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"A refugee, according to the 1951 Convention [relating to the Status of Refugees], is someone unable or unwilling to return to their country of origin owing to a well-founded fear of being persecuted for reasons of race, religion, nationality, membership of a particular social group, or political opinion" .

Refugee crises have indeed become a multi-faceted phenomenon, namely raging across the USA, Europe, and the Middle East today. When the Syrian crisis broke out in 2011, Lebanese households expressed an immeasurable generosity towards displaced Syrians. However, Lebanese hospitality came at a very high economic and social price. Six years into the crisis, Syrian refugees constituted more than 30% of the Lebanese population (1 in 3 is a Syrian).

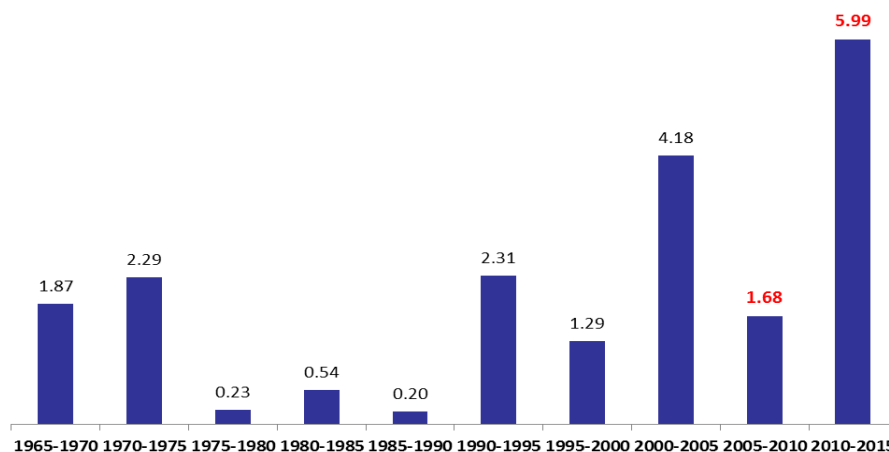
The unprecedented influx and its indirect costs threaten to negatively impact the economy at a quicker pace. The Gross Domestic Product (GDP) growth contracted from 7% in 2010, to 1.5% in 2011, 1% in 2015, and a projected 1% in 2016 as well. Stifled growth rates shadowed a gross public debt that rose by almost 16.5% one year into the crisis, to hit a projected 144% of GDP by 2016. Government spending on public services dilated while revenues contracted, swelling deficits by 16.44% to 8.5% of GDP by 2012; currently, public deficits are back on an upward trajectory estimated at 7.9% of GDP by end 2016.

Besides its geographic proximity, Syria is Lebanon's trade partner, its transit grounds, and its socio-cultural partner. Yet, the Lebanese "relief" -response led by the hosting communities is no longer sustainable or adequate to host Syrian refugees according to the UNHCR's figures. This report traces the economic spillovers of the unparalleled influx of refugees through two transmission channels, the Lebanese labour market and the government budget, and it concludes with a set of best practices proposed to dilute the graveness of the situation in Lebanon.

The large influx of Syrian refugees inhibited Lebanon's GDP growth through labour market developments which contributed to slashing consumption and investment. Under macroeconomic theory, key health parameters like employment levels and labour productivity inflict two major components of GDP: Consumption and private Investment. The substantial

influx of refugees to Lebanon increased the population by 50% compared to the pre-crisis level, increasing the labour force too by 50% as per the IMF. On the expenditure side, the refugee influx is estimated to subtract 2.9 percentage points annually to Lebanon's real GDP growth according to the World Bank.

Average Population Growth in Lebanon over Key Periods



Graph: BLOM Invest; Data: United Nations Department of Economic and Social Affairs.

