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September 2022

TO BANK DEPOSITORS IN LEBANON (Confronting Banks, Banque du Liban, and Government)

OUTLINE

Executive Summary

Bank depositors in Lebanon continue to bear practically alone the impact of the banking collapse. To regain their rights and effectively confront banks, BDL and Government, they need first to understand what happened, determine degrees of responsibility, then act.

Two collapses have occurred in Lebanon, not one, a banking collapse and a Lira collapse, with different natures, causes and impact. Unlike today, the similar Lira collapse in the mid-1980s happened in the context of strong and very $-liquid banks that continued to normally operate.

The cause of and responsibility for the current banking collapse is BDL's mismanagement through its "financial engineering" that led to negative net reserves, alongside the banks' mismanagement that put around 80% of their $-deposit resources at BDL, thus taking their $ liquidity to a very low 7% for the sake of extraordinary but short-term profits. Independently of the banking collapse, the Lira's collapse is the result of a lax fiscal policy by Government and widespread corruption, making Lebanon live for years beyond its means in the context of a fixed exchange rate and an unprecedented balance of payments in deficit since 2011.

An Appendix explains the sources and uses of $ available to BDL during 2015-19. At least 38$ billion outflow from BDL are unaccounted for. The likely explanation is that most of these funds correspond to bank profits, mainly in Liras, and other Lira assets that have been exchanged for $ from BDL through market operations. It is also quite likely that these profits have been transferred in $ outside Lebanon, not in favor of the banking institutions but in favor of their main shareholders.

A course of action is proposed to bank depositors.

i) Confront banks, BDL and Government with the explanation of and responsibility for what happened, a responsibility to be mirrored in an eventual distribution of losses.

ii) Propose that banks should re-capitalize or be subjected to bankruptcy proceedings, as is normal in any country, which would put a stop to continuing bank losses that are eventually paid by depositors, and invite foreign banks to operate in Lebanon, which would lay the basis for a normally operating banking system.

iii) Ask BDL to justify its ad hoc circulars that impose harsh "haircuts" and ceilings particularly on Lira withdrawals from all deposits, leading to a sharp and continuous fall in money supply by more than 95% relative to end 2019, compared to a fall of about two thirds in current GDP . Withdrawal ceilings should be relaxed, and haircuts much reduced, since this BDL policy puts all the burden of adjustment only on depositors, and unnecessarily reduces effective demand, thus straining economic activity and growth.

TO BANK DEPOSITORS in Lebanon

(Confronting Banks, Banque du Liban, and Government)

The Government and the broader political establishment, the Banque du Liban and the banking sector are jointly and severally responsible for the human rights violations that have resulted from the manufactured crisis Lebanon is experiencing today.

UN (2022), p.11.

Almost three years after Lebanon's historic financial collapse in October 2019, no official account yet exists to explain what happened, nor has the Government undertaken any remedial action. Only recently, following a Staff-level Agreement with the International Monetary Fund (IMF) on economic policies for a 4-year Extended Fund Facility, have a draft law for Capital Controls and a draft Plan for Economic Recovery been circulated. But, to date, no corrective policy or action has been implemented.

During this wasted time, as all major economic indicators have been deteriorating, the actual burden of adjustment has been fully borne by bank depositors alone, and practically none by the central bank, Banque du Liban (BDL), commercial banks or Government. The Lebanese Lira (LL) has depreciated by about 95%, and the banking sector, i.e. BDL and banks, is bankrupt in the legal and accounting senses: For both banks and BDL, it is a state of cessation of payment of deposits, and a state of increasingly negative equity following substantial losses occasioned by the depreciation of the Lira and the non-payment by BDL of $-deposits by banks at BDL. The situation remains one of severely restricted access to all deposits, increasing inflation and unemployment, widespread recession, and an unprecedented shooting-up of poverty to about 80% of the population, according to the UN (2022).

Still, in all proposed measures for recovery, whether detailed and written, as by Government, or in the form of general ideas, as by banks or the BDL, most of the envisaged burden of adjustment falls on depositors, as it has in fact been to date.

