Growth and Efficiency in the Lebanese Economy: A Tale from the Pre-crisis and Crisis Years

January 23, 2026

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Table 1:

Average: %	ΔY/Y	ΔL/L	ΔK/K	α(ΔL/L)	β(ΔK/K)	α(ΔL/L)+β(ΔK/K)	ΔTFP/TFP
2014-2018	**0.7**	1.4	4.6	**0.8**	**1.8**	**2.6**	**-1.9**
2019-2023	**-5.8**	-1.6	4.1	**-0.9**	**1.6**	**0.7**	**-6.5**

Source: CAS; WB; and author's calculations. Also: α = 0.6; β = 0.4

How well was the Lebanese economy prior to the crisis? To discerning observers, not very well. In fact, some would even argue that the pre-crisis years, behind the illusive veneer of growth, portended the impending crisis. We will explore this question in this note by also looking at how efficient the Lebanese economy was in the pre-crisis years. We will explore another important question but for the crisis years: what drove the colossal breakdown? Was it the breakdown in labor utilization, or the breakdown in capital accumulation, or the breakdown in the operating environment, or a combination of all three? Since we will show that, contrary to expectations, Lebanese capital managed to remain steady, even vigorous, during the crisis, we will estimate the rate of return on capital during the pre-crisis and crisis periods. And then we will close the note with some policy implications for the future. But before we start, a note on the periods under study: the pre-crisis years run for 5 years, from 2014 to 2018; the crisis years run also for five years, from 2019 to 2023; and we end in 2023 because that is the last year for which data are available from the Central Administration of Statistics (CAS).

The standard approach to the issue of growth and its sources and its efficiency is the Solow growth model, which can be decomposed as follows:

(1) $\Delta Y/Y = \alpha(\Delta L/L) + \beta(\Delta K/K) + \Delta TFP/TFP$

Where the growth of real GDP, $\Delta Y/Y$, is equal to the growth of labor, $\Delta L/L$, weighted by the share of labor in GDP, α, and the growth of fixed capital, $\Delta K/K$, weighted by the share of capital in GDP, β. These represent the tangible and the quantitative sources of growth emanating from labor and capital. But growth is also a qualitative phenomenon. This is modelled by the growth of Total Factor Productivity, $\Delta TFP/TFP$, which is the increase in GDP that takes place for given capital and labor; more importantly, it represents the intangible part of growth, as captured by the quality of institutions, markets, and policies, besides, of course, the state of technology. In other words, it captures the efficiency of economic growth.

So we can see that equation (1), though standard, is quite fundamental: it decomposes the growth process to its essential sources. We can also perform some interesting growth accounting on it, since $\Delta TFP/TFP$ can be calculated as a residual, or simply as the difference between $\Delta Y/Y$ and $\alpha(\Delta L/L) + \beta(\Delta K/K)$. It is hence calculated ex-post, because it is almost impossible to calculate it ex-ante as it is extremely hard to model its constituent elements.

That said, in Table 1 above we show the corresponding figures for the variables in equation (1). We have also shown elsewhere that the share of capital in GDP or income β is about 0.4 and therefore the share of labor α is o.6[1]. Accordingly, for the pre-crisis period 2014-2018, growth averaged an annual rate of 0.7%, contributed by labor growth of 0.8% and capital growth of 1.8%[2]. Though the contribution of capital was decent at 1.8%, the contribution of labor at 0.8% wasn't (relatively low), as emigration had already started to take place with the labor force actually declining in 2016-2018 -- from 2.21 million in 2016 to 2.1 million in 2018.

But the interesting thing was of course the contribution of TFP: it stood at an average annual rate of -1.9%, simply meaning that economic inefficiency was robbing from growth and rendering TFP negative. This is in sharp contrast to the 1994-2014 period where the growth of TFP was at an annual rate of 0.69%[3]. As to why was that, we can unobtrusively attribute it

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[1] See: "Capital and Labor Income Shares: Lebanon, 2004-2019*", Blominvest Bank Blog, February 2025.*

[2] The contribution of capital was derived as follows: $\beta(\Delta K/K) = \beta(I/K) = \beta(I/Y).(Y/K)$, noting that ΔK is equal to investment I and the investment ratio is I/Y. It is thus equal to the product of the capital share times the investment ratio times the inverse of the capital to output ratio. As such, the investment ratio is calculated from CAS and the output to capital ratio is assumed at 0.2.

[3] See our article: "A Note on Growth Accounting for Post-War Lebanon: Preliminary Analysis and Policy Implications", *Association of Banks in Lebanon Monthly Bulletin, 5, 2017.*

to the crisis in governance and sovereignty at the time, as reflected by the prevailing corruption and the malign dominance of the "one party cum militia". Not to mention the war in Syria and what that implied regarding the loss of Lebanese resources, especially foreign reserves[4]; and, of course, the disastrous policy framework as witnessed by a wasteful fiscal policy and an accommodating monetary and exchange rate policy[5]. It is no wonder then, given this operating framework, that keen observers were pessimistic about the country's immediate economic prospects. And though the "writing was behind the wall", so to speak, they were able to discern that the inefficient management of the economy was bound to take it to its impending doom.

