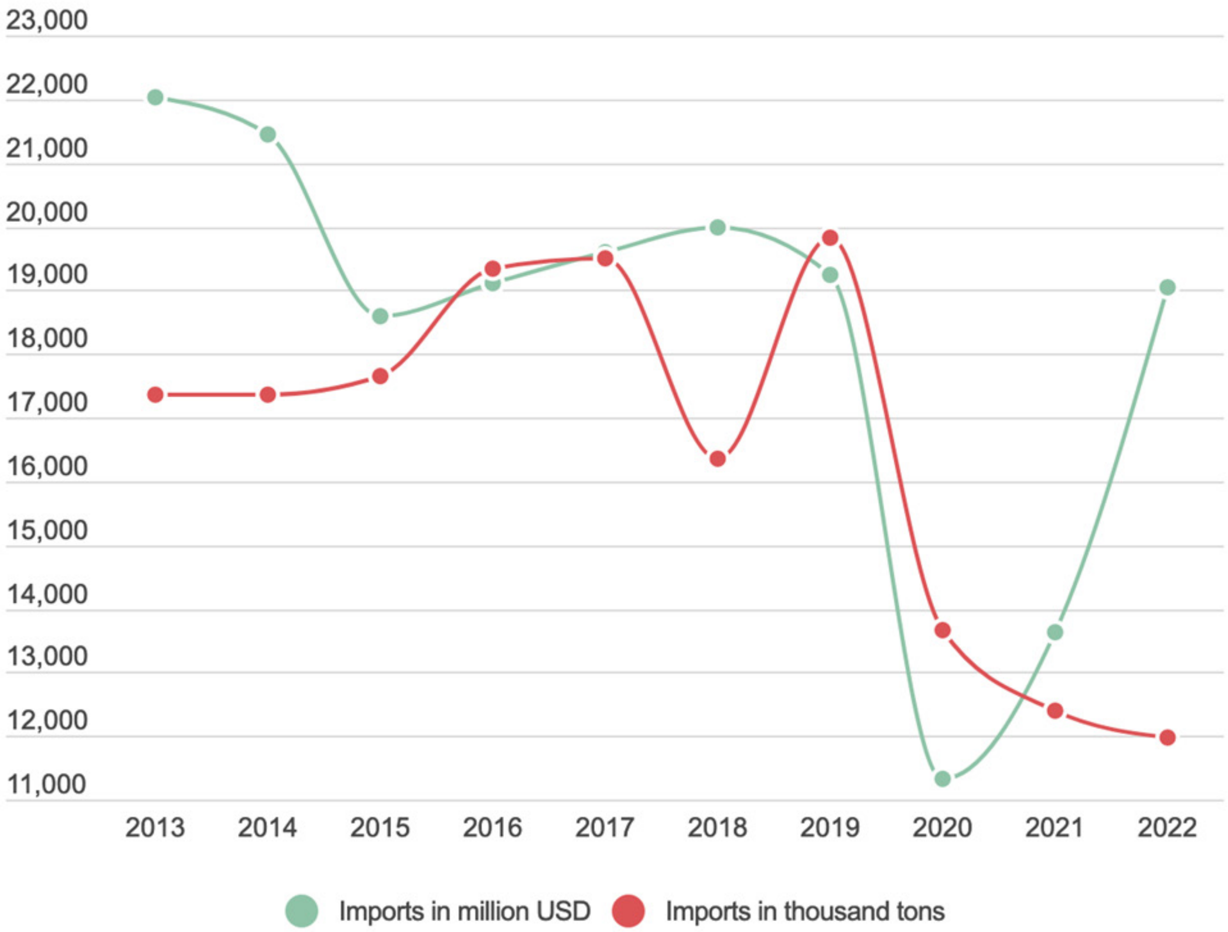


***Figure 2**: Imports in millions of USD and thousand tons between 2013 and 2022.*[9]

Major imported product categories in 2022 included "mineral fuels, mineral oils, and products of their distillation", which accounted for 29.29% of imports; "machinery and electrical instruments" with 12.9%; followed by "vehicles, mainly cars" with 10.49%; and "pearls, precious stones, and metals" with 8.83% (Figure 3).

Petroleum derivatives recorded the highest increase, with an import bill that rose by 44% in 2022, from USD 3.89 billion in 2021 to USD 5.58 billion in 2022 (Figure 3). Despite an increase in import bills, Lebanon imported 15% less mineral fuels and oils in 2022 in terms of quantity. The increased import bill primarily stems from global fuel price hikes and an increasing reliance on generators to provide electricity, with gas oils and fuel oils reaching their highest value levels in 2022 and early 2023. Diesel consumption has increased since late 2019, when already inadequate state electricity production started to falter and residents began spending more on relatively inefficient private generators – compared to state power plants and the national grid – to fill the gap.[10]

[9] Lebanese Customs Administration, الجمارك اللبنانية
[10] A reduction in fuel smuggling to Syria, concurrent with the Central Bank lifting subsidies on fuel imports, also likely led to a drop in petroleum import quantity according to a Blom Investment Bank report, as this eased a likely significant but difficult-to-measure portion of demand. Blominvest Bank, What Drove The Two-Digit Trade Deficit in Lebanon in 2022? January 19, 2023.