The purpose of this proposed paper is to assist depositors in their struggle to regain their lawful rights. To succeed, they need first to understand what happened, determine degrees of responsibility, particularly for the banking collapse, identify a course of action, then act.

To that end, the outline of the paper is as follows. The next section explains what happened, namely the nature and causes of the two collapses, of the Lira and, separately, of the banking sector. The second section imputes the responsibilities for the two collapses to specific institutions and policies. The last section proposes a strategy for action by bank depositors. An appendix explains what BDL has done with the large amounts of US Dollars ($) it has borrowed from banks.

1- The two collapses: what happened

It is essential, for bank depositors to be effective in their action, to identify the reasons for the financial collapse and to ascertain the responsibilities. In this regard, the critical first step is to understand that two collapses, and not one, have occurred: a collapse of the exchange rate of the Lira, and a collapse of the banking sector. The two collapses are different in nature, in causes and in effects.

In fact, the fall in the exchange rate of the Lira in the mid1980-s was similar to the current episode, the Lira falling to the $ by more than 95% between 1985 and 1988. But the banking sector then continued operating normally without any restrictions as to withdrawals or transfers, as it has always done until late 2019. The central difference between the two episodes is the recent failure of the banking sector, i.e. of BDL and commercial banks.

a) The banking collapse

The banking sector, i.e. BDL and banks, are bankrupt institutions. They are bankrupt in the accounting sense because of their negative equity following the severe depreciation of their assets following the depreciation of the Lira and the significant increase in bad debts of customers, including BDL. They are also bankrupt in the legal sense since they are in a state of cessation of payments that usually leads to bankruptcy proceedings. Nonetheless, while both are "dead" in the accounting and legal senses, they both continue to function on a daily basis as normally operating concerns, as living institutions. So, effectively, BDL and commercial banks are "zombie" banks.

What happened? To understand the banking collapse one should focus only on $ accounts and transactions (1). The local currency, the Lebanese Lira, unlike $, can be made available in unlimited amounts through the central bank, but not $, though at a cost to the exchange rate of the currency but not necessarily to the banking sector.

The most telling indicator about the approaching banking collapse was banks' $ liquidity. Lebanese banks have traditionally behaved conservatively, maintaining a relatively high $ liquidity (defined as their own $ deposits with their main correspondent banks abroad, divided by all the $ deposits at their institutions). Indeed, throughout the 15-year warring period, 1975-90, their average $ liquidity was an extraordinary 99% to 100%. That ratio fell to 7% on the eve of the collapse, at end September 2019. Therein lies the main story.

(1) The term symbol "$" henceforth also refers to accounts and transactions in other foreign currencies, such as the euro, which are relatively small..

TABLE 1 Banking Danger Signals

(End period; in $ billions and %, as indicated)

	Average 90-1975	2010	...	2015	...	2017	2018	Sept. 2019
BDL's net $ reserves	1.2	12.8		-1.9		-19.6	-45.6	-68.4
Banks' $ liquidity	>99%	23.4%		11.8%		9.8%	9.8%	7.3%
Memo								
BDL's gross $ reserves	1.2	28.6		36.7		42.0	36.5	32.9
BDL's $ liabilities	0.0	15.8		38.6		61.6	82.1	101.3
of which to Banks	0.0	11.9		37.5		60.7	81.2	98.9

Sources: BCC, BDL, IMF, KPMG.

BDL's $ liabilities are from BCC (2015-17) and the author's estimates based on BDL and IMF data, and on KPMG's Report, which puts Banks' $ deposits at BDL at end September 2021, two years after the collapse, at 86$ billion.
Notes: BDL's reserves exclude gold holdings. Net reserves equal $ gross reserves less $ liabilities.

Banks' $ liquidity equal their own $ reserves at major correspondent banks divided by their total customer $ deposits.
BDL's net reserves listed above may be slightly different from those in (Gaspard ,2020,2017). The reason is the estimates concerning banks' $ deposits with BDL, which are not published but are updated as new data become available.

