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There is a very poignant debate going on in Lebanon right now whether public assets should be used or even sold to pay back depositors who lost more than \$60 billion of deposits as a result of the country's financial crisis. In this respect, the most vocal position is that taken by the Government Plan, or perhaps those who formulated it, which argues that public assets belong not to depositors but to the people and future generations, and therefore should never be sold to pay back depositors.

You do not have to apply sharp, critical thinking to find fault in this reasoning, for a simple reading of it points to three obvious inaccuracies: First, aren't depositors a part of the people? Second, isn't the living as important as the future or unborn generations? Third, what is so sacred about public assets, and why should not they be sold?

We will investigate each of these misconceptions separately, aiming to show that the reasoning in the Government Plan fails, and actually fails miserably.

1) On the eve of the financial crisis in October 2019, there were 1.28 million households in Lebanon with each household composed of four persons on average. At the same time, there were 2.81 million bank-account holders in the country<sup>1</sup>. Additionally, IMF data show that Lebanon had among the most salient deposit and loan penetration rates in the world with 620 depositors and 240 borrowers per 1,000 adults (16 years and above)<sup>2</sup>. These figures clearly show that a wide majority of the people in Lebanon were banked; and, therefore, to argue that depositors – and frankly shareholders too -- are not representative of the people is simply wrong, because they inherently are<sup>3</sup>. This also means, and means strongly, that depositors and shareholders have as much right as everybody else to public assets and the way they are used and disposed of.

More important, the Government plan not only fails in terms of *absolute equity* by not treating depositors and shareholders as part of the people, but it also fails in terms of relative equity. It applies the concept of *vertical equity* by purporting to pay back small depositors<sup>4</sup> – who are presumably the weakest link in the chain – but practically wiping

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<sup>1</sup> Data are, respectively, from CAS and BDL.

<sup>2</sup> In addition, there were 110 branches per 1,000 square kilometers and 24 branches per 100,000 adults; similarly, there were 186 ATMs per 1,000 square kilometers and 41 ATMs per 100,000 adults.

<sup>3</sup> It is important to note that medium-and-large depositors are made of up individuals and, more importantly, institutional investors who represent trade and professional associations including the social security system. Also, as to shareholders, there are those who are concentrated in a few individuals and those who are represented by a multitude of individuals especially for banks listed on the stock market.

<sup>4</sup> Small depositors are defined in the Government Plan as those who have deposits equal to a maximum of \$100,000.

out entirely medium-and-large depositors and shareholders to the detriment of the entire banking system. What this misses out, though, is *horizontal equity*: in other words, why should not all involved be treated equally? More to the point, why should medium-and-large depositors be discriminated against, and their success and livelihood is penalized<sup>5</sup>? Equally, why should bank shareholders bear the brunt of BDL losses when these losses are the responsibility of the government as they were spent entirely on state expenditures and on support of the economy<sup>6</sup>? Note, though, that horizontal equity implies that *all* depositors and shareholders should be treated *fairly but not necessarily equally*. That is because shareholders should be held responsible for the losses incurred on their investment decisions that were done *voluntarily*, such as investments in Lebanese Eurobonds and private loans.

Lastly, applying horizontal equity is not only desirable on *fairness* grounds but on *efficiency* grounds as well. That is because, to do otherwise, will be denying the economy the *benefit of its big savers and investors and the confidence in a much-needed and indispensable banking sector*.

2) Societies that care about future generations are usually called altruistic, but that does not mean at all that societies that care about the current generation are selfish. That is because *intergenerational equity* demands equal caring for each, and not one at the expense of the other. So saying that the disposal of public assets to help the current generation should not be permitted because they are needed for the future generations violates intergenerational equity. It also does not make much sense. How could the current generation prepare for a better future if it is denied its resources and the means to invest them productively and soundly for the next generation? A cynical view would also add that, if the government truly cared about the future generation, it would have created a stable polity and a prosperous economy; and would not have pursued unsustainable fiscal and monetary policies --- let alone poor, degenerate governance practices -- that have rendered the economy un-viable and forced the emigration of most of its current and future talents.

3) Perhaps the most notable writings on public property rights follow from the political thought of the 17th-century English philosopher John Locke. Under Locke's classic theory of the state, government is an agent for its principal, the people. This principal-agent conception of the citizen-state relationship implies that *all property obtained by the agent while acting on the principal's behalf ultimately belongs to the principal and must be managed exclusively and solely for their benefit. On this view, then, citizens or the people are the rightful owners of sovereign wealth*<sup>7</sup>.

This is a simple but powerful idea, and its beauty is that it is gauged in the modern terminology of the principal-agent. The interpretation of this terminology implies that when the agent (the Government) is not acting on the interests of the principal (the people), then the agent has to be changed; alternatively, if removing the agent is not

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<sup>5</sup> That is especially the case since a lot of these individual medium-and-large depositors are Lebanese expatriates who made their money through their hard work abroad.

<sup>6</sup> By April 2022, NFR at BDL reached a *negative \$76 billion* (excluding gold) whereas banks' deposits at BDL stood at *\$86 billion*. And it is very important to note that most of these deposits at BDL were undertaken involuntarily as a result of BDL regulations.