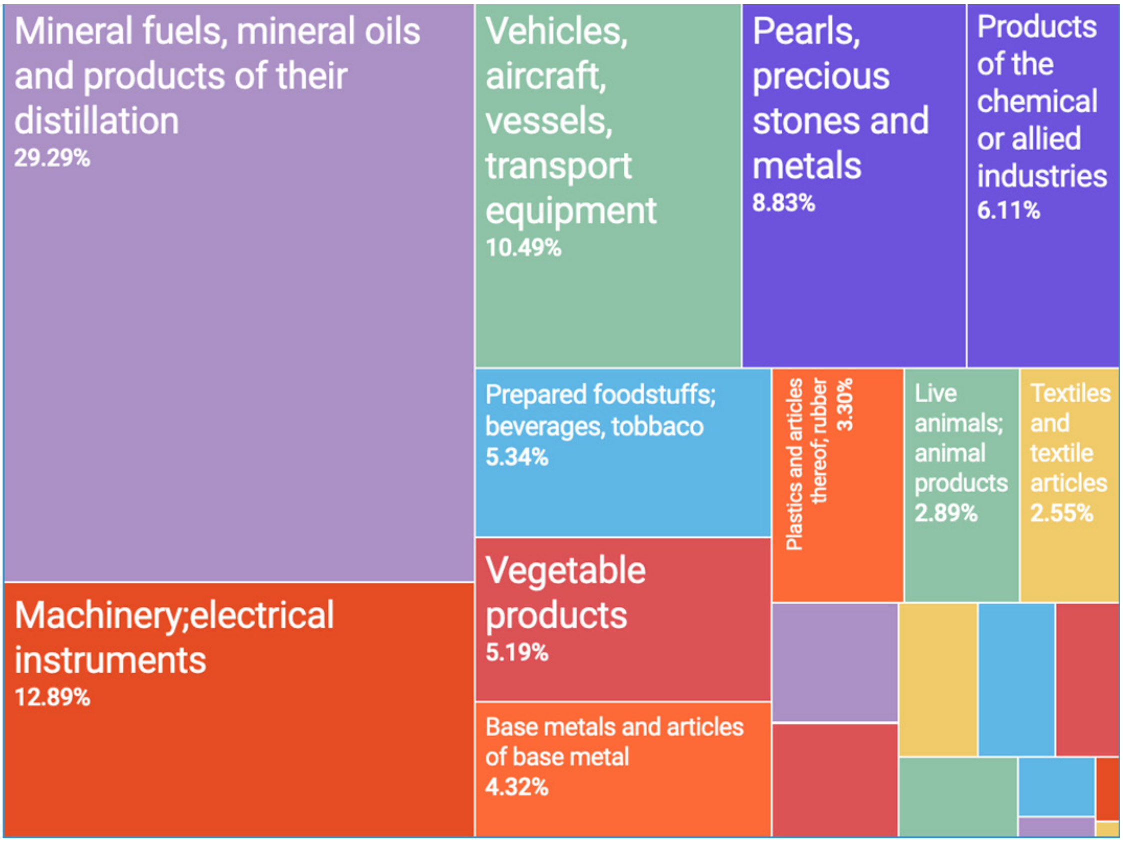


***Figure 3**: Percentage of Imports by Category.*[11]

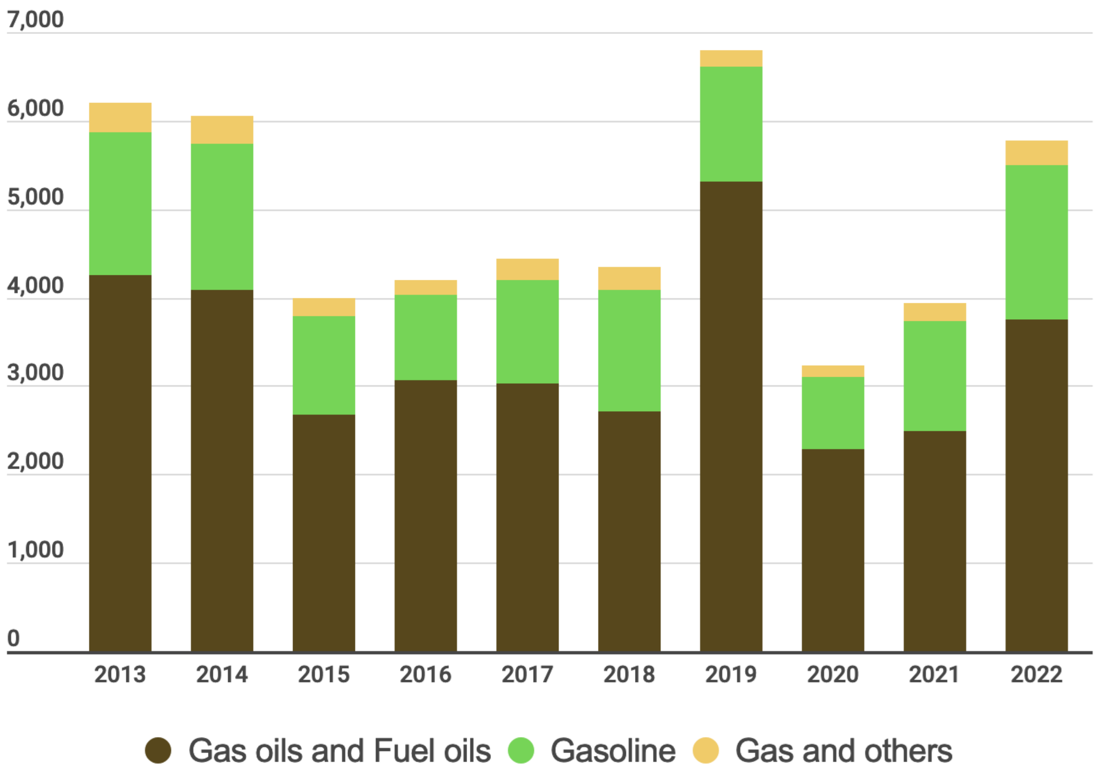


***Figure 4**: Energy import bill in Lebanon in million USD.*[12]

[11] Ibid
[12] Ibid

Inequality and trade: Crisis consumption patterns

When analyzing Lebanon's import trends, it is crucial to highlight discrepancies in the value of essential goods, such as medicines and food, when compared to non-subsistence products like cars and luxury items. For example, the import bill for "works of art, collectors' pieces, and antiques" surpassed that of "baby milk or infant formula" in both 2021 and 2022 (Figure 5). This discrepancy raises important questions about the prioritization of imports and the allocation of resources, warranting a closer examination of implications for Lebanon's economy and society.

> **"The import bill for 'works of art, collectors pieces, and antiques' surpassed that of 'baby milk or infant formula' in both 2021 and 2022."**