Table 1 shows that the writing on the wall was clear about the impending financial storm. The two most important indicators about the perfect storm to hit both BDL and banks were: BDL's net reserves turning increasingly negative since at least 2015, and banks' $ liquidity rapidly falling to single-digit levels since 2017.

The origin of these alarming developments was BDL's so-called "financial engineering". That monetary policy consisted in borrowing ever larger $ amounts from banks at ever higher interest rates. The average spreads, or margins, paid by BDL over international reference rates such as the 6 -month $-Libor, remarkably was more than 5% and later abnormally exceeded 9% (Gaspard 2020). BDL's policy was prompted by its need for $ reserves as the balance of payments (BOP) was for the first time since 2011 turning continuously negative (2).

BDL's unusually generous interest-rate policy did not succeed in reversing the trend in negative net reserves and, in addition, led to mounting losses that were recognized only after the collapse. In fact, BDL then claimed that it "… has been and continues to generate sustained and substantial profits …" (BDL, 2017, p. 4,) while ceasing, since 2002, for the first time ever to publish its annual Profit & Loss Statement.

The banks, on the other hand, could not resist the very high interest rates, and profits, BDL was offering. They willingly and autonomously shifted to BDL close to 100$ billion of their $ reserves, or 80% of their $-deposit liabilities, from correspondent banks, thus turning their $ liquidity into illiquidity (3).

By law, the BDL is exceptionally independent of Government. So the monetary and financial mismanagement by BDL and the mismanagement by the bank's private leaderships were starkly irresponsible, verging on the criminal. Their policies directly led to the death of Lebanon's banking sector and a historic economic meltdown. Those policies were independent of government indebtedness.

(2) Since independence in 1943 until 2010 Lebanon's BOP mostly was positive and never was negative for more than two consecutive years.
(3) See Table A in the Appendix on BDL's sources and uses of $ funds.

b) The collapse of the Lira

The collapse of the exchange rate of the Lira is a totally separate matter. The Lira's downfall in the mid-1980s, while the banking sector remained uncommonly strong, confirms this distinction. Although a banking collapse necessarily leads to a fall of the exchange rate, the reverse is not true.

The basic reason for the collapse of the Lira is the fact that the Lebanese have been living for years beyond their means, with consumption by households and public administration usually close to 100% of GDP. The main other indicators underlying this assessment are the BOP, government and public debt, and the real effective exchange rate (REER).

As previously noted, Lebanon's BOP since independence until 2010 typically was positive and never was negative for more than two consecutive years, whereas since 2011 it became negative practically every year. Thus, during 1991-2010 the cumulative BOP surplus was 7.7% of GDP, whereas during 2011-2019 the surplus turned negative to -4.3% of GDP. The latter is a financially dangerous development in a small and open economy that is following a fixed exchange rate policy.

In addition, the government and public sector debts remained on an ascending trend, especially since 2011. Business literature and news commonly confuse government debt and public sector debt, using the latter term to refer in fact to the former. Public sector debt is the result of a consolidation between government debt and the debt of public enterprises; the debt of public enterprises in Lebanon practically is that of BDL alone since the other public enterprises are not allowed to contract debts (4). Government debt has increased from 137% of GDP at end 2010 to about 170% of GDP just prior to the collapse towards the end of 2019. Worse, it was mostly financing current rather than capital expenditure. In parallel, public sector debt, which is more revealing, increased during the same period from 211% to more than 300%.

Lastly, the real effective exchange rate (REER), which is calculated by the IMF, shows the competitiveness of a country's economy relative to its trading partners (5). An increase indicates a loss of competitiveness. In October 2019, a few weeks before the collapse, the IMF noted in its 2019 Article IV Consultation Report on Lebanon that "The IMF's … methodology suggests that the real effective exchange rate [of Lebanon] is significantly overvalued."

All basic economic indicators, including a negative average GDP growth rate during 2015-19, clearly were pointing to an overvalued Lira. But these indicators were independent from the banking situation and the banking collapse. Had banks kept a relatively high $ liquidity, as they always did in the past, the banking sector in Lebanon would be normally operating today but with a depreciated exchange rate.