The Solow Model, a standard macroeconomic labour market theory the IMF applied on Lebanon in 2016, argues that wages fall as the supply of labour rises. The short-lived mechanism hurts workers now earning "less", which encourages precautionary savings and contracts household consumption of GDP. At the same time, capital owners enjoy improved labour productivity. However, on the long-run, higher capital returns encourage new investments that expand capital stock. This in turn increases demand for labour, allowing the market to accommodate the surplus of workers and lift wages back up.

In Lebanon however, the wage cuts expected to emerge in the labour market were magnified and the longer-term recovery was never attained, for three key reasons: a high substitutability between low-skill Lebanese and Syrian workers, low substitutability between local low-skilled and high-skilled labour, and Lebanon's unfavorable investment climate.

First, informally employed low-skilled refugee workers are perfect substitutes of low-skilled local employees, so the intensified competition slashed wages profoundly. Both refugees and locals competed intensely on the same low-skilled jobs partly because they share the same educational level and skills. For instance, 40% of the Lebanese workforce received no or only primary education and only 3% of low-skilled refugees obtained a university education according to the International Labour Organization (ILO). Identical employment profiles pushed employers to replace "around 10,000 Lebanese nationals [...] with 'foreigners [in 2016]', according to Labor Minister Sejaan Azzi, leaving the national unemployment at 11% in 2016 and a projected 20% for 2019 as per the IMF.

This substitution becomes more dangerous in a Lebanese labour market characterized by high informality and composed of Syrian refugee-workers requesting significantly low incomes. The average monthly salary of a Syrian refugee stands at LBP 418,000 (around US\$280), while the minimum wage of a Lebanese worker is LBP 675,000 (US\$450). The cheaper rate of a Syrian worker is surely an advantage; however, according to Haneen Sayed, Human Development Coordinator for Lebanon, Jordan and Syria and co-author of the World Bank 2013 Miles Report, the worrying competition is intensified by the fact that *"[...] 50 percent of the working age population works in informal jobs"* .

The International Labour Organization (ILO) defines an informal market as one where, "explicit and registered work contracts and/or social security coverage for workers on the job [are absent]" . Local employers are therefore granted a leeway to hire whichever choice is "less costly" for their business. The dynamics of such an "informal" labour market would leave wages suppressed, disturbing the transition of low-paid employees to higher wage brackets as dictated by the Solow model.

Furthermore, the higher degree of substitutability also hits (capital) Owners of Lebanese Enterprises. Many small Lebanese firms have been crowded-out of the market by their Syrian counterparts. According to the ILO, *"hundreds of small businesses, including restaurants, retail shops, bakeries, mechanical repairs and others, have been established in the Bekaa and the North by Syrians since the beginning of the crisis."* Syrian enterprises have a comparative advantage on several fronts. First, they are able to offer clientele cheaper prices for goods and services they acquire cheaply through border-smuggling. Second, national laws and the ILO confirm that Syrian businesses can start-up "without monitoring" by the local government, so they do not need a license or even a rented office space. They ultimately escape the high commercial electricity, water, and tax bills.