Of course, things only got worse during the doom-like crisis years of 2019-2023. From Table 1 above, we see that growth averaged annually -5.8%. In addition, labor's contribution became negative as well, averaging -0.9%, as the labor force fell steeply from 2.04 million in 2019 to 1.89 million in 2021 (though it recovered to 1.93 million in 2023), driven by emigration, labor market drop-outs, and unemployment. Not surprisingly, TFP's contribution turned extremely negative at -6.5%, given the atrocious inefficiency of the operating environment, as defined by a long litany of well-known mishaps: political instability, poor governance, banking failure, exchange rate collapse, foreign debt default, mindless subsidies, and last but not least policy paralysis.

But the surprising thing is that capital's contribution to growth remained steady at 1.6%. That is not to say that investment wasn't affected – it was, as the investment ratio fell to 9.9% in 2020 – but it recovered to around 30% in 2022-2023. It seems then that the crisis years witnessed breakdowns in labor utilization and especially the operating environment, but not capital accumulation. More important, it also seems that the negative shock experienced by the non-tradeable sector – banking, hospitality, and real estate – was perhaps equally compensated for by the positive shock to the tradeable sector, particularly food-processing and agri-business, jewelry and precious metals, pharmaceuticals, and the light machine tools industries[6]. No doubt, the much weaker exchange rate played a role in that transformation, but perhaps the main factor had to be the resiliency of the Lebanese private sector, because

[4] In his only interview with Al-Arabiyya TV station in late 2025, ex-Governor Salameh admitted that between 2011 and 2019 BDL was supporting the FX needs of both Lebanon and Syria.

[5] The infamous policy of "Financial Engineering" by BDL was an integral part of that policy paradigm.

[6] For more on such transformation, see: Bisat, A. and Diwan, I. *Towards A Productive New Lebanon*. IFI: AUB. 2025

no matter how much adverse political and security circumstances were 'thrown' at it, private capital seems to have remained poised and ready to seize opportunities, irrespective of the challenges.

We can also show how well Lebanese private capital adjusted to the crisis years by looking at estimates of the rate of return on capital. Recall that the contribution of capital to GDP growth is equal to:

(2) $\beta(\Delta K/K) = (r.K/Y).(I/K) = r(I/Y)$

Hence:

(3) $r = \beta(\Delta K/K)/(I/Y)$

Where the share of capital in GDP β is equal to r.K/Y with r being the rate of return on capital; and where ΔK is equal to investment I. From equation (3), we can derive the following:

Table 2:

Average %	β(ΔK/K)/	(I/Y)	r
2014-2018	1.8	22.9	**7.8**
2019-2023	1.6	20.8	**7.7**

We can see from Table 2 above that the rate of return on capital stayed at close to 8% (in real terms) in the crisis years, equal to the pre-crisis years. In other words, the fall in the productivity of capital in the non-tradeable part of the economy was met by compensating higher productivity in the tradeable part – once more, a testament to the agility of Lebanese private capital. Incidentally, we know that the sector that was most affected among the non-tradeables or services was banking; so all populist accusations levelled at the banking sector that it was making abnormal rates of return prior to the crisis are simply wrong and unfounded, because if such abnormal returns were lost during the crisis, then it would have been highly unlikely (from a capability point of view) for the tradeable sector to make compensating abnormal returns in the crisis years to equate the rate of return for private capital in both periods.

We would like to conclude with some policy implications for the future. First off, we do know that 2024 was a hard year. But 2025 was perhaps a game changer. The new presidency and government took some serious and courageous measures to help restore sovereignty, governance, and sane policy making, though the process is still incomplete but we are hopeful that 2026 will be a decisive year. From an economic point view and the spirit of this note, the aim of all these measures is to improve the operating environment (TFP) and reverse the brain drain (L). As far as private capital (K) is concerned, we saw that it managed these troubled years rather well. But we don't want to be carried away, as its success was difficult and could be much, much better. Here are some policy prescriptions that can make it so:

1) A reasonable, even an undervalued, exchange rate has proved useful to jolt the tradeable sector into greater activity. Such a policy would then be desirable to maintain or attain, not only to continue promoting import substitution but also towards enhancing export promotion and competitiveness.

2) Structural reform to sovereignty and governance is more – perhaps by far more – important than stabilization. And that is true for ALL sectors, as it lifts TFP for the whole economy. In this respect, it is wise to remember that any IMF program deals with stabilization only[7], which the Lebanese economy has largely outlived. So we should think seriously whether an IMF program is really worthwhile, if it comes at the expense of some tough, perhaps erroneous, policy making such as the proposed Financial Gap Law.

3) The private sector couldn't strive and prosper without a sound banking system. As it is, the private sector has been running almost 'dry' of fresh capital since 2015. That is because the banking sector's liquidity was siphoned off by BDL between 2015 and 2018, and because liquidity all but evaporated during the crisis years; so hardly any was extended to the private sector. And that was largely no banks' fault. So a new restructured banking sector is not only of fundamental importance to private capital, but also of fairness to banks and the entire economy.

[7] Not counting foreign debt restructuring, of course!.

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