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Introduction

Perhaps the most interesting puzzle emerging from the Lebanese economic crisis is the behavior of the trade deficit in goods and services: regardless of the severe decline in income and exchange rates, it has remained largely unaffected, and driven by trade deficits in goods¹. More explicitly, and based on CAS figures, in 2018 the trade deficit in goods and services stood at \$14.7 billion and its ratio to GDP at 26.6%; in 2024, it stayed fairly close at \$12.9 billion, but its ratio to GDP was a whopping 42.4%, among the highest in the world! Proposed explanations for this anomalous behavior vary: perhaps GDP is undervalued; or perhaps goods imports include a lot imports for Syria; or perhaps – but this is the least likely – Lebanese expenditures, especially ingrained conspicuous consumption, is largely inelastic to changes in income and prices.

With that in mind, what we want to do in this note is to suggest new explanation for the puzzle. More important, we will also investigate what impact these persistent trade deficits have had on foreign financial assets and liabilities. We will do that by using basic, but fundamental, economic relations or equations. That done, we will then conclude with a brief discussion of implications and policy recommendations.

Why Have Large Trade Deficits Persisted?

To answer the above question, it helps to utilize the simple GDP identity, which of course runs as follows:

¹ This has not historically been the case. To put things in perspective, in the post-civil war period (1990-2025), goods exports stood at 18% of goods imports; however, in the pre-civil war period (1969-1974), they stood at a third of them, or almost twice as much.

$$(1) \text{ GDP} = C + I + X - M$$

Where GDP is gross domestic product or output; C is private and public consumption; I is private and public investment; X is exports of goods and services, M is imports of goods and services, so $X - M$ is the trade balance. To fit our explanation, equation (1) can be re-written as:

$$(2) \text{ GDP} - (C + I) = X - M$$

From equation (2), we see that when output (GDP) is smaller than expenditure ($C + I$), then a trade deficit ensues ($X - M < 0$). The idea behind this is simple: when spending is larger than domestic output produced, the gap has to be filled in net terms from abroad; hence the trade deficit in goods and services. This is of course the outcome we have in Lebanon. But the thing is, as we can see from equation (2), *if GDP is smaller than $C + I$, but they both fall by the same amount, then the ensuing trade deficit will be mostly the same.* In other words, the Lebanese crisis must have reduced output and expenditure by almost the same proportion for the trade deficit to remain largely the intact. Not that consumption hasn't fallen, it has; but output has also fallen by as much, such that the resulting trade deficit hardly changed.

Billion USD	2018	2024*
GDP	55.3	30.5
Consumption Expenditure	57.6	36.7
Investment Expenditure	12.4	6.7
Total Expenditure	70.0	43.4
Trade Deficit	14.7	12.9

Source: CAS; * 2024 is the last year of available data from CAS

And we can see that from the table above: with GDP (\$30.5 billion) smaller than total expenditure (\$43.4 billion), but with both falling in 2024 compared to 2018, the resulting trade deficit in 2024 (\$12.9 billion) was not far from that of 2018 (\$14.7 billion). That said, three important observations can be obtained from the analysis of the above table:

First, to be exact, *expenditure had actually fallen by a bit more than output* (\$26.6 billion vs \$24.8 billion), as the trade deficit had fallen slightly from \$14.7 billion to \$12.9 billion. So expenditure had adjusted a little better than output.

Second, however, the adjustment in expenditures fell largely on investment. Consumption by 2024 had fallen by 36.3%, whereas investment had fallen by 43.9%. That is unfortunate, as investment is really the engine behind jobs and economic activity, so it would have been best if it had fallen the least, or not at all.

Third, output hadn't adjusted well at all. That happened despite the steep fall in the exchange rate which should have stimulated the production of tradeables, but it didn't, as was shown elsewhere². It seems that the Lebanese economy's production structure is fairly inflexible and its foreign dependence is so immense that it is almost "impossible" to curtail trade deficits. There are two possible reasons for that: 1) the economy's exposure to a litany of shocks during the crisis (COVID, the PoB explosion, the war with Israel, Hezbollah's malign influence and intransigence, the brain drain, capital flight, etc..) have made it extremely hard to adjust output especially towards tradeables; 2) perhaps the Lebanese entrepreneurial spirit is firmly grounded in services, and as a result it is not that easy and straightforward to build a new competitive edge in other viable sectors. Incidentally, though data are not available from CAS for 2025 and 2026, we expect the situation to have been similar, even worse or perhaps much worse for 2026.

The point is that the *persistence of trade deficits in Lebanon is a failure in output and production, and the resulting foreign dependence has to be rectified there*. It is not necessarily a failure in expenditure or the outcome of excessive imports to neighboring countries. But, of course, that still involves the payment of hefty bills. How do we account for that and how was it paid for? That is what we will consider next.

What is their Impact on Net External Debt or Foreign Liabilities?