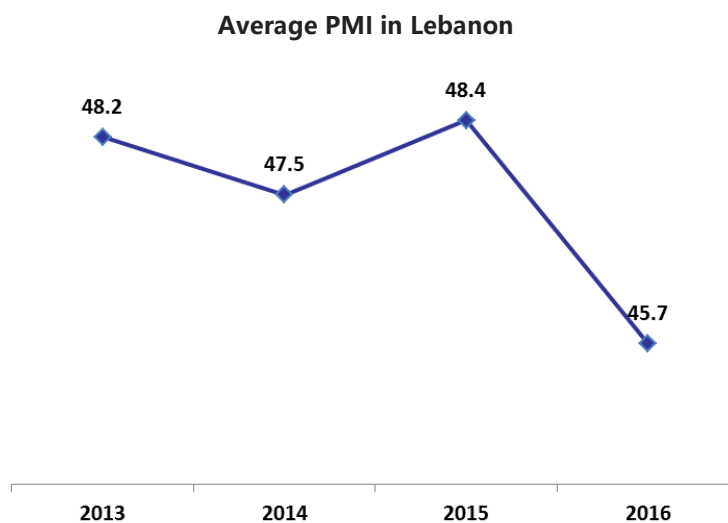
Moreover, these 'foreign' firms stand in host communities exclusively employing Syrians in positions sought by low-skill Lebanese workers, such as: sales persons, waiters, and cleaners. In fact, 45% of Syrian workers are employed in agricultural works, building concierges, taxi drivers, domestic workers, and their likes. Another 43% take on informal positions in commerce and semi-skilled jobs, like carpeting, welding, repairmen, mechanics, handicraft, and food processing. Self-employed Lebanese who provide these services do so at higher charge due to high set-up costs and expensive prices of the goods or services acquired to sell customers. In private interviews conducted by the ILO with resident low-skilled workers in the North, the Bekaa, and Baalbek regions experiencing highest rates in terms of poverty and worst case in terms of refugee concentrations, 90% of the local workforce reported their incomes were slashed by 30 to 50%. Against this backdrop, the magnitude of the contraction in wages cripples the economy and prevents it from pulling wages back up.

Second, low-skilled Lebanese workers were unable to move into the higher-paying jobs of the local high-skilled to dilute the protracted, low wages. Ideally, if the low-skilled local workers competing with Syrian-refugees could substitute the higher-skilled local workers, they would be able to move into higher-paying skilled positions, surmount the direct competition,

and re-boost their wages to meet original consumption levels. In parallel, the market would clear for Syrians to occupy the low-skilled jobs.

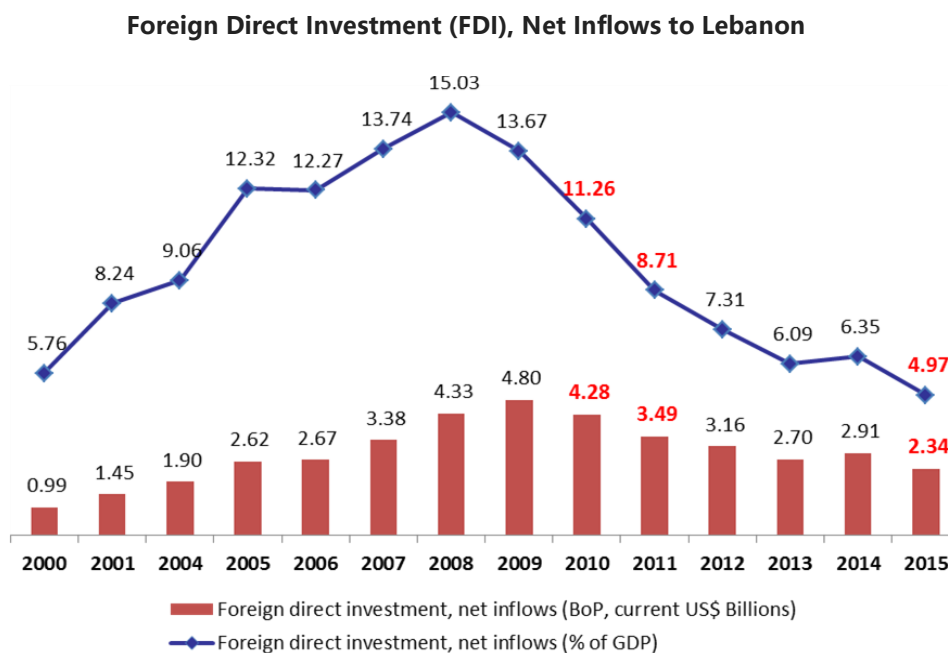
However, the Lebanese economy fails to create sufficient jobs to “absorb the growing number of job seekers [...]”, according to Ferid Belhaj, the World Bank’s Middle East Director. The few jobs left created by the economy are concentrated in “low productivity sectors” as per the World Bank’s Miles Report. Ultimately, the intense competition between low-skilled Lebanese and Syrians persists in a vicious cycle, with wages left to free fall to protracted highs.