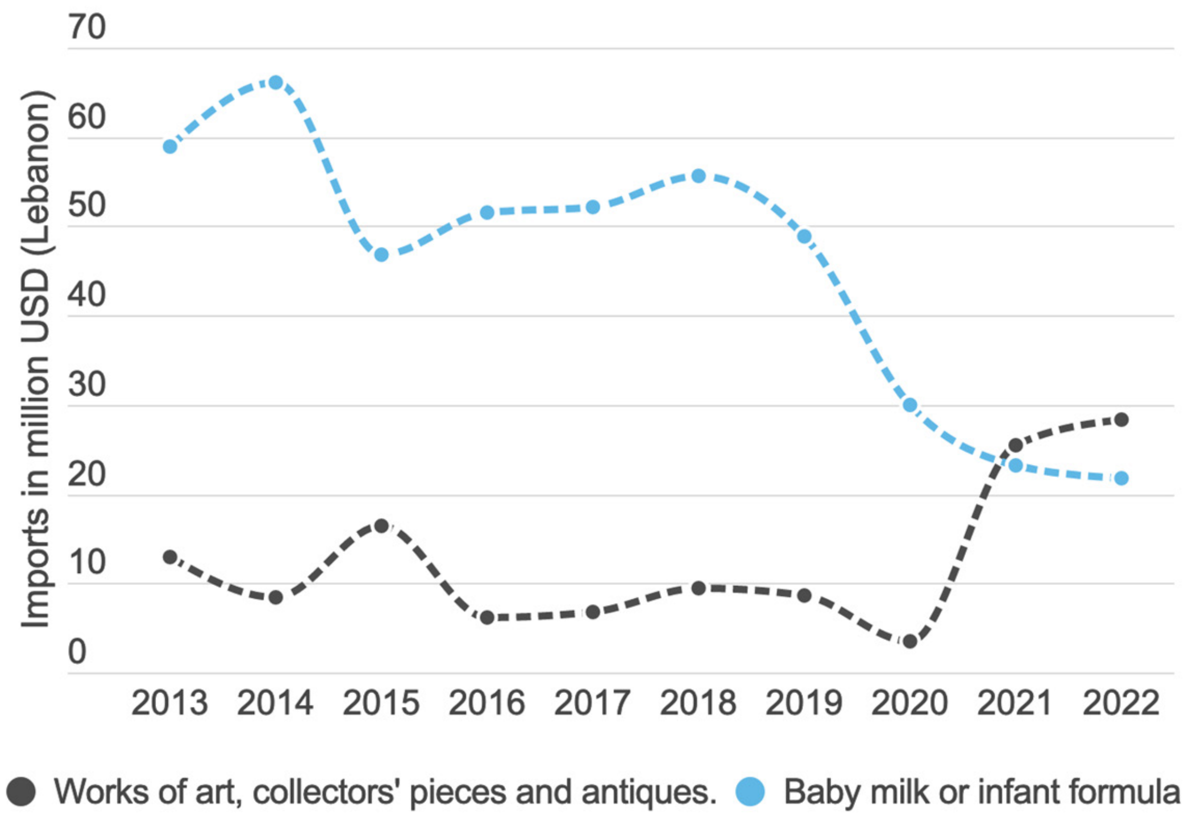


***Figure 5**: Artistic and Baby Milk Imports in Million USD.*

The largest drop in imports by category in 2022 was in pharmaceuticals, which accounted for USD 551 million in 2022, half of that recorded in previous years (USD 1.33 billion in 2018). As a sub-category, medicines reached USD 341 million in 2022, while prior to the crisis, they accounted for approximately USD 1 billion per year.

The progressive removal of import subsidies partially explains the sizable drop in drug and medication imports, in addition to the collapse of the National Social Security Fund and the critical condition of public and private hospitals. This is indicative of Lebanon's poor healthcare system, with many residents deliberately limiting their access to medication and medical checkups or unable to access them entirely.

A lack of access to private insurance is one reason that medicine sales have declined post-2019 according to one pharmaceutical importer.[13] According to the same importer and media reports, the state has struggled to maintain medicinal subsidies, with the Central Bank providing slightly less than USD 25 million per month for the purchase of pharmaceuticals and raw materials for the local pharmaceutical industry.[14] "Unfortunately, USD 25 million is not sufficient to cover the market," the importer said, adding subsidy program administrative errors as well as delays in Central Bank payments complicate imports of subsidized products.[15]

Another import category, "jewelries, precious pearls and metals, including gold," reached a record level of USD 1.69 billion in 2022, fivefold the imports of medicines. This may be partially due to a growing interest in investing in precious material to account for Lebanon's dire monetary and banking situation. Interestingly, the data suggests that most precious metals and stones imported in 2022 were not used in value-added processes to produce exportable items. This suggests that the relatively high volume of precious metal and stone imports was primarily due to jewelry businesses making large purchases before customs exchange rates increased, enabling them to build and maintain stock without paying higher tariffs.[16] Although striking, import statistics on precious stones and metals are likely imprecise because these items are often illegally brought into the country, meaning the total amount imported could be higher than official statistics indicate. An industrialist who follows the trade of gold and precious stones said that diamond dealers travel to Lebanon with millions of USD worth of the stones and sell a portion of them before leaving the country with the rest.**"**There are simply numbers, nothing else**"** ,the industrialist said in reference to Lebanese Customs statistics, who explained that the trade statistic does not account for the fact that much, if not most, of these imports neither remain in the country or are purchased for local jewelers for sale.17 Another industrialist following the trade said that **"**It is the worst kept secret that Lebanon imports gold bars for re-export**"**, meaning the trade does not heavily impact Lebanon's import bill in practice despite data suggesting otherwise.[18]

[13] According to an importer: "Only a tiny portion of [consumers] have private insurance, and people with insurance usually have coverage for hospitalization, but not medication…There is no country in the world where the population can pay fully for their own health."
Member of the Lebanese Pharmaceuticals Importers Association, KII April 2023.
[14] Member of the Lebanese Pharmaceuticals Importers Association, KII April 2023;
L'Orient Today, How the new subsidy halt will (finally) give Lebanese industry a boost L'Orient Today March 2023.
[15] Member of the Lebanese Pharmaceuticals Importers Association, KII, April 2023.
[16] The "import" of gold bullion and diamonds – which together were worth just shy of 8% of Lebanon's import bill in 2022 – is best understood as part of a transnational trade, and not products being paid for in Lebanon and retained by end owners in the country. Jewelries and precious stones were Lebanon's largest export category from 2016 to 2021, peaking at about USD 1.5 billion annually from 2019 to 2021. This value was nearly halved in 2022 to USD 808 million. Unlike in previous years when greater amounts of imported precious stones and metals were reprocessed for export, it appears that jewelers and associated importers sought to shore up their stocks prior to the imposition of a higher customs dollar exchange rate.
[17] According to an industrialist: "All these gold or diamonds should not be considered proper imports or exports, unless brought in for use by local jewelry manufacturers for export."
Former head of Association of Lebanese Industrialists, KII, May 2023.
[18] According to an industrialist: "This does not affect our trade balance, as people in Lebanon did not pay to import them. Someone was sending them and exporting them."
Board member of the Association of Lebanese Industrialists, KII April 2023.