(4) BDL's debt here is defined as composed of its $ debt, mostly all banks' $ deposits at BDL, plus its issued LL-certificates of deposit.
(5) The REER is calculated as the weighted average of a country's currency relative to a basket of other currencies.

2– Government debt is not the cause of banking collapse

Unfortunately, the private or public gaze do not extend beyond the superficial or the slogan. This is all the more shocking since what happened in Lebanon is probably the largest financial and economic collapse in modern history.

Almost three years after the event no official explanation yet exists of the collapse, but a semi-official and widely circulating explanation throughout most of the media about what happened is the following simple one, without any recourse to supporting evidence: People put their money in banks, banks put the money at BDL, BDL lent the money to Government, which wasted most of it through corruption, which led to the collapse. Therefore, Government debt and its corruption are the only culprits.

That story is fictional; the explanation is incorrect and is not supported by facts. Its main purpose has been to divert attention from what really happened, and from identifying those responsible for what happened. Government debt has played a significant role in the collapse of the Lira, as explained in the previous section, but not in that of the banking sector. In explaining the latter, and as shown in Table 1, one should focus on $ categories, $ liquidity in particular, and not on the Lira.

TABLE 2 Banks' Credit to Government and to BDL

(End period; in $ billions at market exchange rates)

	2015	...	2017	...	Sept. 2019	2019	...	2021
Banks' credit to Government	37.8		32.0		31.7	24.5		5.0
of which in $	17.6		14.2		14.9	13.8		4.4
BDL credit to Government	17.0		25.6		32.7	39.2		6.3
of which in $	1.1		2.0		3.4	5.6		4.2
Banking sector credit to Government	**54.8**		**57.6**		**64.4**	**63.7**		**11.3**
of which in $	18.7		16.2		18.3	19.4		8.6
Banks' $-credit to BDL	**37.5**		**60.7**		**98.9**	**93.6**		**85.0**
as % of $-deposits in banks	38%		52%		80%	78%		83%
Memo								
Government debt	70.3		79.5		86.8	75.3		41.9
of which in $	39%		38%		37%	45%		92%
LL/$ (market)	1,507.5		1,507.5		1,507.5	2,100		27,65

Sources: BDL, IMF, MOF, http://www.lebaneselira.org and http://www.lirarate.org (for market LL/$ rates).

Notes: Banking sector is the central bank (BDL) plus commercial banks.

Regarding $ credit to Government, Table 2 shows that banks' $ credit to Government has usually been relatively small, standing at 14.9$ billion at end September 2019, which then represented only 12% of the banks' $-deposit base. More important, at the same time, banks were lending BDL close to 100$ billion, or 80% of their $-deposit base, and that was the problem!

As for $ credit by BDL to Government, it has always been small and has usually taken the form of holdings by BDL of Eurobonds, which are bonds issued by Government in foreign currencies, usually $. The notable aspect of this alleged "$ lending" by BDL to Government is that BDL does not lend or give $ to Government but Liras in exchange for these Eurobonds. BDL itself has initiated in the past frequent exchange operations whereby the Ministry of Finance (MOF) issued new Eurobonds solely for the sake of BDL and at its request, against holdings by BDL of Treasury Bills (TBs) in Liras. During the period 2019-2009, these exchange operations amounted to 17.5$ billion in Eurobonds issued in favor of BDL against equivalent amounts in Lira-TBs. During the same period, BDL separately had transferred 13$ billion to Government for various operations (6). The net effect of all these $ operations was 4.5$ billion extended by Government to BDL. In other words, it was Government that was the net-giver of $ to BDL and not the other way round!

In sum, the semi-official and popular story about the collapse, particularly the banking collapse, is incorrect and is not supported by official or other data. Nonetheless, it survives in official circles, the media and in popular explanations of what happened.

(6) Sources are unpublished documents by the MOF. See (Gaspard 2020) for more details on these operations.

3- Who is responsible for the two collapses?

