How High is Inflation to the Lebanese Poor? An Approximation

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Type of Expenditure	October 2019 Index	April 2022 Index	Actual Weights %	Adjusted Weights %
Food	110.29	4396.97	20	50
Tobacco and Alcohol	125.86	3050.25	1.4	1
Clothing and Footwear	194.6	5224.99	5.2	3.9
Housing and Utilities	107.83	288.08	28.4	21.2
Household Furnishings	118.82	3631.21	3.8	
Health	98.63	675.27	7.7	5.8
Transport	97.74	2496.61	13.1	9.8
Communication	77.03	202.50	4.5	3.4
Recreation	123.81	1193.63	2.4	
Education	123.97	186.22	6.6	4.9
Restaurants	115.19	5408.82	2.8	
Miscellaneous	114.19	2287.73	4.1	

	October 2019 CPI Index	April 2022 CPI Index	Overall Inflation %	Monthly Inflation %
Actual Weights	110.34	1092.21	889.9	29.7
Adjusted Weights	110.86	2793.64	2419.9	80.7

There are three interrelated things that stand out about the Lebanese crisis that has entered its 32nd month by June 2022: the disintegration of the banking sector, the collapse of the exchange rate regime, and the extent of poverty. While the first two have garnered a lot of analysis and debate, the third – the extent of poverty – hasn't, except from some international organizations and NGOs, most notably the ESCWA[1].

The inter-relatedness arises from the fact that exchange rate depreciations – especially for an import-dependent country like Lebanon – translate via the pass-through effect into higher prices, which in turn impact negatively the cost of living and poverty, especially if these were not met by corresponding adjustments in income or wages[2]. So the crucial link is that of prices or the general price level. In this respect, the Central Administration of Statistics (CAS) has done a commendable job building a Consumer Price Index (CPI) for Lebanon since 2008 so as to gauge the cost of living in the country. The index is based on consumer surveys whereby the weight for each price category is set by the expenditure share on each of these categories by the *median household.*

The table above shows the twelve price categories (note that the one for Housing and Utilities include gas, water, electricity, and fuel) with their corresponding weights; and they reveal that the CPI rose from 110.34 in October 2019 (the starting date of the crisis) to 1092.21 in April 2022 (the last month of available data); in other words, it has risen by 889.9% for the 30-months period *or by 29.7% on an average monthly basis*. Note also the steep rise in the food price index from 110.29 to 4396.97, the third highest price increase after restaurants and clothing. As important, during the period, the LBP exchange rate to the USD depreciated from 1,800 to 26, 800, a depreciation of 1390% for the period or *46.3% for the monthly average*. The latter, when compared to the monthly average inflation rate of 29.7%, implies a *pass-through effect from exchange rate changes to inflation of about 65%.* As to be expected, it is not 100% due to the impact of non-tradeables or services in the index.

That said, the crucial figure to discern form the above table is the weight of 20% assigned to the food price index. That is because it is the weight given by the expenditure of the representative median household on food. But the thing is, this median household is not representative of poor households; more to the point, *poor households are known to spend at least 50% of their expenditures on food*[3]. An interesting question at this point is: who are the poor? Latest World Bank data show that the poor are those who live at $2.15 (at 2017 prices) or less a day; so given that USD inflation between 2017 and 2022 is at 20%, then the poverty line in 2022 prices is given at $2.6 per day or $78 per month. In Lebanon, at end April 2022, with the exchange rate at 26,800 LBP per 1 USD, *this would be equivalent to 2 million LBP, which is exactly equal to the Lebanese minimum wage*[4]. This is a finding to be remembered, as it simply means that all what the Lebanese minimum wage does is to enable one person to live at or sit on the poverty line!

[1] See: ESCWA, "*Multidimensional Poverty in Lebanon",* 2021.

[2] In well-managed, developed economies, higher cost of living usually ignites higher wages to protect purchasing power. This could cause a wage-price spiral that is known as cost-push inflation. In Lebanon, however, most of the inflation we see is because of the pas-through effect.

[3] See the classic paper: Banerjee, A.V. and Duflo, E. 2006. "*The Economic Lives of the Poor"*, MIT, Department of Economics Working Paper, 6-29.