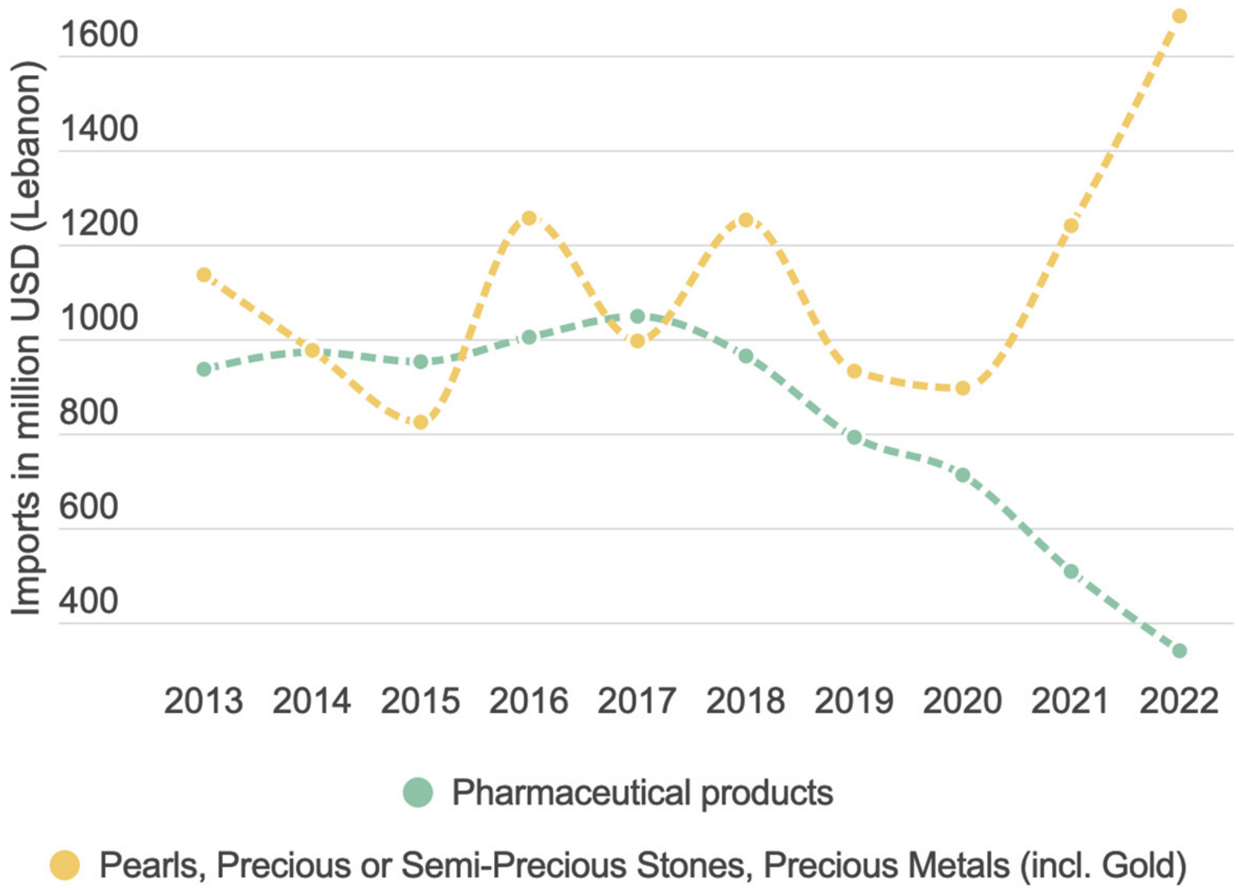


***Figure 6**: Pharmaceutical and Jewelry Imports in Million USD.*

Since 2019, consumers have shifted to purchasing cheaper foodstuffs and in smaller quantities according to a representative of the supermarket syndicate, who added that this has resulted in a 60% to 70% reduction in consumption compared to 2018 and the closure of some 3,000 grocery stores.[19] As shown in figure 7, the value of imported food reached USD 2.7 billion in 2022, up from USD 2.2 billion.[20] While Lebanon remains heavily dependent on imports for its food needs, 2022 food imports remain significantly lower than the USD 3.4 billion in food imports recorded in 2018. Food import data suggests that consumers are adapting to the new reality when purchasing lower cost non-durables. Consumers are increasingly substituting more expensive imports for inferior counterparts, or reducing their consumption where possible. While this trend has helped reduce food import dependency at the macro level, it may have long-term negative impacts on individuals' health and access to nutritious food.

While essential item imports have decreased, cars and vehicles import bills significantly increased from 2020 to 2022, reaching their highest recorded level (See Figure 7). In 2019, car imports totaled USD 1.17 billion, decreased to USD 472 million in 2020, increased to USD 1.12 billion in 2021, and jumped to USD 2 billion in 2022.

[19] According to a supermarket owner: "[Instead of] buying two to three liters of cooking oil, consumers are buying one or even half a liter of cooking oil…during the past three and a half years we have seen consumption decline between 60% to 70% from 2018 levels…We estimate that 3,000 grocery stores out of 25,000 have closed down."
Member of the Syndicate of Supermarkets in Lebanon, KII April 2023.

[20] According to the World Food Programme, the main imported food items in 2022 included cereals (wheat and maize), pulses (soya beans), and vegetable-derived products (sunflower, cane, or beet sugar). Proteins (live bovine animals and cheese) and sweets (chocolate) also featured prominently.
World Food Programme, Market Monitor - Food Security Analysis January 2023.

This increase is striking in light of a decrease in the number of private loans and payment facilities granted by banks, weaker private consumption, and critically low levels of foreign currency reserves to provide credit lines for trade. Other product categories had noticeable increases in their import bill, mainly "manufacturing machinery and inputs", such as plastics, timber, and metals. Those increases and values were the highest recorded over the last 10 years and are likely due to suppliers hoarding stocks before the application of new customs exchange rates on imported products. The customs exchange rate was adjusted from LBP 1,507 to LBP 15,000 in December 2022, increased to LBP 45,000 in March 2023, LBP 60,000 in April 2023, and LBP 86,000 in May 2023, nearly aligning with the "official" Sayrafa exchange rate.