Third, Lebanon’s unfavorable investment climate lengthened the market’s recovery of lower wages as it suppressed investment in job opportunities for new market entrants. New job opportunities for market entrants and existing labour became non-existent in light of Lebanon’s labour market dynamics and elevated degrees of substitutability. So, foreign investments remain the only possible option to relax the strain imposed by Syrian refugees. Nonetheless, Lebanon has also been struggling on this front since 2011. Its PMI parameter which reflects the health of the private sector and its ability to engage in new projects, is subdued, leaving the labour market further pressured.



Source: Markit; Blom Bank

In addition, Lebanon is characterized by weakened growth outlooks, low or non-existent investment incentives, and undermined local confidence, as mentioned in every IMF Article IV since 2011. With Foreign Direct Investments (FDIs) on a fast downward trajectory, key players of the economy are not empowered to create jobs for new local entrants, refugees, or to attract the educated workforce to stay and modernize the labour cycle so that it contributes more efficiently to GDP. Given the main hurdles to FDI and the intensifying internal competition, households’ and businesses’ propensity to spend and invest declines, and so does their contribution to GDP, leaving a labour market that is irreparable, from inside or outside.

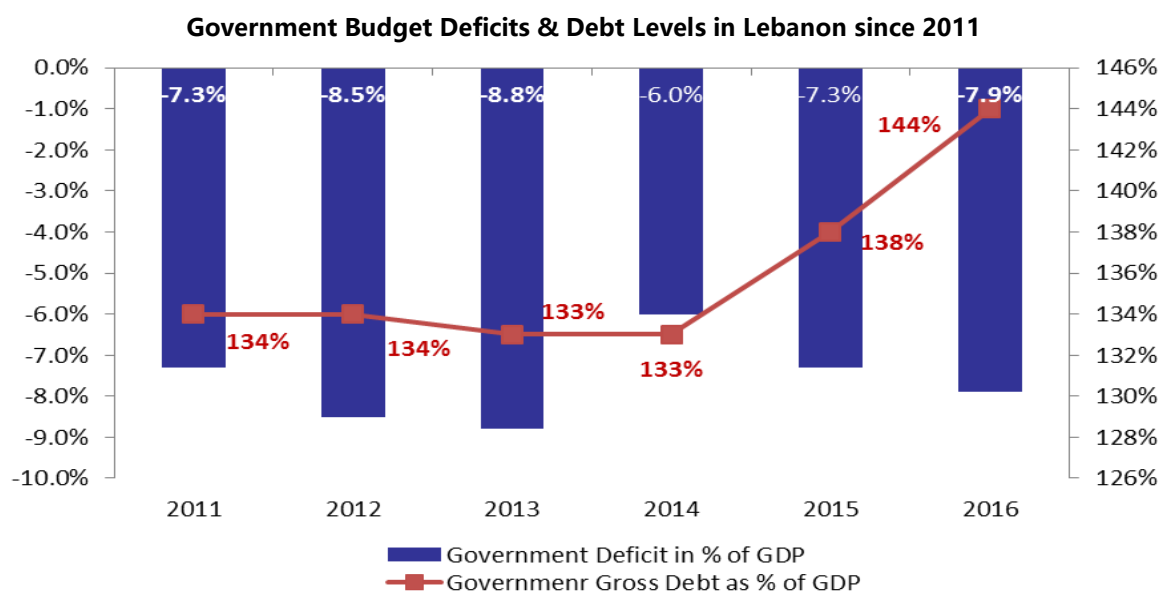


Graph: Blom Invest, Data sources: World Bank, IMF BOP Database, UNCTAD, & official national sources.