[4] Note that the minimum wage was increased in mid -June 2022 to 2.6 million LBP.

To revert back to the fact that the poor spend 50% on food, and in order to capture the impact of this fact on inflation, we have assigned a weight of 50% for the food price index, instead of 20%. Additionally, we included 7 additional categories (Tobacco and Alcohol, Clothing and Footwear, Housing and Utilities, Health, Transport, Communication, and Education), as the poor can't afford to spend outside of basic necessities (restaurants, for example). We have also adjusted the weights for each of these 7 categories: for instance, the sum of the actual weights for these 7 categories is 66.9%, so Housing and Utilities at 28.4% becomes actually 42.4%; and since all 7 categories are assigned a weight of 50% in the adjusted weighting scheme, then Housing and Utilities' new adjusted weight is at half of 42.4% or 21.2%; and so on.

Given the above, what would be the corresponding CPI with the new adjusted weights?. This would be given by the calculation below:

CPI October 2019 = 0.5 (110.29) + 0.01 (125.86) + 0.039 (194.6) + 0.212 (107.83) + 0.058 (98.63) + 0.098 (97.74) + 0.034 (77.03) + 0.049 (123.97) **= 110.86**

CPI April 2022 = 0.5 (4396.97) + 0.01 (3050.25) + 0.039 (5224.99) + 0.212 (288.08) + 0.058 (675.27) + 0.098 (2496.61) + 0.034 (202.50) + 0.049 (186.22) **= 2793.64**

A CPI that would reflect better the poor's living conditions has risen from 110.86 in October 2019 to 2793.64 in April 2022; this is equivalent to an overall inflation rate of 2419.9% or a monthly inflation rate of 80.7%. It is also *2.7 times higher* than the actual (of actual weights, that is) monthly inflation of 29.7%. It is no wonder then that ESCWA's report *Multidimensional Poverty in Lebanon* argued that Lebanon's poverty rate has increased from 27% to 78% because of the crisis – *poignantly, an increase by 2.8 times*. A relevant question here is: Has the poor witnessed any adjustments in income along the way? The only adjustment that we can track is for the increase in the minimum wage that rose from 675,000 LBP to 2 million LBP, an increase of close to 200% at a time when their corresponding CPI rose by many multiples of that!

It is apparent that the country has failed the poor, and it has failed them on two essential grounds. First, instead of devising a cash-based, direct support program that could have benefited them individually outright, the government – especially the previous Diab Government – has implemented a blanket subsidy program that was applied to all classes and that has cost the country in precious foreign exchange (FX) more than $10 billion[5]. And the end result has been, paradoxically, doubly negative: *wasted FX resources, in conjunction with rising poverty*. Second, and in fact this is what perhaps strikes you most about the Lebanese crisis, is the absence whatsoever of any reform and recovery program to deal with the crisis and its ramifications on the poor – an unprecedented inaction or impotence that is truly impossible to justify!

The last point is very fundamental because experience shows that the *most effective antidote to poverty is steady and inclusive growth*[6]. The endless debate on IMF programs

[5] Between October 2019 and April 2022, BDL has lost $19 billion in FX currency reserves, from $31 billion down to $12 billion

[6] China, for example, grew at more than 10% annually between 1978 and 2000; as a result, its official statistics show a dramatic reduction of China's poor population from 250 million in 1978 to 32 million in 2000. As a share of the rural population, the poverty headcount fell from 33% to 3% over this period, a reduction of historic magnitude.

won't create jobs; and the hot-air talk about "resistance" and "self-reliance" won't deliver growth. What delivers growth is putting to work efficiently its essential ingredients – notably: political stability, macroeconomic prudence, healthy banks, open and attractive investment climate, smart capital and labor, and, perhaps most importantly, good governance and institutions. In this respect, an IMF program is at best a necessary condition, but unless these ingredients manifest themselves sufficiently, the program will not succeed and poverty will only get worse. And the implications of that will be grave, not only because with rising poverty society will be badly nourished, badly educated, and badly tempered, but also because the basis of citizenship, societal bonds, and civil peace will be eroded.

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