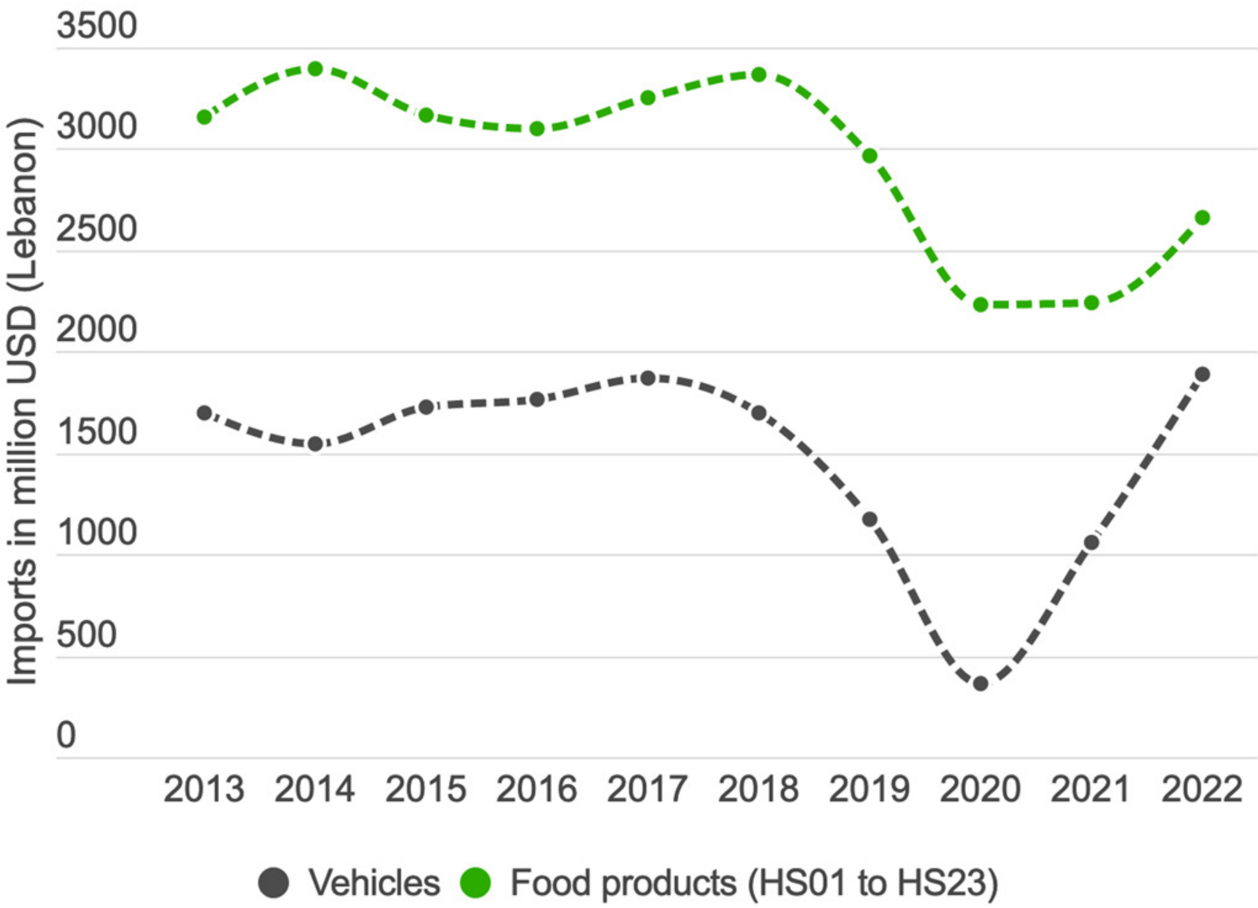


***Figure 7**: Vehicles and Food Imports in Million USD.*

Since 2017, the types of vehicles registered by consumers in Lebanon have changed. In 2017, 52% of registered vehicles were new, while the rest were used. In 2022, 85% of registered vehicles were used, according to an automobile importer familiar with import statistics.[21] While this trend appears to be at odds with importing new cars, a prominent business figure and former minister said that the increase in automobile imports in 2022 was due in part to the anticipated hike in customs fees, incentivizing imports ahead of the new rate, which went into effect in December 2022.[22]

[21] According to an importer: "People in Lebanon prefer to buy an eight-year old used Mercedes or BMW than a new Peugeot or other more economical car." Member of the Automotive Importers Association, KII April 2023.
[22] Former head of Association of Lebanese Industrialists, KII, May 2023;
L'Orient Today, Customs dollar to be set at LL15,000 rate starting December: Finance Minister, November 23, 2022.

Cash-based trade: An enduring pressure on depreciation

According to a recent World Bank report, the systemic failure of Lebanon's banking system and LBP collapse have resulted in a dollarized cash-based economy, estimated in value at USD 9.86 billion, or 45.7% of GDP in 2022.[23] The report asserts that the Central Bank-administered USD-LBP exchange platform, Sayrafa, primarily benefits users by allowing them to profit via arbitrage because currency converted at the official Sayrafa rate – by public servants, importers, and select individuals and businesses – can be reconverted at the parallel market rate.[24] Such practices in Lebanon's new cash-based economy have placed significant pressure on the LBP while commercial banks' limited electronic payment systems and informal and selective capital controls – in addition to a general reliance on cash transactions – complicate importer payments to suppliers.

There is a need to further examine the scale of trade payments settled through recently established offshore accounts, which have been used to streamline transaction procedures. Additionally, understanding the degree of dependency on cash or unconstrained "fresh" dollar accounts within local banks is crucial to gaining insights into the dynamics of import financing. Importers amassing large amounts of USD banknotes from the market has contributed to LBP depreciation. This has made importers part of the "war of attrition" over USD banknotes in the market as intense competition for USD banknotes not only places immense pressure on importers but also affects the overall stability of the Lebanese economy. Cash-based trade in Lebanon also challenges official capacities to monitor and regulate capital flows, leading to practices such as fiscal evasion, incorrect customs and corporate taxes declarations, corruption, and money laundering.[25]

[23] World Bank, Lebanon Economic Monitor, Spring 2023: The Normalization of Crisis is No Road for Stabilization, May 2023.
[24] World Bank, Lebanon Economic Monitor, Spring 2023: The Normalization of Crisis is No Road for Stabilization, May 2023.
[25] LCAT, "Lebanese Financial Service Providers" (forthcoming).

Trading outside the banking system

Lebanon's de-facto insolvent banks are no-longer able to fulfill their role as financial intermediaries by honoring deposits and issuing loans, hampering business growth and consumption. Multiple examples from KIIs conducted across Lebanon illustrate this point. A member of the Association of Lebanese Industrialists said a lack of credit facilities has forced manufacturers into a **"**cycle of ordering raw materials self-financed from sales revenues,**"** which has impaired the sector amid the economic downturn.[26] One poultry sector representative said that limited access to personal savings and **"**no facilities to get new debt**"** has resulted in poultry farms struggling to pool together money from short-term sales, which is needed to buy shipments of chicken feed.[27] Trade credit facilities from Lebanese commercial banks have dried up, with the volume of banks' utilized letters of credit for imports dropping from USD 5.9 billion in 2018 to USD 223 million in 2022.[28] Letters of credit – a mechanism whereby a bank promises to pay a supplier on behalf of a buyer for shipment of goods – are an essential cog of international commerce, covering at least 13% of global trade.[29] In Lebanon, letters of credit covered just shy of 30% of the import bill in 2018 and 2019, before plummeting to between 0.83% and 3.91% in the ensuing years.[30]