Alongside the impact of refugees on local private consumption and investment, the indirect fiscal costs of Syrian refugees magnified refugee-specific expenditures and reduced tax revenues, ultimately pressuring the government budget. It is mostly argued that the Lebanese Government is “fairly” sharing the burden of refugee costs on food, health, and education services with the international community, which is mainly the UNHCR and its fellow UN government agencies in Lebanon. However, this is only partly true for two key reasons.

First, the UNHCR’s database updated on Jan.1, 2017 shows that 45% of the funding requested has not been granted yet, while the Lebanese Government is covering the gap indirectly. It is worth noting that while 55% of refugee costs are funded by the UNHCR & sister agencies, this 45% gap (approximately \$850.46 million) of refugee-related costs was left to be tackled primarily by the local Lebanese government as indirect social and infrastructure costs. By doing so, the Lebanese economy has maintained a certain degree of stability.

In fact, “economic stability” is a public good and its provision is the prime responsibility of national governments who strive to give citizens a chance for a “fair quality of life” through a stable economy and affordable costs of living. However, the advent of more refugees heightened refugee-specific expenditures by 24% and 15% in 2012 and 2013, respectively, exacerbating Lebanon’s budget deficit and reducing the country’s capacity to discipline its elevated Debt-to-GDP ratio.



Graph: Blom Invest, Data source: IMF Article IV of 2016, 2015, and 2011.

Second, Syrian refugees not registered with the UNHCR settled in host communities where they strained the country' s already weak infrastructure. Not being a signatory of the 1951 Refugee Convention, the Lebanese government facilitated the entry of Syrian refugees to Lebanon, and therefore, their access to public services. The World Bank' s Economic and Social Impact Assessment of the Syrian Conflict on Lebanon (ESIA, hereof) estimated the direct fiscal cost over 2012-2014 at US\$2.6 billion, of which US\$589 million are in infrastructure losses: water and sanitation, electricity, and transport sub-sectors. An additional US\$1.1B is incurred if action is taken to restore infrastructure access and quality to pre-crisis levels.

The influx of refugees shot electricity usage , water consumption, and healthcare services to new highs. Pre-crisis, under-capacitated EDL was funded by high government transfers, while water supplied 13hours per day was strained with an extra 7% consumption by 2013. Increased demand on healthcare services also triggered severe shortages in health workers and increased unpaid commitments by the Ministry of Public Health (MOPH) to contracted hospitals.

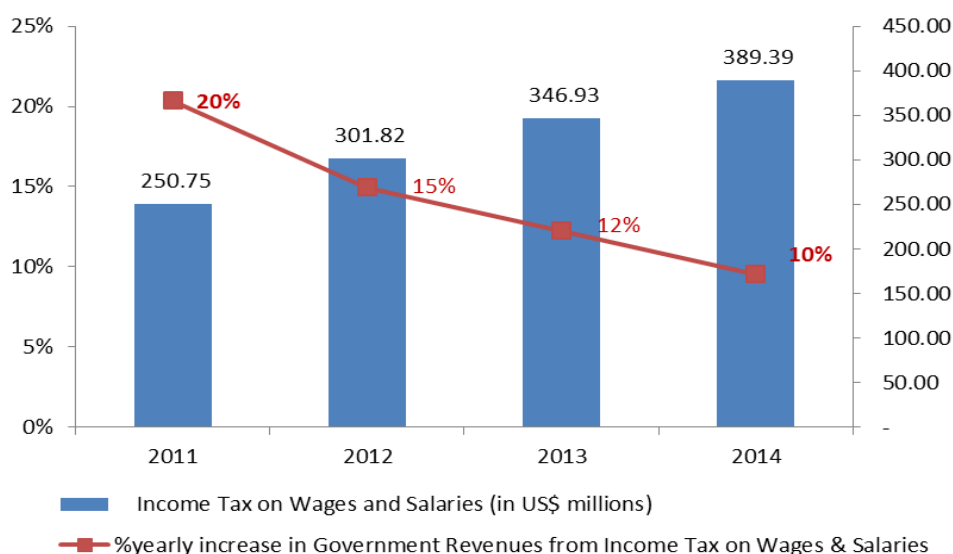
In addition, the quality of education in Lebanese public schools deteriorated especially in overcrowded regions. Lebanese public schools accommodated for only 30% of total students, yet they received 40,000 refugee children in 2012 alone. The Ministry of Education and Higher Education (MEHE) paid an additional US\$29M to integrate them, while total student capacity was stretched to 57% by 2014. With the growing number of refugees, schools will necessitate new buildings and equipment, expenditures that will further strain government funds.

