

Dollarization in Lebanon; Advantages and Disadvantages

Author: Tracy El Nar¹

Affiliation: CIRAME Research Center, Business School

Holy Spirit University of Kaslik, P.O Box 446, Jounieh, Lebanon

Abstract:

This study shows benefits and disadvantages of adopting dollarization in Lebanon and how it affects economic stability. After the 2019 crisis in Lebanon, dollarization was used in the Lebanese economy, since the Lebanese currency depreciated significantly and inflation increased very quickly. This research uses non-numerical and informative methods with the help of scientific studies, financial reports, and articles that support the idea. It shows that dollarization has short-term advantages. Individuals and businesses feel more confident while using the U.S Dollar for all their savings and transactions and keeping their value with greater stability. In addition, if the exchange rate is going up and down, it makes people feel safer. On the other hand, the analysis also shows some disadvantages or drawbacks. Since the Central Bank is the one who controls the money supply and uses the monetary policy, adopting dollarization will take away some of these tasks. In addition to that, decision makers won't be able to manage inflation and stabilize the economy. In conclusion, even though dollarization can benefit and provides some stability, like everything it also has disadvantages and risks.

Keywords:

Dollarization, Lebanon, Monetary policy, Currency depreciation, Economic stability

Introduction: "The What & Why"

Lebanon has experienced in the latest years one of the most alarming financial crises throughout its history. The Lebanese currency the Lebanese Pound has lost most of its meaning and value, inflation has risen drastically, and the Lebanese citizens lost their trust and confidence in Lebanese banks and the system. Because of this dramatic change, many people and organizations have transitioned toward paying with the US Dollar in most of their daily transactions, investments and savings. This occurrence is called dollarization.

Dollarization is when a country uses a currency which we are talking about the US Dollar instead or with its own original currency. Lebanon was viewed as a highly dollarized economy since most bank deposits and large transactions were made in US Dollars even before the 2019 crisis. However, after the crisis people started to notice it and use it more in their everyday lives such as tuitions, rent and even getting their salaries in US Dollars.

Why was this change happening? This turn happened because the Lebanese Pound lost its credibility in the eyes of the citizens. The people were looking for a better alternative for the Pound since inflation increased and their currency was fluctuating in value. In this case, they chose the US Dollar as their alternative for a safer store of value and more reliable.

Nevertheless, even if dollarization shows various advantages like price stability and reduced exchange rate risk, it holds some disadvantages. Dollarization reduces the Central Bank's ability to make independent monetary decisions and limits the government's control over money supply. Because of this dollarization can't be really seen as a solution to the crisis.

Moreover, this research aims to study the advantages and disadvantages of dollarization in Lebanon. In particular, this study will:

- 1- explain the concept of dollarization and the different types.
- 2- analyze how and why dollarization rose in Lebanon after the crisis in 2019.
- 3- talk about the advantages, including stability and reduced inflation risk.
- 4- test the disadvantages, most importantly the loss of monetary independence.
- 5- evaluate if dollarization could be a sustainable solution for Lebanon's economy.

The main question of this research is:

Does dollarization help stabilize Lebanon's economy, or does it create new long-term economic challenges?

Literature Review: "The story so far "

A- Concept of Dollarization

Dollarization is an economic event where a state chooses to adapt a foreign or external currency, usually the U.S Dollar, either with or in replacement of its original national currency. As maintained by previous scholars, dollarization usually takes place in economies that undergo excessive inflation, macroeconomic uncertainty, or simply self-doubt in their national currency. When natives and companies don't have confidence in their domestic currency and don't see it as a dependable store of value, they start saving and making transactions using a more secure and fixed currency.

There are various shapes of dollarization. When a country legally uses a foreign currency as its authorized currency, it is called official dollarization, as observed in countries like Ecuador and El Salvador. Partial or unofficial dollarization happens when a foreign currency is widely used in everyday transactions even though the domestic and original currency is still in use and officially recognized. Lebanon is broadly recognized as a highly dollarized national economy since a lot of bank deposits, loans, and huge transactions have been carried out in U.S Dollars.

Based on Reinhart, Rogoff, and Savastano (2003), dollarization can arise progressively as individuals and businesses try to keep their wealth safe against inflation and the decline in the value of the currency. For example, in this event, people and businesses feel safer while using a stable external currency instead of their original national one.

B- Causes of Dollarization in Crisis Economies

Dollarization usually happens and starts when there is a financial crisis. Levy-Yeyati (2006) says that dollar also rises with the increase in inflation and when exchange rates start fluctuating. So people will lose their trust and look for a better option and use another currency.

Lebanon is a very clear example of this phenomenon. After the 2019 financial crises, the Lebanese Pound suffered a significant decline in value while inflation rose rapidly. In result of that, many individuals preferred using the U.S Dollars for savings, wages, and everyday payments to shield themselves from the instability of the national currency.

C- Advantages of Dollarization

Many studies emphasize that dollarization can have many benefits. One of the most significant advantages is its ability to promote price stability. When a country decides to adopt and use a stable external currency like the U.S Dollar, inflation usually decreases because the government loses the ability to print excessive amounts of money.