In lieu of a lack of requisite access to letters of credit, importers bring USD cash to Lebanese commercial banks to wire to suppliers, using "fresh dollar" accounts.[31] For the most part, importers have been able to adjust to Lebanese banks' increasing fees and commissions on transfers of USD abroad since 2019. Some banks increased commissions to 3% or even 4%, but according to a trade company owner, these policies were quickly reversed when traders with fresh dollars stopped conducting business through these banks.[32]

The timing and structure of payments to suppliers is often dependent on their relationship with exporters and the type of product being traded. Suppliers can request a downpayment and then arrange for the rest of the payment in conjunction with the shipment, or for the full amount up front.[33] Foreign suppliers provide few open credit accounts – a mechanism favorable to importers whereby shipments are made before payment – due to the lack of bank guarantees in Lebanon and the global recessionary environment.[34][35] Suppliers in China and elsewhere in east Asia demand payment up front, whereas some in Europe offer up to three-month timelines for payment.[36] Key informants said that in a minority of cases, large firms in Lebanon can obtain trade financing from banks abroad when they have accounts and collateral in foreign countries.[37]

[26] Board member of the Association of Lebanese Industrialists, KII April 2023.
[27] Member of the Syndicate of Lebanese Poultry Producers, KII April 2023.
[28] Banque du Liban, Documentary L/Cs for Import: Utilized Credits Statistics and Research accessed April 19, 2023.
[29] Friederike Niepmann, Tim Schmidt-Eisenlohr, International trade, risk and the role of banks, Journal of International Economics, July 2017.
[30] Lebanese Customs Administration, Trade Statistics, Ten Years Comparative, By Heading HS4, 01.00 through 99.99, accessed April 26, 2023.
[31] According to an importer: "You bring cash to the bank with supply invoices and other needed documents, wait a couple days, and the bank will transfer it for you." - Steel importer, KII, April 2023.
[32] According to a trader: "One bank tried to increase its commissions to 3% or 4%, so us and other companies said we would not deal with them, and they lowered it back…customers with fresh dollars are king and market forces made them go back in line to pre-2019 fees."
Trade company owner, KII May 2023.
[33] Member of the Syndicate of Importers of Foodstuff in Lebanon, KII April 2023
[34] Member of the Syndicate of Importers of Foodstuff in Lebanon, KII April 2023;- Board member of Lebanese Industrialists Association, KII April 2023.
[35] According to an importer: "Open accounts are largely not available now, maybe for smaller accounts, but since steel costs a large amount of money, payment is up front." - Steel importer, KII, April 2023.
[36] Owner of a trading company, KII May 2023.
[37] According to an importer: "If I want to open a letter of credit in France or Switzerland, some banks do it, but I have to put up collateral from an account there…[generally] the market requires importers to pay in advance because [suppliers] do not trust the creditworthiness of the Lebanese."
Member of the Lebanese Pharmaceuticals Importers Association, KII April 2023;
Board member of the Association of Lebanese Industrialists, KII April 2023;
Board member of Lebanese Industrialists Association, KII April 2023;
Steel importer, KII, Apr. 2023.

Alternative payment methods are available, including informal arrangements for transferring money out of Lebanon to pay suppliers. An importer can approach one of these intermediaries, often called "exchangers," who can then move the money to a partner "exchanger" in Turkey, who will then set up a bank account there on behalf of the customer that can be used for international payments. These "exchangers" take a 2% commission on transfers, higher than the 0.5% to 1% offered by Lebanese banks.[38] A Lebanese importer said he was not interested in using such an arrangement and had approached a licensed money transfer agency to inquire about whether they could handle transfers in the event of any further failure by Lebanese banks' to process international transfers. However, the money transfer agency said it was impossible, as these organizations can only transfer small sums of money each month. An industrialist said that there has been a huge growth in confirming houses – specialized businesses that arrange the trade of goods – in China servicing the Lebanese market since 2019. These confirming houses take cash payment directly in Lebanon from importers and arrange the shipment of goods.[39]

The CedarOxygen fund launched in late 2021 to offer manufacturers short-term financing for the import of raw materials. However, its scope is limited, raising only USD 175 million since its establishment.[40] Two industrialists said that the International Finance Corporation (IFC) – a World Bank Group organization providing international trade finance assistance – is considering restarting its program in Lebanon, but would not move forward until an IMF deal is reached.[41] From 2006 until its program ended in 2019, the IFC provided annual commitments valued at up to USD 550 million through participating banks for trade finance.[42]

Cash-based dollarization in a shadow economy

Lebanon's economy has transitioned to a more-or-less unbanked and informal one since the failure of the country's financial system in 2019. Hefty import bills and trade deficits continue "to be financed from the remaining usable gross foreign reserves at the central bank and a pervasive cash economy," the World Bank wrote in the fall of 2022.[43] In KIIs, stakeholders expressed concerns over the consequences of this development and how it could further complicate Lebanon's relationship with the global financial system underpinning trade.[44]

Generally, a shadow economy encompasses various economic activities that remain concealed from official authorities due to monetary, regulatory, and institutional motives. Monetary motives include evading tax payments and avoiding social security contributions, while regulatory motives entail circumventing governmental regulatory processes.

[38] Owner of a trading company, KII May 2023.
[39] According to an industrialist: "Lebanese set these [confirming houses] up in China, there used to be 1 or 2, but now there are more than 100, which will buy whatever you need, ship it to you, and pick up the cash in Lebanon."
Former member of the Association of Lebanese Industrialists, KII, May 2023.
[40] L'Orient Today, Cedar Oxygen: A tale of disillusionment May 23, 2022.
[41] Board member of the Lebanese Industrialists Association, KII April 2023;
Board member of the Association of Lebanese Industrialists, KII April 2023.
[42] UNESCWA, Trade finance in Lebanon: A recipe for collapse 2022.
[43] World Bank Lebanon Economic Monitor Fall 2022 Time for an Equitable Banking Resolution
[44] According to an importer: "The whole world is seeing Lebanon as risky from a [banking] compliance perspective, they need to know money from here is generated from clean business, but it's a cash business here and there is a major compliance risk."
Member of the Lebanese Pharmaceuticals Importers Association, KII April 2023.