The collapses of the Lira and the banking sector, the latter in particular, are man-made. It is the result of policies designed and implemented by "responsible" people over a number of years. During all that time, the supervisory authorities in charge, or those with the authority to question or put a stop to those toxic policies, were absent, preoccupied with other matters, mostly of personal interest. The previous two sections clearly point to various and distinct responsibilities.

a) The collapse of the banking sector: BDL and Banks

The collapse of the banking sector is the result of BDL's "financial engineering" operations that stripped banks of their $ liquidity while BDL's net reserves kept falling in negative territory. The responsibility specifically falls on BDL's Central Council that is legally responsible for setting monetary policy, and on commercial banks that voluntarily and knowingly shifted their $ liquidity from strong correspondent banks to BDL, thus turning their $ reserves into illiquidity. Banks mismanaged for years their $ liquidity and their institutions, ignoring clear warning signals, and succumbing to the lure of high interest rates and of large and unsustainable short-term profits.

A frequent, and appropriate, question often arises, usually in the defense of BDL. What should BDL have done? Of course, for years, at least since 2011, BDL's policy was to accumulate $ reserves to defend the Lira peg. That policy was significantly intensified with BDL's "financial engineering" operations, which basically consisted in borrowing $ from banks at unusually high interest rates or margins, and at having the MOF issue new Eurobonds, not needed by Government, in exchange of holdings by BDL of LL-TBs in order to sell them in the market. As banking (not fiscal!) dangers were obviously mounting, on the $-liquidity front in particular, and instead of its notorious "financial engineering" since 2016, BDL should have stopped defending the peg, thus saving the banking sector and, consequently, financial and economic stability. This was exactly what the Governor of BDL, Dr. Edmond Naim, then did in 1987, in similar circumstances.

b) The Lira's downfall: Government

The effects of the Lira's downfall are insignificant relatively to the effects of the banking crisis. The systematic financial and economic collapse in practically all sectors of the Lebanese economy, including the availability of basic living items, such as fuel, electricity, bread, medicine, etc., and the dramatic increase in poverty, is not the result of the collapse of the Lira but of the banking sector. Thus, the responsibility for the banking collapse borders on the criminal.

The Lira's downfall is mainly the responsibility of various Governments. The problem did not reside only in its high and often rising debt relative to GDP but, more important and let alone wasteful spending and corruption, in the small share of capital expenditures, which averaged only %8 of total spending during 2019-1993. Fiscal policy remained for years incompatible with a fixed-exchange rate policy, which requires above all for its success a tight fiscal policy.

c) Government's overall responsibility

Government's responsibility extends beyond that related to the Lira's downfall only. Though indirect, its responsibility in the banking collapse nonetheless is as important as that of BDL and banks.

Governments do not manage banks. But as in all countries, Government has a decisive oversight responsibility over matters regarding monetary policy, the exchange rate and banking conditions. The Government's oversight channels in Lebanon are through the Banking Control Commission (BCC), the Minister of Finance, who has direct oversight, though not control, over BDL, the Council of Ministers through the MOF, and Parliament.

The BCC obviously was aware of the banks' continuously falling and low $ liquidity, advised in writing BDL accordingly, but no action was taken [(7)]. The inaction is all the more serious since BCC has the independent legal latitude to impose regulations on banks in this regard. Equally, the Minister of Finance and the Council of Ministers were totally neglecting of the situation, presumably taken by more important matters. Finally, Parliament never asked BDL's Governor, since his appointment in 1993 to date, to comment in person in Parliament on monetary and economic developments, which it regularly did in the past, even during wartime.

A more glaring responsibility may be that of most of the media, visual and written, which forgot their primary raison d'être as early warning vehicles or critics of power and its excesses since, unusually, they repeatedly kept praising the exceptional talent and competence of BDL's Governor.

Why this systematic dereliction of duty by Government and public authorities? The short answer is the political and (indirect) military occupation of Lebanon by Iran through Hezbollah. In fact, the UN General Assembly, the International Criminal Tribunal and the International Court of Justice are associated with the view taken by the International Red Cross that "...occupation could be exerted through local armed groups enlisted by a foreign army, who would be acting as de facto agents of another State" (ICRC 2012, p. 23).