Another benefit is that it reduces the risks of exchange rates. Usually businesses and investors prefer and enjoy working in a stable environment with a strong currency since they become certain with their international transactions and trades. Therefore, dollarization can provide that trust and encourages investments and activity (Kamel, Kaspard & Khalil, 2023).

Finally, Berg and Borensztein (2000) believe that dollarization can increase reliability in the financial system by linking the economy to a steady and secure external currency.

D- Disadvantages of Dollarization

Even though dollarization has benefits, it also shows serious disadvantages. The first disadvantage is the loss of seigniorage revenue, which means that the profit the government gets by using its own currency falls. The government loses this source of revenue when a foreign currency dominates.

To add to that, the decline in the independence of the monetary policy is another disadvantage. The Central Bank won't be able to do its job and put the interest rates while stabilizing the economy if the country uses a foreign currency too much (Mawad & freiha, 2003).

As Fischer(2001) says, because of this governments won't be able to handle and know how to deal with crisis and shock. In addition, the economy won't grow and won't become stable.

These disadvantages are shown in Lebanon's case, since the Central Bank stopped working properly after dollarization.

E- Research Gap

Even if many articles show the goods and bads of dollarization, Lebanon's case is very hard and complicated because it has been falling and falling to this day in challenges and crises. Therefore, analyzing the pros and cons of dollarization in Lebanon, for both NGO's (Saber & Sassine, 2022) and firms is crucial to determine if it can stabilize the economy or impose additional long-term economic constraints.

Methodology: "The how we did it "

This study uses a qualitative analysis with a descriptive approach to test the benefits and disadvantages of dollarization in Lebanon and its result on the stability of an economy.

The research uses previously published data such as economic reports, academic studies, and papers from international organizations like International Monetary Fund(IMF), World Bank, and Central Bank publications. Past articles on dollarization were reviewed and used to better understand the conceptual and applied outcomes of the occurrence.

This article sheds light mainly on Lebanon's economy and its situation after the crisis in 2019, that led to the fall of the Lebanese currency and a quick rise in inflation. Because of those changes, Lebanese citizens turned over and relied on the U.S Dollar instead of the Lebanese Pound for daily economic activities.

To study this topic, this paper uses a comparative analytical approach. It first explains the concept of dollarization and its different types based on existing economic literature. Later on, it shows why dollarization is more popular when crisis hits in an economy, especially when people lose trust in the national currency, increase in inflation, and financial instability. In addition, gives the advantages like price stability, lower exchange rate risks, and more trust in transactions. Lastly, it gives the disadvantages, including the decrease of monetary policy and the loss of the Central Bank's tasks.

This methodology helps to evaluate if dollarization is actually a good decision or if it will lead to more challenges.

Results: "The facts "

Based on the reviewed literature and economic reports, dollarization has become very popular in Lebanon, especially after the 2019 crisis that happened. The results of it shows that the use of the U.S Dollar has helped a lot in daily activities and payments.

The dollarization helped keep prices stable, unlike the Lebanese pound where inflation and depreciation occurred. Because of this, many citizens and companies switched to the U.S dollar because they have more trust in it and keeps things stable (Beainy et. Al, 2025).

Even with some benefits, the study also gave disadvantages. Because of dollarization, the Central Bank cannot control how much money is coming and going since a lot of payments and transactions aren't made in the national currency.

In addition, the analysis shows that Lebanon is being dependent fully on the U.S Dollar which may give bad effects. Even if it gave temporary support and relief, it reduces the stretchiness of the economic policy in crisis.

Discussion and conclusion: "The so what ? "

This study gave some advantages and disadvantages of dollarization in Lebanon and how it had an effect on the economy. Dollarization became more popular after the 2019 crisis in Lebanon.

Dollarization may give short term benefits, like reduction in depreciation and high inflation helping people protect their savings and transactions.

Even with the benefits, the analysis also provided some drawbacks. Most importantly being the loss of control in the Central Bank and not allowing them to control supply. Inflation won't be managed because of that. With time this weakens the economy.

All in all, even though dollarization can give some advantages, in the long run it will show some challenges in the economy and its management. In Lebanon's case, dollarization is still complicated because it is still connected to the ongoing crisis. Future research could explore possible policy solutions that may help restore confidence in the national currency and improve economic stability.

References

- Berg, A., & Borensztein, E. (2000). The dollarization debate. *Finance and development*, 37(1), 38.
- Beainy, R., Kamel, C., Subrahmanyam, S., & Younis, M. (2025). The World needs the USD. *Available at SSRN 5734284*.
- Kamel, C. A., Kaspard, J. A., & Khalil, F. C. (2023). The Information System of Lebanese Exporting SMEs. *Journal of Law and Sustainable Development*, 11(6), e1212-e1212.
- Mawad, J. L., & Freiha, S. (2024). Entrepreneurial intentions in the absence of banking services: The case of the Lebanese in crises. *Journal of Risk and Financial Management*, 17(7), 264.
- Reinhart, C. M., Rogoff, K. S., & Savastano, M. (2003). Addicted to dollars.
- Saber, A. M., & Sassine, M. E. (2022). Reflections on internal control and internal audit roles for ensuring financial transparency toward Lebanese NGOs financial donors. *EuroMed Journal of Management*, 4(3), 186-198.