A member of Lebanon's industrial lobby estimated that 70% to 80% of Lebanon's economy is informal and that leads to nonpayment of the state's value-added tax. He also said the cash-based system posed a challenge to banking compliance, adding that it could lead the Financial Action Task Force (FATF), an intergovernmental organization combating money laundering, to place Lebanon on its grey list of countries requiring more monitoring.[45] Echoing a recently published article by Reuters,[46] a banker said that Lebanon's addition to the FATF grey list appears likely. The financial professional explained that in this event, Lebanese banks' correspondent relationships – key for banks' money transfer facilities used by importers – will remain open. Nevertheless, the banker added that correspondent banks abroad "will become more circumspect" of Lebanese financial institutions[47] and a lawyer specializing in Lebanon's financial laws explained that individuals using Lebanese banks to make transfers abroad will be required to provide more documentation if Lebanon is grey listed.[48]

This heavily dollarized cash economy has become the main source of USD for imports, with Central Bank subsidies dwindling since the fall of 2021. The LBP has lost nearly 98.5% of its value against the USD since the fall of 2019, sparking a process of de-jure, state-approved, and de-facto business-mandated dollarization throughout the economy. According to a foodstuff importer, USD is largely sourced from the black market or business transactions,[49] with retailers invoicing in USD or in LBP indexed to USD.[50] Prior to a Ministry of Economy decision in March 2023 that allowed supermarkets to price foodstuffs in USD, more than 90% of importers and local food suppliers invoiced in LBP. Now, almost all suppliers invoice supermarkets in USD, even though about half of consumers pay USD at supermarkets.[51] [52] Certain exceptions exist, such as the Ministry of Public Health policy of setting prices for pharmaceuticals in LBP. Even for medicine, de-facto dollarization has taken hold as actors in the pharmaceutical sector convert and hold nearly all revenues in USD to protect against inflation.[53]

The agricultural sector, meanwhile, is less dollarized, according to an importer, who said that while he invoices in USD, farmers, wholesalers, and others that invoice in LBP do not necessarily convert their LBP revenues into USD on a daily basis.[54] Locally grown fruit and vegetables are less dollarized and less impacted by LBP depreciation than imported goods, though this mainly results from the sector's cheap labor force, which primarily comprises low-paid Syrian nationals.

[45] According to an industrialist: "The impact of this will be immediate, when we are added to the grey list it will become more difficult to transfer money… seventy to eighty percent of [Lebanon's] economy is no longer registered, it's completely informal. The cash economy means you are destroying the formal economy that is registered, invoiced and audited." - Board member of the Association of Lebanese Industrialists, KII April 2023.
[46] Reuters, Exclusive: Lebanon set to be grey-listed by financial crime watchdog, May 23, 2023.
[47] According to a commercial bank executive: "The corresponding banks might continue to work with bigger Lebanese banks, they've known them for a long time, but they might stop working with smaller banks." - Executive at Lebanese commercial bank, KII April 2023.
[48] According to a lawyer focusing on financial and commercial law: "[Offshore banks] will ask everyone transferring money abroad [from Lebanon] to provide more justification and compliance documentation." - Lawyer involved in talks with FATF and Lebanese financial and commercial law, KII, May 2023.
[49] According to an importer: "In this cycle, I as an importer need to have cash in dollars for my transactions, and to get my dollars either I get paid in dollars, or I go to the market to convert Lebanese pounds to dollars." - Member of the Syndicate of Importers of Foodstuff in Lebanon, KII April 2023.
[50] Member of the Lebanese Pharmaceuticals Importers Association, KII April 2023;
Member of the Syndicate of Importers of Foodstuff in Lebanon, KII April 2023;
Board member of the Association of Lebanese Industrialists, KII April 2023.
[51] L'Orient Today, Lebanon's supermarkets to price their items in dollars starting Wednesday February 28, 2023.
[52] According to a supermarket owner: "[Supermarkets] convert their daily receipts in Lebanese pounds to US dollars in order to avoid currency risk … in terms of losing the value of their working capital. This is a normal practice in a hyperinflationary environment."
"[Prior to the ministry decision enabling supermarkets to price in dollars], probably more than 90% of distributors and importers and local manufacturers used to invoice in Lebanese lira. After the decision to price in dollars, almost all of them have converted to invoicing supermarkets in dollars…[as for consumers] close to 40% and sometimes 50% of receipts are now in US dollars in cash." - Member of the Syndicate of Supermarkets in Lebanon, KII April 2023.
[53] According to an importer: "Even if importers are invoicing pharmacies in Lebanese pounds, all players in the sector are automatically converting their revenues into dollars to protect against inflation, acting as if [the sector] is dollarized."
"Why does the Lebanese pound lose its value so much? Because all economic players immediately convert to hard currency. You won't find stability in the parallel market rate, you need to establish trust first [in the Lebanese pound]." Member of the Lebanese Pharmaceuticals Importers Association, KII April 2023.
[54] According to an importer: "Many farmers still believe in the Lebanese pound and will hold onto a 1 billion LBP thinking it will improve to an extent."
Manager of family-owned agricultural importing firm, KII May 2023.

LCAT calculated the pass-through effect of the components of the Survival Minimum Expenditure Basket (SMEB) to measure the level of dollarization of basic goods in Lebanon. The pass-through effect is calculated by measuring the effect of changes in a country's exchange rate (e.g., against the USD) on local market prices. In the case of Lebanon, LCAT measured the effect of the USD-LBP parallel market exchange rate depreciation on changes in the price of basic items. The results, shown in Figure 8, highlight the fact that dollarization began accelerating in 2022 and that the Food SMEB became fully dollarized over the course of 10 months (June 2022 to April 2023). However, the pass-through effect of the Other NFI SMEB was not statistically significant over any time period because the basket includes categories that are less responsive to USD-LBP parallel market exchange rate dynamics, such as telecommunications, rent, water, and education fees.