Hezbollah is an unofficial Lebanese party that publicly vows absolute ideological, political and military subservience to Iran's Wilayat al Faqih, which advocates total obedience to the leader who represents the absent infallible imam. Such a party has for years been controlling Lebanon politically and militarily, and hence all essential Government decisions, at least through a veto power. It even openly admits its military participation in wars in several countries in the region, particularly in Syria and Yemen.

Foreign occupation automatically implies subservient public authorities, and the absence of good governance and of effective regulatory restraints. No real economic recovery is possible, whatever the financial or economic assistance or program, if Lebanon does not regain its sovereignty. That is an essential and necessary condition for a durable recovery.

(7) Personal communication to the author by two ex-senior BCC officials.

4- An action plan for bank depositors

What should bank depositors in Lebanon do? In their struggle to recover their deposits they need, above all, to confront the authorities and especially banks and BDL, with the causes of the Lira and banking collapses, which still is an unsettled issue. This naturally leads to the identification of the guilty institutions, which is elaborated in the previous sections above. Specification of responsibility or guilt distribution allows a tentative allocation of the resulting losses, which is attempted below. A strategy for action by bank depositors then logically follows, which is the focus of this section.

As a prelude, the following provides a more comprehensive list of the damage incurred by bank depositors than usually mentioned.

a) Persistent damage to bank depositors

The damage done to bank depositors, which is still unfolding, is of historical proportions. At end September 2019, just prior to the crisis, total bank deposits were the equivalent of 169$ billion, or more than 320% of GDP [8]. About 73% were in foreign currencies. The banking collapse thus practically wiped out the wealth accumulated in banks by, and for, three generations: the fathers, the sons, and the new rising generation.

Consider first the general economic context. Lebanon's real GDP at constant prices has fallen in 2022 to about 25% its level in 2016. This means that the size of the Lebanese economy in six years has shrunk by three quarters, and currently is about the same size it was about 30 years ago, in 1993. Let alone future losses in GDP and incomes. More telling, and shocking is the current standard of living, with 80% of the population living at or below the poverty line (UN, 2022). All these developments, and the systematic collapse in most sectors of the economy, are the result of the banking and not of the Lira's collapse.

Since October 2019, bank depositors in Lebanon have been bearing the brunt of the accommodation to the financial collapse. Their access to their deposits has been severely constrained. Allowed monthly withdrawals in $ are a few hundred, while withdrawals in Lira, mostly from $ accounts, are subject to a highly depreciated exchange rate compared to the market rate. The current "haircut" imposed on depositors varies between 60% and 73%. These limits and rates are subject to ad hoc circulars by BDL that are issued without justification.

The result of the new banking rules has been an unusual contraction in money (M) supply, as shown in Table 3 below..

(8) Total deposits in all currencies, for resident and non-resident depositors.

TABLE 3 Money Supply

(End period, in $ billions and %, as indicated)

	Unit	2018	2019	2020	2021	June 2022
Total M Stock	$ billions	**141.3**	**7.7**	**7.0**	**5.5**	**5.7**
	%	100	100	100	100	100
Cash (LL & $)	%	3.8	100	100	99.9	99.9
Bank money	%	96.2	0.0	0.0	0.1	0.1
LL-M supply	% tot. M	35.2	60.9	49.9	27.4	21.6
Memo						
$ Cash in circ.	$ billions	2.5	3.0	3.5	4.0	4.5
GDP	$ billions	53.2	51.6	24.7	*18.1*	*16.5*
M/GDP	%	2.7	0.1	0.3	0.3	0.3
LL/$ -Market	$	1,508	2,100	8,400	27,650	28,100

Sources: BDL, World Bank (for GDP in 2021; GDP in 2022 is the author's estimate), http://www.lebaneselira.org and http://www.lirarate.org (for market LL/$ rates). $ Cash in circulation is an estimate based on information provided by $-cash importers.

Notes: LL cash and transactions are converted into $ at the market exchange rates.

