Does Lebanon Need a New Economic Model?

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Trillion LBP	2018	2019	2020	2021
GDP	82.8	80.3	96.9	245.6
Total Exports	17.2	16.6	27.2	96.2
Goods Exports	5.5	7.0	16.4	53.1
Service Exports	11.7	9.6	10.8	43.1
Total Imports	39.3	33.9	57.2	212.5
Goods Imports	29.8	24.9	45.9	172.8
Service Imports	9.5	9.0	11.3	39.7
%				
Goods Exports/ Service Exports	47	73	152	123
Goods Exports/ Goods Imports	18	28	36	31
Total Exports/ GDP	21	21	28	39
LBP				
Exchange Rate per USD	1,507.5	1,507.5	3,879.6	12,413.7

Source: CAS

Being a small, open economy, Lebanon’s productivity and economic potential is perhaps best measured by its export capabilities and success. Traditionally, Lebanon’s export base is known to have *centered on services* – mostly: tourism and travel; finance; real estate; personal, cultural and recreation; and transport. But the financial crisis, which erupted in October 2019 and continues unabated, has damaged the confidence in this model and even accused it of being rentier or crony. There are thus insistent calls now for a new “economic model” that is centered largely on the *export of goods*, sustained by a wider industrial and technological base[1]. In this sense, the purpose of this short note is to assess the viability of such a transformation and whether the export-based model can be turned around towards goods and tech products[2].

But why was Lebanon's economy centered on an export base of services? In the economics literature, comparative advantage arises as a result of nature and/or nurture; in other words, it is determined by geography and resource endowments on the one hand, and/or national policies and skills development on the other hand. In Lebanon, comparative advantage in services was established early as the outcome to some of these factors: the country's beauty and its strategic location on the Eastern Mediterranean, along with its liberal, open economic policies and the relatively good education and flair of its people. As such, between 1950 and 1975 (the year the civil war started), Lebanese service exports were probably at their apex, considered to be the best in the region. After the civil war ended in 1990, service exports managed to do well till 2018, but they didn't regain their previous shine. And since the financial crisis erupted in 2019 – not to mention Hezbollah's mindless 'resistance' wars since at least October 2023 -- the country's position as an export services hub has been further weakened, in that tourism, banks, hospitals, universities, ports, media, art and publishing houses…etc, are no longer what they used to be and they have become perhaps a shadow of their previous self.

How well do the data agree with this analysis? We will answer this question using 'relative terms or ratios', which is the proper way to analyze issues in base theory and policy. In 2018, which is a rough indicator of the pre-crisis years, exports of goods and services (total exports) stood at $11.4 billion, with goods exports at $3.7 billion and service exports at $7.7

[1] Among others, see: Tawile, J. "After the Crony: A New Competitive Model for Lebanon*", Konrad Adenauer Stiftung, November 2021*; Bisat, A. and Diwan, I. "Towards a Productive New Lebanon", *Issam Fares Institute, AUB, March 2025.*

[2] Keep in mind that in terms of structural transformation, the share of services in the economy is bound to increase over time. In 1973, the sectoral shares in the economy were as follows: 9.1% agriculture; 20.4% industry; and 70.5% services. Whereas in 2021, they were: 5.2% agriculture; 10.8% industry; and 80% services.

billion, or goods exports were less than half of service exports (47%). On the other hand, imports of goods and services stood at $26.1 billion, with $19.8 billion for the former and $6.3 for the latter. More important, with service exports larger than service imports ($7.7 billion vs $6.3 billion), we can simplistically but not unreasonably argue that Lebanon's comparative advantage laid in services, while the opposite is true for the case of goods ($19.8 billion vs $3.7 billion), implying that Lebanon had a comparative disadvantage in goods[3].

For the crisis years, the data from the Central Administration of Statistics runs to 2021 only, unfortunately! But still, we can tell an interesting story.

Although services remained mainly the country's comparative advantage by our simple yardstick (except for the deep crisis year 2021), goods exports performance was relatively better, both in relation to goods imports and to service exports. That is reflected in the ratio of goods exports to goods imports which increased from 18% in 2018 to 31% in 2021, and the ratio of goods exports to service exports which rose from 47% to 123%. We don't expect this pattern to have changed much going onwards, except perhaps for higher service exports in 2022 and 2023. More interesting, we believe that this relative improvement in goods exports had a lot to do – other things being constant -- with the depreciation in the exchange rate that changed on average from 1,507.5 to 12,413.7 LBP per USD.