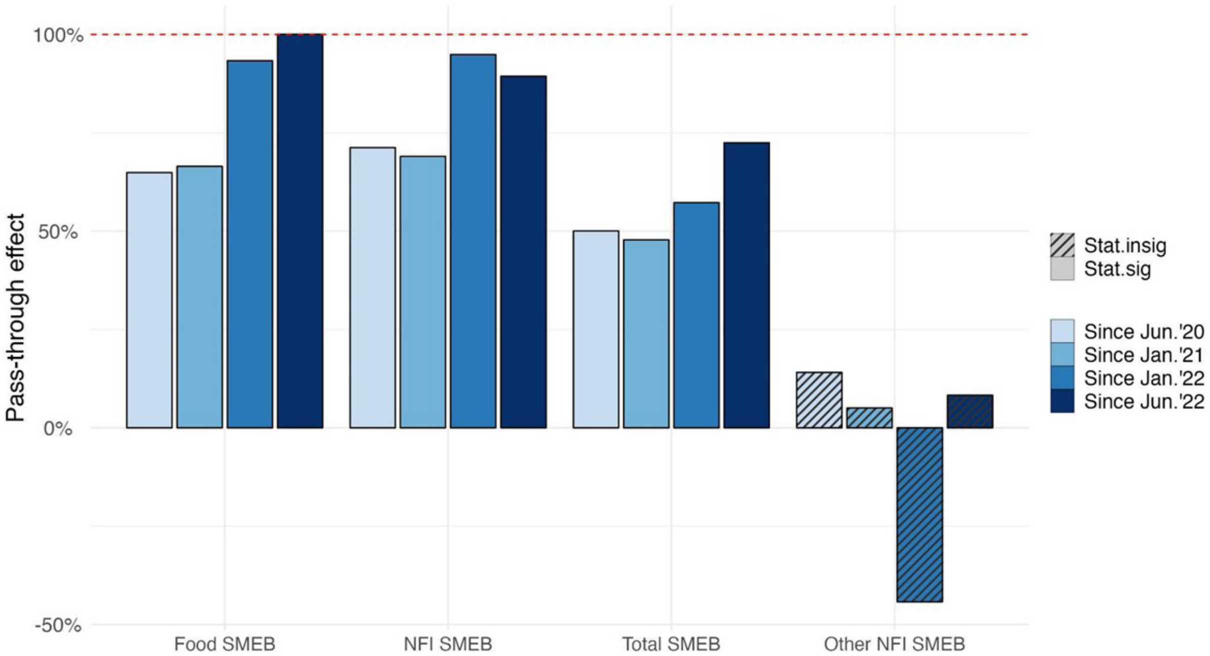


***Figure 8**: The pass-through effect of different minimum expenditure baskets from different beginning months until April 2023.*
The red line represents a 100% pass-through effect, which is essentially a proxy for full dollarization. Price data obtained from the World Food Programme.

Conclusion

During economic crises, imports are expected to decline due to high costs and changes in consumption patterns. Import data for Lebanon in 2022 not only bucks this trend, but also is indicative of questionable resource allocation prioritization. Foreign currency in the market and foreign currency in the BDL's reserves are linked, since the latter must purchase USD from the market as its own reserves dry up. Two separate dynamics are emerging, driven by competition over foreign currency: consumer demand from US dollar holders is channeling resources to non-essential goods, while the country's poorest are less able to afford imported goods, forcing them to reduce their consumption or switch to lower quality imports. Lebanon's lopsided import bill adds to the challenges that many Lebanese households face meeting basic needs due to LBP depreciation and near-comprehensive dollarization. This perverse economic outcome highlights growing socio-economic disparities within the country which carry implications for policymaking and humanitarian programming.

Decisive policymaking is required to rectify this imbalance. Import restrictions could discourage the allocation of foreign currency to non-essential goods while targeted subsidies direct these funds towards essential items. The pharmaceutical sector is an obvious candidate for targeted subsidies, coupled with continued development and humanitarian aid. As shown in this report, declining imports of essential goods like medicines are exacerbating the population's already limited access to vital medications and healthcare services. As residents are forced to limit medical checkups and their purchases of medication, chronic diseases and cases of non-communicable diseases (NDCs) are more likely to increase. Targeted subsidies based on the needs of Lebanon's most vulnerable could take the pressure off low income households in the short run. Later, policymakers could consider ways to foster a domestic pharmaceuticals industry specializing in low-cost generic medication, with continued support from the aid sector.

More generally, reducing dependency on imports by prioritizing local production would enhance Lebanon's resilience to price shocks and encourage long-term economic stability. It would also provide a degree of protection to LBP wage-earners whose purchasing power continues to be eroded, whilst lessening the need for coping strategies such as consumption reduction and product substitution. However, with the government in deadlock, Lebanon appears stuck on a path of import dependency, despite the economic and currency crises which in other contexts might favor increased local production and export-driven growth.

While policymaking aimed at affecting these trends or ameliorating their negative effects falls outside the scope of most aid program targeting, aid actors will nevertheless need to consider import trends and state policies affecting it when planning or implementing programming. The rising prominence of Lebanon's cash-based economy, for example, is complicating importer payments to suppliers, with possible knock-on effects for transactions related to aid programming. In a cash-based society, immediate access to cash in hand remains a priority for humanitarian cash distributions, as does the need to preserve purchasing power in the midst of rapid LBP depreciation. Future programming should also be informed by the shifting vulnerabilities of Lebanon's residents which can be predicted to a certain extent by import dynamics. Food security and access to medication remain key priorities, as demonstrated by the analysis in this report. International aid response will continue to be key in ensuring medical coverage for the country's most vulnerable and access to nutritious food. Further category-specific research is required to better understand the impact of import trends on humanitarian operations.

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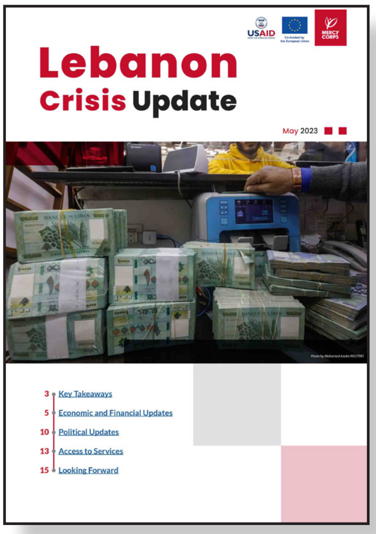

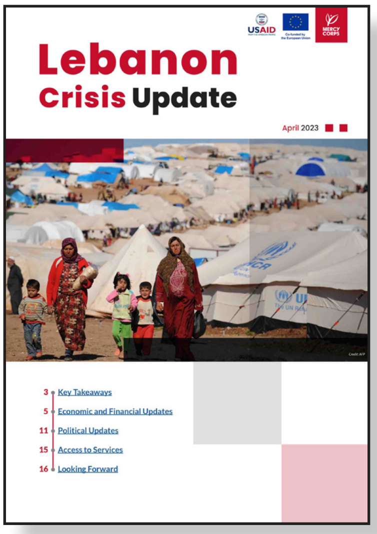

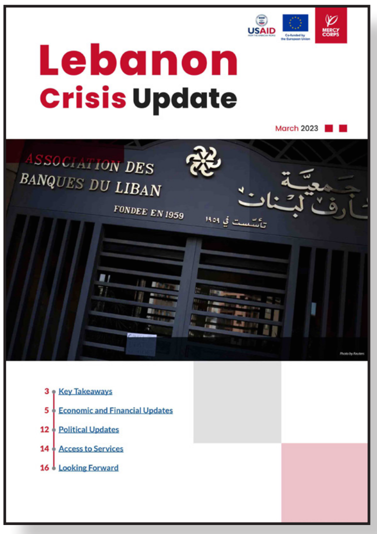

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