Ultimately, the quality of life of citizens changed, leaving more citizens below the poverty line. The UNDP' s 2008 national poverty assessment pre-crisis confirms around 30% of the

Lebanese population (1 million individuals) were living below the poverty line of US\$4 per capita per day. The study was complemented by the 2013 ESIA Report, which revealed very high poverty rates concentrated in Akkar area (53% poverty rate) and the Bekaa (40%), where Syrian refugees mainly settled. The World Bank estimated 170,000 to 200,000 additional Lebanese lived below poverty line by 2014, as the access of already poor and vulnerable families to adequate public services and jobs was slashed by the large number of settling Syrian refugees.

On the revenues side of the government budget, losses were incurred in revenue collection and taxes on wages and salaries since 2011. Revenue collection from overcrowded communities and informal employment fell by US\$1.5B between 2012 and 2014, according to a World Bank estimate. Knowing that a chunk of government revenues is collected from taxes on workers' salaries and wages, the wider workforce base formed in the labour market ideally meant substantially higher government revenues earned from taxes paid on wages. However, the high degree of informality and substitutability between Syrian and Lebanese workers stifled the growth of income tax revenues. The latest figures available from the Ministry of Finance reveal that the pace of growth of government revenues from Income tax on wages & salaries is on an alarming downward trajectory.

Yearly Government Revenues from "Income Tax on Wages & Salaries"



Graph: Blom Invest; Data: Ministry of Finance

In conclusion, the economic spillovers of the large influx of Syrian refugees to Lebanon hit the two key transmission channels. The dynamics of the labour market as well as the government budget could not handle the unprecedented pressures created by the refugee influx. The strain on labour market participants and on the government continues to be unmanageable, and the future outlook for Lebanon's under capacitated and highly leveraged economy is grim if strategic action fails to be taken.

In parallel, the ongoing humanitarian “relief-response” the Lebanese have led since 2011 proves insufficient. The capacity of the Lebanese economy has been stretched since 2011, in attempts to meet the growing social and economic demands of locals and displaced Syrians but to no avail.

Currently, the Lebanese government is contemplating a solution to return some of the Syrian refugees to safe zones in Syria, in coordination with the Syrian government and international agencies. In addition, the government’s “open border” policy needs to be revisited with the concerned international and regional entities to limit the inflow of unregistered Syrian refugees. The reality shows that any further straining of the host communities’ already limited resources would push further citizens into poverty.

On alleviating the strain on the Lebanese government in particular, greater support from the international community is vital. Endorsed by the UN or its agencies, the international community is incited to share the burden of “indirect costs” incurred by the Lebanese government, in the forms of infrastructure spending and provision of public services.

Last but not least, a labour-specific measure proposes a new legislation. To optimally alleviate the prolonged downward pressures on wages and crowding out of Lebanese enterprises in the labour market, the government is encouraged to propose a new legislation that mandates, if not treat Syrians entirely as “foreign workers” in Lebanon, that refugee-workers and their enterprises are on the same level playing field of Lebanese workers and local firms. This procedure would render Syrians’ labour activities bound by legal payments, such as the National Social Security charges, income taxes, and business licenses the same way the Lebanese workforce is accountable on these to its government.

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The Economic Burden of Lebanese Hospitality During the Syrian Crisis



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