<sup>7</sup> See: Locke, John. *The Second Treatise of Government*. 1690.

feasible, then the principal will have to dispose of the public property and end the malignant relationship with the agent<sup>8</sup>.

Applied to Lebanon, it is no secret that public assets and enterprises (sovereign wealth) are very badly managed and are even a burden on public finance, that is in addition to being largely the personal fiefs of politicians rampant with patronage and corruption<sup>9</sup>. It is also no secret that removing the agents (the Government or politicians) as guardians of the people's public assets has proven almost impossible in Lebanon's dysfunctional political system. The alternative, then, is to dispose of or sell public assets, as it will be a joke to consider them to be sacred or "untouchable" given how inefficiently they are managed. And doing this should be doubly beneficial: the principal or the people will benefit from the proceeds of the sale and (hopefully) ex-public assets will be put in the hands of a more efficient, less corrupt private sector.

More important, the proceeds from privatization could be used to pay back depositors and close part of the financial gap at BDL. Granted, they are not overly big these days – bullish estimates put them at close to \$14 billion, *excluding public land*<sup>10</sup> -- but in principle there is no reason at all not to do it on optimality grounds. The same holds true of the potential future oil and gas revenues, if the country ever comes back to its senses and start excavating oil and gas reserves. Given the corruption that we should expect in appropriating future oil and gas revenues in Lebanon, it would be very congenial to earmark in law a percentage of these oil and gas revenues to close BDL's financial gap. The fundamental drawback in using privatization proceeds and/or future oil and gas revenues in this way is that we will be using people's money to pay back people's lost money – in other words, it is a zero-sum outcome. But given how deep and prolonged Lebanon's financial crisis is, ending up with such an outcome is not all that bad, especially given the unjust alternative of a negative-sum outcome in the event of not getting anything at all.

There are two additional crucial points that have been raised in this ongoing debate and need to be addressed. First, there was the suggestion that public assets (including future oil and gas revenues) should stay intact and not be touched; instead, depositors – so as to close the financial gap -- can be paid over time from the accumulated foreign reserves that BDL can build as the economy recovers and grows. There are, however, two problems with this reasoning: one, it could take a lot of time, and it is uncertain as to whether BDL can accomplish that given how vulnerable the Lebanese economy is; two, it is still a zero-sum outcome in the sense that we will be using people's money (future BDL foreign reserves) to pay back people's lost money.

Second, it was rumored that borrowing to pay back foreign currency deposits is not an option as it will make the public debt unsustainable. But the public debt now is only equivalent to \$7.5 billion if we evaluate it at the market exchange rate of 27,500 LBP to the dollar and a recovery rate of 15% on Eurobonds, which makes it at only 34% of GDP.

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<sup>8</sup> This is similar to the modern business corporation where the principal (shareholders) either changes the agent (CEO) and/or sells the company.

<sup>9</sup> This is not only true of the notoriously inefficient enterprises (like EDL, OGERO, the Zahrani refinery...the list goes on), but also the modestly profitable ones (like MEA and Casino du Liban) because of the overstaffing and undue political influence in the latter. *The irony is that even those who formulated the Government Plan most likely admit that.*

<sup>10</sup> See: *Privatization of Lebanon's Public Assets: No Miracle Solution to the Crisis*. Issam Fares Institute, AUB. 2021.

So this option is actually viable once a credible reform program is adopted as there will be room for foreign borrowing (from official and private sources) without endangering sustainability<sup>11</sup>.

What the above has shown is that closing the financial gap without wiping out large depositors and shareholders is not only *fair but is also feasible*. It could be done with privatization proceeds or with future oil and gas revenues, or even with accumulated BDL foreign reserves and borrowing. *And, of course and better still, it could be done with a combination of all these*. No doubt, it will be a complicated process, but the Lebanese crisis is a complicated crisis and could not be solved by shortsighted, “flash in the pan” measures. And solving it might give the country a chance to embark on a reform path that could restore sound macroeconomic policies and activate credible governance practices.

The bottom line is that the Lebanese crisis is not only complicated but it is also unique. It is perhaps the only banking crisis where the problem does not lie with banks but with the Central Bank or BDL. But being unique does not mean that its solution has to be unjust. *What it means is that large depositors and shareholders are not legally and morally responsible for the financial gap. This responsibility lies with the Government and the Government alone*. The money was spent by the Government and politicians for state purposes, so they “can’t have their cake and eat it” by enjoying the benefits from these expenditures but letting others pay for them. This would be against each and every revered principle in the land! And even that does not constitute a big sacrifice, because *in reality it would only imply that the Government is assuming the responsibility to take action, as it would be the people as owners of the public assets who will be paying themselves for their lost deposits and for the closure of the financial gap at BDL. And taking responsible action is only the necessary condition, as the sufficient condition is having the right governance framework to translate this action into the desired outcomes*.

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<sup>11</sup> See: Bolbol, A. “Can the Government Assume More Foreign Borrowing to Close the Financial Gap at BDL?” *Blominvest Bank Blog, Spotlights, May 2022*.

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