In the same vein, to answer the above question, we will have to derive a simple technical equation. Let net foreign debt or liability be D ; and let GDP be Y . Hence, the net foreign debt or liability to GDP ratio, d , as a measure of the country's net external burden, will simply be:

$$(3) d = D/Y$$

It follows that the rate of change in the ratio d is equal to:

$$(4) \Delta d/d = \Delta D/D - \Delta Y/Y$$

The important point to realize here is that a country's current account deficit has to be financed by accumulating net foreign debt or liabilities (foreign loans, foreign deposits, FDI, etc..), or alternatively depleting the country's net foreign assets (loss of central bank reserves, drawdown of private foreign assets, etc..). In Lebanon, the crucial components of the current account for our purpose would be the trade deficit in goods and services and the servicing of net foreign debt or liability, as the latter will be gaining more prominence when foreign debt restructuring gets underway. That is:

² Estephan, M. "An Initial Empirical Analysis of the Determinants of Lebanese Imports and Exports", Blominvest Blog, September 1, 2026. In fairness, though, the impact of the exchange rate on the trade deficit follows a J-curve type pattern, meaning that lower exchange rates worsen the trade deficit initially, then improve it after the economy has enough time to adjust. In Lebanon's case, however, we are into our 7th year of the crisis, yet the trade deficit has stayed largely unchanged.

$$(5) \Delta D = TD + rD$$

Where TD is the trade deficit in goods and services and r is the interest rate on net foreign debt, making rD equal to net foreign debt servicing. Replacing equation (5) in equation (4), we get:

$$(6) \Delta d/d = (r - \Delta Y/Y) + TD/D$$

From equation (6), an important point is that, under most circumstances, the term $r - \Delta Y/Y$ is mostly equal to zero (or $r = \Delta Y/Y$)³. As a result, we obtain:

$$(7) \Delta d/d = TD/D$$

Equation (7) implies that the *rate of change* of the net foreign debt or liability to GDP ratio is roughly equal to the trade deficit to debt ratio. And its meaning is straightforward: the net foreign debt or liability ratio will continue to rise as long as the economy is running trade deficits in goods and services. *In other words, trade deficits will be obtained only at the expense of increasing net foreign indebtedness, irrespective of the important finding or fact that net foreign debt servicing cost don't factor in if $r = \Delta Y/Y$.*

Implications and Policy Recommendations

Lebanese trade deficits in goods and services have failed to adjust during the crisis period, registering large deficits close to those obtained during the pre-crisis period, at \$12.9 billion in 2024 for instance. And these deficits have entailed incurring higher net external debt or foreign liabilities, which unfortunately means that, despite the severe drop in investment and consumption and the resulting rise in poverty, the country still “lives beyond its means”. The interesting question is how could the country afford the net foreign liabilities needed to finance these deficits, especially given that it was shut out (and of course remains) from international financial markets during the crisis. In all likelihood, the country seems to have limped along, scrambling for finances from a combination of sources: official lending; grants; un-official political money; and the depletion of BDL and private foreign assets⁴, *as net foreign liabilities will increase with higher foreign liabilities and/or lower foreign assets*⁵.

A more important question is: can the country keep incurring these large deficits and accumulating higher net foreign liabilities indefinitely? The answer, of course, is that theoretically it can't. Practically, however, the country could manage to stay much longer on “life support” as it were,

³ Note that the sufficient condition for net external debt stability is $\Delta Y/Y > r$, but in most economies that is mostly the exception not the rule.

⁴ We haven't included remittances; that is because remittances are not part of the capital account; it is part of the current account, and including it will not affect the trade deficit, it will only reduce the current account.

⁵ Note that of all these sources, official lending and the loss of BDL reserves and drawdown of and private foreign assets will increase net foreign debt or liabilities. *As a matter of fact, between 2018 and 2024, the country's position moved from net foreign assets of \$16.9 billion to net foreign liabilities of \$5.9 billion.*

though it would be devoid of full “liveliness” and of meaningful adjustment and transformation. But once its sources of finance are depleted or diluted⁶, *and baring an adjustment in output*, the exchange rate will have to deteriorate much further, forcing total expenditures to adjust drastically to help narrow (not necessarily close) the trade deficit to sustainable levels⁷ -- admittedly a very difficult but necessary scenario.

Alternatively, and as a much desired outcome, output can adjust strongly to do the job. And to do the job effectively, the lower exchange rates will have to be complemented with sound industrial policy and commercial policy (trade facilitation) to increase both *domestic output and tradeables*. And the good thing about this adjustment is that, as we saw from equation (7), *any upcoming net foreign debt servicing won't constitute a burden and can be undertaken 'harmlessly', as taking care of the trade deficit will take care of debt or liability servicing, by releasing enough funding for the latter and helping to enhance the country's credit-worthiness*.

The crux of the matter, though, is that these policies can't succeed – or succeed fully -- in an environment of political, security, and sovereign instability. And if they can't, and funding dithers, then the country as alluded to above could find itself in the midst of very dire circumstances. That is why the stakes are high for governance, economic, and financial reforms to succeed, as without them the country can never become a modern, respectable economy.

⁶ Not an unlikely possibility, especially given the state of war and troubled politics in the region.

⁷ It will also involve savings getting close to investment, as consumption drops, given that the equality of savings to investment is the condition that ensures trade, actually current account, balance. We will have more to say about this in a futures note.

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