The money stock that is actually, not nominally, available for spending by the private sector has sharply fallen: from the equivalent of 141$ billion at end 2018 (it was 139$ billion at end September 2019) to 7.7$ billion at end 2019. This is a drop of 95% over a 3-month period! It has fallen not only in absolute terms but also relative to GDP. Moreover, the share of bank money (checks, transfers, credit cards, etc.) in total money supply has practically disappeared, from a dominant %96 in 2018 to become almost nil at 0.1%, turning banks essentially into cash institutions only for deposits and withdrawals, and Lebanon into a rudimentary cash economy.

This is the result of BDL's adjustment policy which focusses on restricting the Lira supply through restricting even Lira withdrawals with a view to contain demand for $, and to increase $ supply by forcing holders of $ to convert $ into Liras for their spending purposes. But this policy has failed, as confirmed by the Lira's exchange rate developments. And what of the large segment of the population that possesses little or no $ and has no access to its deposits in banks!

More seriously, however, is the fact that an excessive reduction in the supply of money, Lira money in particular, is negatively impacting effective demand and growth. This is true since an extra Lira supply may well go in part towards purchasing $ but also towards spending on the currently more competitive local goods and services, thus stimulating overall economic activity and employment. It is this author's belief that incomes have fallen so low that the latter option would take the greater part of the extra Lira supply.

Finally, it is important to underline the continuing damage that is being done to depositors by banks, separately from the other damages. Lebanese commercial banks, though bankrupt with negative equity, continue to function as normal operating concerns. Many declare annual losses. These losses, by definition, are deductions from the banks' equity that becomes even more negative, thus reducing the banks' net assets. In other words, in case of bank liquidation, the residual that would be paid to depositors from the continuously decreasing net assets also is shrinking with every bank operating day and losses. So the damage to depositors by banks not only has been taking place for almost three years but is also being done to their future prospects.

b) Strategic actions by banks depositors

Depositors need to adopt a coherent and clear strategy that is based on facts in order to maximize the recovery of their deposits. The following are three strategic actions to be shortly undertaken.

i) First, depositors should confront BDL, banks and Government with the facts and arguments detailed above. The assignment of responsibilities for the banking collapse automatically entails a parallel distribution of banking (BDL and banks) losses. As BDL is a public enterprise whose ultimate source of funding is the Government, the following distribution of losses seems appropriate: 40% on Government (including BDL), 40% on banks, and 20% on depositors for their blind trust in banks..

ii) Bank restructuring is critical. Depositors should ask for the simple application of the law and of international practice, whereby failing banks should re-capitalize or be subjected to bankruptcy procedures. That is a universally applied principle. Failure to quickly address the banking situation means continuing additional losses by depositors, as explained above.

The "threat" by banks of a general closing down if the bankruptcy option is applied, thus cutting off all liquidity from the economy, can be simply addressed.

Shortly prior to that action, the (new) BDL can invite foreign banks, Arab, European and US, to open branches and operate normally in Lebanon, with very favorable tax and other conditions. These new banks would be flooded with most of the $ billions in cash that are kept privately in households and enterprises. A mechanism would also be established with BDL to supply the new banks with Liras.

A small but important core of a normal banking system would then emerge. That would be a key foundation block for economic recovery. After all, what Lebanon urgently needs now is a normal banking system and not necessarily a "Lebanese" banking system. Moreover, such a solution supports depositors by stopping the continuing erosion of their deposits through the current practices and mounting losses of Lebanese banks.

iii) Depositors should insist on BDL to justify in writing, as central banks normally do, the ad hoc ceilings put on Lira withdrawals. In light of the assigned responsibilities and Table 3 above, depositors should further ask for a significant increase in the ceilings on Lira withdrawals, and a significant reduction in the "haircuts" on depositors through the imposed exchange rates. BDL's arbitrary policy to date has put the full burden of adjustment solely on depositors. A new approach in this regard would alleviate some of that unfair burden and, importantly, stimulate economic activity, particularly through additional spending on local production.