But the real story lies elsewhere. In 2018 total exports to GDP was at a lowly ratio of 21%. For a small open economy like Lebanon, it is widely believed that a ratio of total exports to GDP should be around 50% so as to take advantage of the larger foreign markets that compensate for the limited domestic one. Even later in the crisis years, when this ratio reached 39% in 2021, it was in all likelihood an outlier, as the over-estimation was due to the unusual fall in GDP during the deepest year of the crisis. The

[3] Service exports also had a larger income multiplier than good exports: 2.12 vs 1.35;.see, "Can Lebanon Turn Around its Export-Based Economy? A Brief Note", Blominvest Bank Blog, Spotlight, February 2022 The reason is that services are more labor intensive and don't require as many intermediate imports..

point is that at these low ratios of exports to GDP, the engine of exports was underperforming, both for services and goods, though up to 2018[4] it was more so for goods because of the overvalued exchange rate -- fixed at the rate of 1,507.5 LBP per USD -- that normally favors the services sector visa-vis other sectors[5]. More important, this underperformance of total exports is fundamentally related to structural factors that primarily has to do with poor governance, inadequate infrastructure, a cumbersome business environment, and of course political instability[6].

1973	Million USD
GDP	2,679
Total Exports	1,240
Goods	670
Services	570
Total Imports	1,510
Goods	1,320
Services	190
	%
Total Exports /GDP	47
Goods Exports/Services Exports	117
	LBP
Exchange rate per USD	2.65

Source: World Bank, “*Current Position and Prospects of Lebanon*”, May 1975.

We can see the significance of this argument by looking at the corresponding figures for 1973, perhaps the last year of Lebanon’s ‘good times’ in the pre-civil war period. Though, simply, Lebanon’s comparative advantage still laid in services as service exports were larger than service imports ($570 million vs $190 million), the interesting thing is that the ratio of total exports to GDP was at 47%, indicating a potent performance on the part of the total export sector. Also interesting is that goods exports were actually slightly larger than service exports ($670 million vs %570 million) – at a ratio settling at 117% -- signaling a mostly balanced performance of the exports sector, in all likelihood caused by an

[4] That is from 1997 to 2018.
[5] In more technical terms, favor the non-tradable sector visa-vis the tradable one.
[6] See, World Bank, “*Lebanon Economic Monitor: Mounting Burden on a Crisis-Ridden Country*”, Fall 2024.

equilibrating exchange rate – neither over-nor-undervalued – at 2.6 LBP per USD[7].

That said, we can derive three important observations from the analysis presented above:

First, the desired economic model should aim to increase the exports potential of both goods and services as a ratio of GDP. And as was clear from the Lebanese pre-and-post war experiences, this depends sufficiently on strong fundamentals such as good governance, good business conditions, and a tranquil political environment. What this truly means is that what Lebanon needs is a 'New Governance Model', both economically and politically.

Second, it was also clear that enhancing total exports should be more tilted towards increasing goods exports. This is not an easy thing to do, but it can only be "created" in a dynamic sense; and the emphasis would then be at the level of the firms and the establishing of competitive advantage, as comparative advantage at the static national level is no longer the appropriate paradigm. Thus, in general, competitive advantage relies on a "bottom-up" approach starting from firms upwards, while the "top-down" approach of comparative advantage starts from national characteristics downwards. As such, successful developments of competitive advantage in Lebanon can be seen in firms like Murex and CGA CGM, to name a couple of good examples.[8]

Third, the need to have a balanced development of goods and services exports necessitates the pursuit of reasonable exchange rate policies that don't undermine competitiveness. It also needs to be coupled with reasonably open trade and investment regimes to guarantee access to markets and to technology, besides the efficient protection of nascent firms and industries.

[7] And we are old enough to remember that that period – the early 1970s – was home to less corruption, to a more welcoming investment climate, and to less political instability.

[8] For more on firm-level examples and developments, see Bisat and Diwan, *ibid.*

In closing, it is habitual these days to come across frequent articles and talks arguing that Lebanon has to become a productive, rentier-less economy *because the service export base model has failed* as we tried to duplicate that model of the pre-civil war experience to the post-civil war period from (the early 1990s onwards). The truth, however, *is that the model hasn't failed but we have failed it*: the shameful and poor governance systems that we have followed, the unsustainable exchange rate and fiscal policies that we have adopted, and the serious security and political issues that have plagued us, all have rendered that model ineffective and harmful, with considerable damage to the goods and services sector, both real and financial. Perhaps now we have a chance to apply better that model; but for it to succeed, it has to embody governance, competitiveness, and balance, so as to have the right ingredients that would enrich, and enrich steadily the country's economic base and prospects.

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