APPENDIX

TABLE A Banque du Liban:
Sources & Uses of $ Funds, 2019-2015
(Cumulative flows, in $ billions)

Sources of $ funds to BDL	**81.1**	**Data sources:**
Banks' $ deposits	65.5	BCC, KPMG, Auditors and estimates
Interest on BDL's $ reserves	3.0	At 6-month LIBOR, and US 10-year TBs for securities
Eurobonds exchanged for LL-TBs	12.6	MOF-unpublished
Uses of $ funds by BDL	**29.9**	
Interest on banks' $ deposits	21.3	At 6.5% average
Other interest cost	0.4	At 5% average, on other FX liabilities
$ Overdraft to Government	7.7	MOF-unpublished
Change in gross reserves	- 2.8	IMF Article IV Reports (excluding Eurobonds)
Change in Eurobond holdings	3.3	Estimate, based on BDL and IMF data
$ Funds unaccounted for	**51.2**	
(+ is $ outflow from BDL)		
N.B.		
BDL's FX reserves, end 2014	**32.4**	BDL, IMF
BDL's FX reserves, end 2019	**29.6**	BDL, IMF
Memo (2019-2015 period)		
(All are $-payments & receipts)		
Fuel imports for EDL	6.7	MOF budget outcomes
PTT transfers to Budget	5.8	MOF budget outcomes
Imports for Government	1.3	MOF budget outcomes
Balance of payments	- 12.9	BDL

Notes: EDL is Électricité du Liban. PTT is the Ministry of Telecommunications. Transfers to Treasury were effected in both $ and LL, with about two thirds in $

An important question remains outstanding. How did BDL use the nearly 100$ billion borrowed from banks by end 2019 (see Table 1 above), mainly through its "financial engineering" operations? Table A above offers an answer; it is very similar to Table 2 in (Gaspard 2020), except that it is for a shorter period, 2019-2015.

It is remarkable that the large amount of $ funds borrowed by BDL from banks, which are the central element causing bank illiquidity and banking failure, are never mentioned officially, in the media, or even by BDL. Importantly, it should be noted that it was Government that was providing, on a net basis, BDL with $ funds rather than the other way round, as popular opinion and the media still state. This was done through several exchange operations since 2009 whereby BDL asks the MOF to issue new Eurobonds, which are TBs issued by the MOF and denominated mostly in $, in exchange for equivalent Lira-TBs held by BDL. BDL subsequently sold those Eurobonds in the market, as a source of $ funds.

Table A shows that, during the period, the MOF issued such Eurobonds to BDL alone in the amount of 12.6$ billion, whereas BDL had advanced to the MOF only 7.7$ billion, also against Liras, to the net $ advantage of BDL. The same applies since 2009 (9).

Interestingly, Table A indicates that over a 5-year period more than 51$ billion outflow from BDL cannot be accounted for. Even if we assume full financing by BDL of the BOP deficit of about 13$B, which implicitly includes all important operations such as fuel imports, there still remains a large outflow from BDL of more than 38$ billion that are unaccounted for.

The reasonable and likely explanation is that most of these unaccounted-for 38$ billion correspond to bank profits, mainly in Liras, and other Lira assets that have been exchanged for $ from BDL through market operations. Since 2016, banks have made through BDL extraordinary profits, particularly in Liras. This is acknowledged by the IMF, which states in its 2016 Article IV Consultation Report (p. 11) that BDL's "financial engineering" has produced over a few months in 2016 profits "akin to a money-financed capital injection (without any equity stake in return … equivalent to 10 percent of GDP)", i.e. more than 5$ billion in only a few months. It is also quite likely that these profits have been transferred in $ outside Lebanon, not in favor of the banking institutions but in favor of their main shareholders.

More seriously, had BDL not subjected Government, through the MOF, to exchange operations of Lira-TBs for Eurobonds, which amounted to 17.5$ billion since 2009, the $-Government debt would have amounted, after accounting for accumulated interest, to only about 6-5 billion instead of 31$ billion prior to the collapse. And Lebanon then would have been able to avoid bankruptcy.

(9) For details on these exchange operations, see (Gaspard 2020, section 2).

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September 2022

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